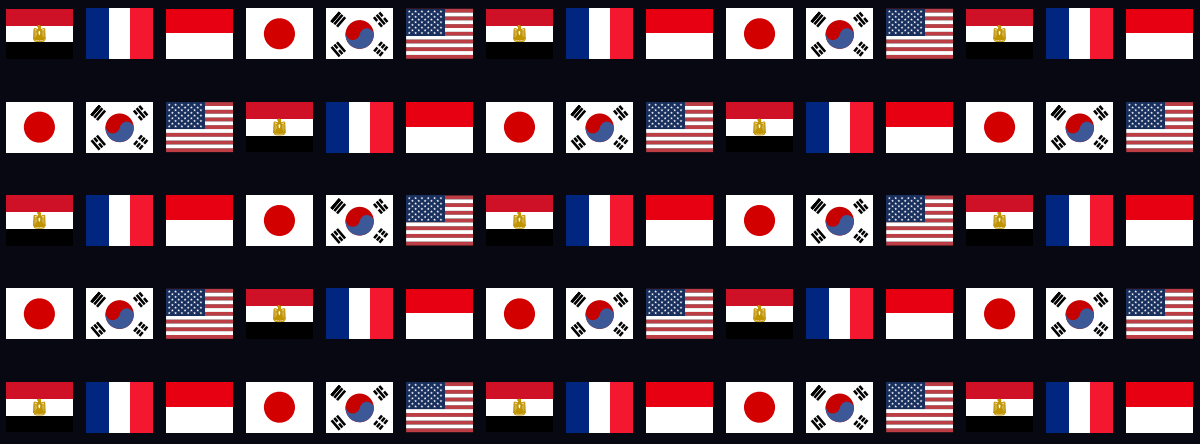
FINANCIAL SERVICES M&A

Japan



LEXOLOGY
Getting The Deal Through

Consulting editor
Cravath, Swaine & Moore LLP

Financial Services M&A

Consulting editors

David L Portilla, Minh Van Ngo

Cravath, Swaine & Moore LLP

Quick reference guide enabling side-by-side comparison of local insights, including into the market and policy climate; key legislation; required regulatory consents and filings; ownership restrictions; directors and officers' issues; foreign investment restrictions; competition law and merger control issues; deal structures and strategic considerations; tax; ESG, public relations, political and policy risk management; shareholder activism; due diligence, including in relation to emerging technologies; pricing and financing; purchase price adjustments; deal terms (including reps and warranties, indemnities and closing conditions); dispute resolution; and current trends.

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Table of contents

Contributors

Japan

Koji Toshima
koji.toshima@mhm-global.com
Mori Hamada & Matsumoto

Masaki Yukawa
masaki.yukawa@mhm-global.com
Mori Hamada & Matsumoto

MARKET AND POLICY CLIMATE

Market climate

How would you describe the current market climate for M&A activity in the financial services sector in your jurisdiction?

The current market climate for M&A activity in the financial services sector is quite active, with a recent increase in both the number and scale of transactions.

One important area is fintech, where there are many fast-developing businesses and technologies. An example of an M&A transaction in this field is the acquisition of Paidy, Inc by PayPal Holdings, Inc (US$2,730 million).

Another active area is outbound M&A by traditional Japanese financial institutions. This activity has been spurred by Japan's decreasing population, which has prompted traditional institutions to seek new opportunities in foreign countries. Representative transactions include the acquisition of Bank Danamon Indonesia Tbk PT by MUFG Bank, Ltd (US$3,500 million) and the acquisition of Privilege Underwriters, Inc by HCC Insurance Holdings, Inc (a subsidiary of Tokio Marine) (US$3,100 million).

As for domestic deals, the government is now facilitating mergers of regional banks based on its assessment that there are too many regional banks (there were 62 regional banks at the end of 2021).

Law stated - 31 December 2021

Government policy

How would you describe the general government policy towards regulating M&A activity in the financial services sector? How has this policy been implemented in practice?

The current government policy toward regulating M&A activity in the financial services sector seems to be generally neutral. Required licences or authorisations are smoothly granted for M&A activity in the financial services sector as long as such M&A activity is not viewed as being prejudicial to the stability of the Japanese financial system. In the financial services sector, the nationality of the purchaser (whether domestic or foreign) does not generally affect the difficulty or required time for obtaining required licences or authorisations. Especially in the asset management field, the Financial Services Agency (the FSA) has sought to promote the entry of foreign financial institutions into the Japanese market, and in 2020 the FSA opened a special window for a one-stop registration process for foreign financial institutions in which the English language can be used.

In the domestic M&A market, the FSA has taken the view that there is an oversupply of regional banks taking into account Japan's decreasing population, which could weaken the stability of the financial system. Therefore, the FSA has pursued a policy to promote mergers between regional banks to enhance the efficiency and stability of the banking system. As a result, mergers in this area are expected to continue at a high level.

Further, with a view that digitalisation will affect the business models of the banking and insurance sectors, the FSA has been relaxing the historical requirement that these sectors be separated from other businesses. Therefore, M&A activity between such traditional financial sectors and emerging digital businesses is increasing and may become even more active.

Law stated - 31 December 2021

LEGAL AND REGULATORY FRAMEWORK

Legislation

What primary laws govern financial services M&A transactions in your jurisdiction?

Japanese financial services are not regulated by a single uniform statute. Instead, the Banking Act (Act No. 59 of 1981) regulates banking, the Financial Instrument and Exchange Act (Act No. 25 of 1948) regulates financial instruments (including broker-dealers and asset management), the Insurance Business Act (Act No. 105 of 1995) regulates the insurance business, and the Payment Services Act (Act No. 59 of 2009) regulates the payment business (including businesses related to blockchain and crypto-assets).

In addition to the laws that regulate specific sectors, there are also laws that apply to financial and non-financial businesses in general. These general laws include the Foreign Exchange and Foreign Trade Act (Act No. 228 of 1949), which regulates investments in Japanese companies, and the Act on Prohibition of Private Monopolization and Maintenance of Fair Trade (Act No. 54 of 1947), which grants the Japan Fair Trade Commission (the JFTC) the ability to suspend M&A transactions where there are monopolisation concerns.

Law stated - 31 December 2021

Regulatory consents and filings

What regulatory consents, notifications and filings are required for a financial services M&A transaction? Should the parties anticipate any typical financial, social or other concessions?

The shareholding requirements with respect to shares in banks and insurance companies are similar. Any person (foreign or domestic) who holds in excess of 5 per cent of the voting rights of a bank or insurance company must submit a major shareholding report to the Financial Services Agency (the FSA) within five days. (This report is separate from the major shareholding report generally applicable to holdings in listed companies, and the foreign investment report applicable to foreign investors.) Furthermore, prior authorisation of the FSA is required for any foreign or domestic person to hold voting rights in a bank or insurance company in an amount equal to or greater than 15 per cent (for a strategic investment) or 20 per cent (for a non-strategic investment). Similarly, mergers and company splits of banks and insurance companies also require authorisation of the FSA.

With regard to shareholdings in registered broker-dealers, asset managers and payment service providers, major shareholders (10 per cent or more) must be reported to the FSA. No special authorisation of the FSA is required for mergers and company splits of these types of businesses.

Law stated - 31 December 2021

Ownership restrictions

Are there any restrictions on the types of entities and individuals that can wholly or partly own financial institutions in your jurisdiction?

Authorisation of the FSA is required to hold voting rights in a bank or insurance company in an amount equal to or greater than 15 per cent or 20 per cent (as applicable). In the authorisation process, the FSA examines whether:

- the sound and appropriate management of the services of the bank or insurance company is unlikely to be impaired in light of the particulars of the acquisition funding, the purpose of the acquisition or any other particulars;

- the sound and appropriate management of the services of the bank or insurance company is unlikely to be impaired in light of the financial condition, income and expenditures of the acquirer and its subsidiaries; and
- the acquirer has a sufficient understanding of the public nature of banking or insurance services and has sufficient social credibility.

If a majority of the assets of a majority shareholder of a bank or insurance company is comprised of shares in Japanese subsidiaries, the majority shareholder will be regulated as a bank or insurance holding company. If so regulated, the scope of its and its subsidiaries' activities will be restricted and the holding company will need to satisfy management and capital requirements. Because of these regulations, it would be impracticable for a special purpose company (SPC), which does not have sufficient management or capital, to hold a majority of the shares of a bank or insurance company.

Law stated - 31 December 2021

Directors and officers – restrictions

Are there any restrictions on who can be a director or officer of a financial institution in your jurisdiction?

A full-time director of a bank or an insurance company must meet 'fit and proper' requirements. As for the 'fit' requirement, a full-time director must have sufficient knowledge and experience to enable an understanding of and compliance with the requirements under applicable laws and regulations and the regulator's expectations as to management as indicated in their supervisory guidelines, as well as knowledge and experience with respect to compliance, risk management and overall management of the business of the financial institution. As for the 'proper' requirement, a full-time director must not have been associated with any organised crime group or convicted of any financial services crimes (or imprisoned for any crime), nor have caused any other financial institution to be subject to an administrative order or to fail.

There is no residency requirement for directors or officers of financial institutions.

Law stated - 31 December 2021

Directors and officers – liabilities and legal duties

What are the primary liabilities, legal duties and responsibilities of directors and officers in the context of financial services M&A transactions?

The directors of a corporation owe fiduciary duties to the corporation under the Companies Act. If an M&A transaction does not involve any related party (such as a parent company or management member), the decision of the directors with respect to the transaction would be evaluated by the 'business judgment rules' under which the directors would not be deemed to have breached their fiduciary duties unless they make a careless mistake in the collection and analysis of information, or make a grossly unreasonable decision.

On the other hand, if any related party such as a parent company or management member is involved, a more stringent standard would apply, and the directors would need to establish an independent committee. Since the ' Fair M&A Guidelines ' were formulated in 2019, the establishment of independent committees has become more common.

Law stated - 31 December 2021

Foreign investment

What foreign investment restrictions and other domestic regulatory issues arise for acquirers based outside your jurisdiction?

Under the Foreign Exchange and Foreign Trade Act, prior notification is required when a foreign investor acquires 1 per cent or more of the shares in a listed Japanese company or any shares in an unlisted Japanese company, if such company engages in a business designated by the Ministry of Finance and other authorities as requiring review from the viewpoint of national security or economic adverse effect. While financial services are not a designated category for this purpose, some financial institutions engage in designated businesses such as software development and information processing businesses, in which case prior notification and review by the authority may be required.

Regulated financial institutions are exempted from such prior-notification requirements if:

1. Investors or their closely related persons will not become board members of the target company.
2. Investors will not propose to the general shareholders' meeting any transfer or disposition of target company's business activities in the designated business sectors.
3. Investors will not access non-public information about the target company's technology in relation to business activities in the designated business sectors.

If exempted from prior notification, the regulated financial institutions are required to make a post-investment notification if they acquire 10 per cent or more of the shares.

Other general foreign investors (except for investors with a record of sanctions due to violation of the FEFTA and certain state-owned enterprises) that fulfil requirements (1) through (3) above are exempted from prior notification unless the target company engages in business in 'core' sectors and the investors acquire 10 per cent or more of the shares. An investment in 'core' sectors requires additional fulfilment of (1) and (2) below to be exempt from prior notification:

1. Investors will not attend the target companies' committees that make important decisions in business activities in core sectors.
2. Investors in target companies engaged in business activities in core sectors will not make proposals, in a written form, to the executive board of the target companies or board members requiring their responses and/or actions by certain deadlines.

If exempted, post-investment notification is required for acquisition of 1 per cent or more of shares.

Law stated - 31 December 2021

Competition law and merger control

What competition law and merger control issues arise in financial services M&A transactions in your jurisdiction?

Under the Antimonopoly Act, an acquirer that has consolidated annual sales in Japan exceeding ¥20 billion must file a notification with the JFTC at least 30 days prior to crossing the 20 and 50 per cent threshold in the shareholding of a Japanese company that has consolidated annual sales in Japan exceeding ¥5 billion.

While the FSA has a policy to promote mergers between regional banks to enhance the efficiency and stability of the banking system, the Antimonopoly Act has been an obstacle for mergers of regional banks located in the same area due to the impact on local market share. To eliminate this obstacle, a special law to exempt mergers between regional banks from the Antimonopoly Act was enacted in 2020, under which an exemption is granted to regional banks if authorised by the FSA.

Law stated - 31 December 2021

DEAL STRUCTURES AND STRATEGIC CONSIDERATIONS

Common structures

What structures are commonly used for financial services M&A transactions in your jurisdiction?

The structures commonly used for financial services M&A transactions are basically the same as the structures used for M&A transactions in other sectors.

The purchase of shares is the simplest way of acquiring a private company, while an asset purchase or company split (kaisha bunkatsu) is used to purchase the whole or part of a business. Generally, the main advantage of a company split (as compared with an asset purchase) is that all rights and obligations, including contracts and debts, are transferred to the successor company by operation of law, without the necessity of requesting consents from creditors or other counterparties unless specifically required in the target's contracts. However, certain financial institutions, such as banks and insurance companies, are already exempt from obtaining consents from their account and policy holders, as those consents are deemed to be obtained if the financial institutions notify such holders of the transfer and no objections are raised. In this respect, a company split does not offer as many advantages as would ordinarily be the case.

If equity consideration is to be used in the integration of financial institutions, there is a statutory reorganisation procedure called a 'share transfer', which enables the parties to establish a holding company that will hold all outstanding shares of the integrating financial institutions.

Approval of the Financial Services Agency (the FSA) is generally required for M&A transactions involving certain regulated financial institutions, such as banks and insurance companies, regardless of the transaction structure.

Law stated - 31 December 2021

Time frame

What is the typical time frame for financial services M&A transactions? What factors tend to affect the timing?

The time frame heavily depends on the nature of the transaction. An acquisition of shares in a bank or insurance company generally requires authorisation of the FSA, and that authorisation process affects the time frame. The process is typically shorter when a financial institution acquires or merges with another financial institution, as compared to a case where a non-financial institution buyer acquires a financial institution. In the latter case, it is necessary to demonstrate to the FSA that the acquired financial institution will continue to be managed in a proper manner after the acquisition.

Except in limited cases, the clearance process from the Japan Fair Trade Commission (the JFTC) under the Antimonopoly Act is not usually critical to the timing. Cases in which the JFTC has conducted more extended and detailed review are typically those in the mobile payment services sector and the regional banking sector. However, with regard to the regional banking sector, a special law was enacted in 2020 to exempt a merger between regional

banks from clearance under the Antimonopoly Act if the merger is authorised by the FSA, in which case FSA authorisation will affect timing rather than JFTC clearance.

Law stated - 31 December 2021

Tax

What tax issues arise in financial services M&A transactions in your jurisdiction? To what extent do these typically drive structuring considerations?

As with M&A transactions in other sectors, tax issues drive structuring considerations quite heavily.

For example, it is important that any reorganisation be a qualified reorganisation under Japanese tax regulations. Otherwise, tax could be imposed on the target company as well as the shareholders in connection with the reorganisation.

Other considerations to be addressed are the capital gains from the sale of shares, which are subject to corporate tax (or income tax if the seller is an individual) at approximately 30 per cent. On the other hand, there is no stamp duty payable upon a sale of shares.

In cross-border M&A transactions, the jurisdiction of the purchaser entity needs to be chosen carefully as the relevant tax treaty (if any) could affect the tax considerations of the transactions.

Law stated - 31 December 2021

ESG and public relations

How do the parties address the wider public relations issues in financial services M&A transactions ? Is environmental, social and governance (ESG) a significant factor?

In Japan, many listed companies (including financial institutions) voluntarily make disclosures in accordance with the rules set by the Task Force on Climate-related Financial Disclosures (TCFD). Companies listed on the prime market of the Tokyo Stock Exchange will essentially be required to make these disclosures from and after April 2022, given that the Corporate Governance Code requires that such listed companies that elect not to make the disclosures are required to explain their reason. Further, major Japanese financial institutions have announced a policy to stop financing coal-fired power plants. Given these circumstances, ESG considerations, especially environmental considerations, will now be more important in financial services M&A transactions.

Law stated - 31 December 2021

Political and policy risks

How do the parties address political and policy risks in financial services M&A transactions?

Political and policy risks that arise between signing and closing may be taken into account in the conditions precedent of the purchase agreement – for example, with the inclusion of a material adverse change (MAC) condition. A MAC condition is quite often accepted in Japanese M&A transactions unless the seller has established a particularly strong position (eg, a bidding process or a private equity seller).

Law stated - 31 December 2021

Shareholder activism

How prevalent is shareholder activism in financial services M&A transactions in your jurisdiction?

Although shareholder activism is not as prevalent in Japan as in the US, it is becoming more and more important in Japanese M&A transactions. Following the global trend, Japanese M&A transactions have increasingly become a focus of activists, who now often undertake campaigns in opposition to announced transactions seeking an increase in shareholder return. The typical M&A transactions that are targeted by shareholder activists are those where the target company has fewer stable and friendly shareholders, those where a conflict of interest is involved, and those where there is a long period of time from the announcement to the expected closing.

Law stated - 31 December 2021

Third-party consents and notifications

What third-party consents and notifications are required for a financial services M&A transaction in your jurisdiction?

The types of third-party consents and notifications that are required depend on the structure of the transaction.

In a simple transfer of shares, no third-party consents and notifications are required except to the extent required in contracts to which the target company is a party (ie, change of control clauses).

In transactions structured as a merger or a company split (kaisha bunkatsu), there is a statutory creditor notification process pursuant to which creditors can object to the transaction. In asset purchase deals, the consent of each creditor and contractual counterparty is generally required, although certain financial institutions, such as banks and insurance companies, do not need to obtain consents from their account and policy holders, as those consents are deemed to be obtained if the financial institutions notify the holders of the transfer and no objections are raised.

Law stated - 31 December 2021

DUE DILIGENCE

Legal due diligence

What legal due diligence is required for financial services M&A transactions? What specialists are typically involved?

As with M&A transactions in other sectors, legal due diligence includes document review and Q&As related to the company's capital structure, assets, debt, contracts, compliance, employee matters and disputes.

In financial services M&A transactions, there may be additional focus in due diligence on governmental authorisation and compliance matters, including anti-money laundering obligations.

Depending on the nature of the target's business, there may be a review focused on any transactions subject to economic sanctions or any associations with organised crime, particularly if the target deals with a considerable number of counterparties. The regulations pertaining to organised crime (or 'anti-social forces') are specific to Japan and are required under the guidelines of the Financial Services Agency (the FSA). Each buyer in the financial services sector needs to conduct its own screening for organised crime issues, particularly with respect to any problematic counterparties of the target.

Lawyers are always involved in legal due diligence. If the buyer is a financial institution, the compliance department of

the buyer itself would also need to conduct its own due diligence.

Law stated - 31 December 2021

Other due diligence

What other material due diligence is required or advised for financial services M&A transactions?

In financial services M&A transactions, due diligence would typically cover business, legal, finance and tax areas in a manner similar to M&A transactions in other sectors. Depending on the nature of the financial services target, due diligence on IT systems may be conducted as well. In addition, there may be additional focus in due diligence on the valuation of financial assets.

Law stated - 31 December 2021

Emerging technologies

Are there specific emerging technologies or practices that require additional diligence?

From a legal perspective, regulatory compliance should be a focus of due diligence if the target's business involves blockchain or crypto assets. The Payment Services Act regulates businesses engaged in the exchange, brokerage, intermediation, agency or management of crypto assets. A 'crypto asset' is defined as an electronically recorded value that can be used as payment for goods or services to unspecified people, can be purchased from or sold to unspecified people, and is not denominated in any fiat currency. Such business activities are subject to a registration requirement with the FSA, as well as anti-money laundering obligations, such as know your customer and suspicious transaction reporting. Further, derivatives, such as margin trading, of crypto assets are regulated under the Financial Instrument and Exchange Act. The operation of any such business, such as dealing, brokerage, intermediation or agency, requires registration with the FSA.

Further, a working group of the FSA clarified in a report published in January 2022 that stable coins, which do not fall within the definition of crypto assets since they are denominated in or intended to be linked with a fiat currency, are only permitted to be issued by a licensed bank or a registered funds transfer business operator.

Law stated - 31 December 2021

PRICING AND FINANCING

Pricing

How are targets priced in financial services M&A transactions? What factors typically affect valuation?

A listed target would be valued based on its market price, as with M&A transactions in other sectors. However, a valuation based on a dividend discount model is also taken into consideration in the financial services sector in addition to the market price. In other sectors, a valuation based on the discounted cash flow method is taken into consideration.

Law stated - 31 December 2021

Purchase price adjustments

What purchase price adjustments are typical in financial services M&A transactions?

While net value adjustments are often used in financial services M&A transactions, earn-outs may be used in the fintech sector, where there is likely to be more uncertainty as to the realisation of future value of the business.

Law stated - 31 December 2021

Financing

How are acquisitions typically financed? Are there any notable regulatory issues affecting the choice of financing arrangements?

Acquisitions are usually financed by cash or debt; however, in the Financial Services Agency (the FSA)'s authorisation process for the acquisition of banks and insurance companies, the FSA will review whether the financing of the acquisition excessively relies on borrowing. There is no clear-cut threshold for a borrowing ratio, but the FSA will undertake a review as to whether the acquirer will be able to stably operate the business. It should be noted that a merger involving banks or insurance companies is subject to authorisation of the FSA, and this may pose an approval risk with respect to a leveraged buyout of a bank or insurance company.

Law stated - 31 December 2021

DEAL TERMS

Representations and warranties

What representations and warranties are typically made by the target in financial services M&A transactions? Are any areas usually covered in greater detail than in general M&A transactions?

It is usually not the target but the seller that makes representations and warranties in Japanese M&A transactions, including transactions in the financial services sector. Representations made by the seller with respect to the target in financial services M&A transactions are similar to those made in transactions in other sectors, although a purchaser in the financial services sector is likely to focus in greater detail on governmental approval and compliance issues, including compliance with anti-money laundering obligations and the absence of any relationships with organised crime (which is specific to Japan and is required under the Financial Services Agency (the FSA) guidelines).

Law stated - 31 December 2021

Indemnities

What indemnities are typical for financial services M&A transactions? What are typical terms for indemnities?

There is nothing particularly unique about the terms of an indemnity in a financial services M&A transaction as compared to an indemnity in an M&A transaction in any other sector. In that regard, it is typical to provide a survival period, cap, de minimis and tipping basket in a share purchase agreement or asset purchase agreement, although a special indemnity for specified liabilities is not often provided. The specific time periods and amounts to be included in these provisions vary widely depending on the size of the transaction and the relative bargaining power of the parties.

An indemnification provision that is included in a merger agreement or other integration agreement would not survive the closing.

Law stated - 31 December 2021

Closing conditions

What closing conditions are common in financial services M&A transactions?

The closing conditions that are particularly important in financial services M&A transactions are those regarding requisite approvals from governmental authorities with respect to the transaction, since governmental approval is usually required in this sector. Otherwise, closing conditions in financial services M&A transactions are not different from those of other sectors, and would typically include conditions as to: no breach of representations, warranties, or obligations; clearance from competition authorities; and other required consent or approvals (eg, shareholders, important contractual counterparties, etc).

Law stated - 31 December 2021

Interim operating covenants

What sector-specific interim operating covenants and other covenants are usually included to cover the period between signing and closing of a financial services M&A transaction?

While the interim covenants in financial services M&A transactions are not particularly different from those in other sectors, there may be somewhat more focus on compliance issues. If any compliance issues are found in the course of legal due diligence, a purchaser would want a covenant that those issues be appropriately remedied prior to the closing. In addition, the purchaser would request the seller and target to notify and consult with the purchaser with respect to any communications with governmental authorities prior to closing.

Law stated - 31 December 2021

DISPUTES

Common claims and remedies

What issues commonly give rise to disputes in the course of financial services M&A transactions? What claims and remedies are available?

The sector-specific issues that would give rise to disputes would typically be compliance-related, since a breach of regulations would cause serious damage to the target's business in this sector.

If compliance issues are discovered before the execution of the definitive agreement, they could be dealt with in the agreement through special indemnification provisions, for example. On the other hand, if the compliance issues are not discovered until well after closing, the survival period of the indemnity will be key. In addition, in that situation, the seller would likely argue that the damages are (at least partly) attributable to the purchaser, as the purchase became responsible for monitoring compliance issues after the closing.

Law stated - 31 December 2021

Dispute resolution

How are disputes commonly resolved in financial services M&A transactions? Which courts are used to resolve these disputes and what procedural issues should be borne in mind? Is alternative dispute resolution (ADR) commonly used?

Japanese courts are still most commonly relied on for dispute resolution in connection with domestic Japanese M&A deals. Typically, the Tokyo or Osaka District Court is designated as having jurisdiction since those courts have special divisions for commercial disputes.

ADR has not been commonly used in Japan, although it is increasingly chosen for cross-border transactions and transactions where the parties have a particular concern about confidentiality.

Law stated - 31 December 2021

UPDATE AND TRENDS

Trends, recent developments and outlook

What are the most noteworthy current trends and recent developments in financial services M&A in your jurisdiction? What developments are expected in the coming year?

While traditional financial institutions still play a major role in Japan, fintech industries and start-ups have grown rapidly, and will become a focus of financial services M&A in the near future. Blockchain and crypto-currency businesses are also likely to become active in M&A transactions.

One noteworthy development in 2021 was the successful hostile takeover of Shinsei Bank by SBI Holdings. Hostile takeovers have not been common in Japan and have very rarely been successful. However, it seems likely that they will increase in number going forward.

Law stated - 31 December 2021

Jurisdictions

Egypt	Soliman, Hashish & Partners
France	Bredin Prat
Indonesia	ABNR
Japan	Mori Hamada & Matsumoto
South Korea	Bae, Kim & Lee LLC
USA	Cravath, Swaine & Moore LLP