Bill on Provisional Measures for the Facilitation of Financing to Small and Medium Sized Businesses (the "Moratorium Bill")

On October 30, 2009, the Japanese Cabinet approved the Bill on Provisional Measures for the Facilitation of Financing to Small and Medium Sized Businesses (中小企業者等に対する金融の円滑化を図るための臨時措置に関する法律案)[1] and submitted said bill to the Japanese Diet. Reflecting the arguments leading up to it, this bill is commonly referred to in the Japanese media as the "Moratorium Bill". As shall be explained below, however, the Moratorium Bill does not impose a compulsory legal obligation to offer a moratorium on debt.

The Moratorium Bill is expected to be enacted as the Act on Provisional Measures for the Facilitation of Financing to Small and Medium Sized Businesses (中小企業者等に対する金融の円滑化を図るための臨時措置に関する法律) (the "Act") after deliberation in the Diet, possibly around the end of the calendar year 2009.

1. Background Leading to the Submission of the Bill

A general election for the House of Representatives of the Japanese Diet was held on August 2009. As a result, there was a change in government from the Liberal Democratic Party, which had held power in Japan almost successively for the past several decades, to a coalition led by the Democratic Party of Japan.

The comments of Mr. Kamei, who was appointed Minister for Financial Services in the new Government, calling for legislation to effect a "moratorium" were given wide coverage by the media.[2] From Mr. Kamei's comments, initially it was feared that a "moratorium" would mean that the authorities would compel financial institutions to offer a postponement of debt. Financial institutions and industry voiced their concerns on how such a "moratorium" would impact the operations and financial health of financial institutions.

It turns out, however, that, under the Moratorium Bill, financial institutions are only required to extend new credit and to offer postponements of debt on a "best efforts" basis, and that their legal obligations are, essentially, limited to establishing a framework to make such "best efforts" measures effective and to implement certain disclosure measures in connection with the same. In this regard, the appellation "Moratorium Bill" is somewhat misleading. Further, as the branch offices of banks with headquarters located overseas, registered moneylenders (both Japanese and foreign), as defined under the Money Lending Business Act and insurance companies are excluded from the application of the Act, the immediate effect of this Act on foreign financial institutions is expected to be limited.

Nevertheless, in connection with the enforcement of this Act, *inter alia*, the relevant Supervisory Guidelines issued by the Financial Services Agency (the "FSA") may be amended, resulting in stricter supervision on steps taken to facilitate the postponement of debt owed by small and medium sized businesses and borrowers of residential housing loans. As such, we need to follow carefully how the supervisory authorities intend to implement the Act.

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[1] As of the date of this newsletter, there is no official English designation of the Moratorium Bill.

[2] September 29, 2009 Bloomberg:
http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aeVgB4qAoch4

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Below, we give an overview of the Moratorium Bill, with emphasis on how it would effect the businesses of foreign financial institutions operating in Japan.

2. Name of Bill

Bill on Provisional Measures for the Facilitation of Financing to Small and Medium Sized Businesses

3. Enforcement Date, Term

It is expected that, after deliberation by the Diet, the Bill, as may be amended pursuant thereto, will become law. At an official press conference held on October 23[3], the Minister for Financial Services suggested that the Government will try to enforce the Act by the end of this calendar year.
The Act takes the form of an emergency temporary legislation to deal with the effects of the global financial crisis which erupted in 2008 and will cease to be effective after the end of March 2011 (Supplementary Provisions, Article 2 Paragraph 1).

4. Overview of the Moratorium Bill

4.1. Purposes of the Moratorium Bill

The purpose of the Moratorium Bill is to support and rescue the cash flow of Small and Medium Sized Businesses and Borrowers of Residential Housing Loans who have been adversely affected by the global financial crisis (Article 1).

4.2. Scope of the Moratorium Bill

(a) Financial Institutions

The persons to whom the various burdens pursuant to the Moratorium Bill (please see 4.3 below) are addressed are limited to "Financial Institutions" (Article 2 Paragraph 1).
"Financial Institutions" are defined to include banks and regional financial institutions[4] but exclude institutions which have their head offices in a location "other than the territory of enforcement of this Act". Consequently, Japanese branches of foreign banks are not included in "Financial Institutions" and are unaffected by any obligations which may be imposed by this Act. Further, insurance companies and registered moneylenders also do not fall within the definition of "Financial Institutions" and are therefore also beyond the scope of this Act.

(b) Debtors

Debtors who are addressed under the Moratorium Bill are limited to "Small and Medium Sized Businesses" (please refer to the Appendix for more on this defined term) and individuals who have taken out residential housing loans ("Borrowers of Residential Housing

[3] http://www.fsa.go.jp/common/conference/minister/2009b/20091023-1.html（Japanese）
[4] e.g., *shinkin* banks, *shinkumi* banks and agricultural cooperatives

Loans").
Consequently, loans to large businesses, local municipal bodies and to individuals other than for business or residential housing are outside the scope of this Act.

4.3. Burden of Financial Institutions

The burden of Financial Institutions can be categorized as (a) "best efforts" requirements and (b) legally binding obligations imposed to effect (a) above.

(a) "Best Efforts" Requirements

The following two (2) requirements are imposed on Financial Institutions:

(i) To endeavor to extend credit (e.g., the provision of new loans) to Small and Medium Sized Businesses as flexibly as possible（Article 3）; and
(ii) Upon receipt of a request for the postponement of repayment of debt by a Small and Medium Sized Business[5] or a Borrower of Residential Housing Loan, to endeavor as much as possible to take measures flexibly to respond to such request（Article 4 Paragraph 1, Article 5 Paragraph 1).

Neither (i) nor (ii) above oblige Financial Institutions to extend new credit or to agree to postpone the repayment of debt and merely require them to endeavor to do the same. However, Financial Institutions are under legal obligation to ensure the effectiveness of these requirements, as per (b) below.

(b) Legal Obligations

(iii) Obligation to establish a framework to give effect to the steps described in (ii) above[6] (Article 6); and
(iv) To disclose how (ii) above has been implemented in practice and the status of its establishment of the framework required pursuant to (iii) above by means of retaining certain records at its offices for public inspection, as well as periodic reports to the competent administrative bodies[7] (Articles 7 and 8).

In connection with (iv) above, any delinquency in disclosure or reporting or any false disclosure or reports of a malignant nature may be subject to criminal penalties (Article 17 Items 1 and 2, Article 18).

5. Financial Services Agency

[5] For the purpose of this (ii), the following are excluded from the Small and Medium Sized Businesses: certain Financial Institutions; subsidiaries, parent companies or other group companies of Financial Institutions; Large Companies (meaning a stock company, the amount of stated capital of which is JPY 500 million or more, or the total sum of liabilities of which is JPY 20 billion or more); and subsidiaries or other group companies of Large Companies.
[6] Details of the framework which must be established shall be stipulated in the relevant Ministerial Ordinance to be issued separately.
[7] The exact period, which shall not exceed six (6) months, shall be stipulated in the relevant Ministerial Ordinance to be issued separately.

According to the materials made publicly available by the FSA at the time the Moratorium Bill was submitted to the Diet, in connection with the establishment of a framework described in 4.3(b)(iii) above, the FSA will revise its inspections manuals relating to the inspection of financial institutions by its inspectors and its supervisory guidelines.
In press conferences held on October 16 and October 30, the Minister for Financial Services stated that inspections and supervision will be conducted with emphasis on how financial institutions are extending credit to and supporting the management efforts of small and medium sized businesses[8].

6. Analysis

6.1. Impact on Foreign Financial Institutions Operating in Japan

As described in 4.2(a) above, "Financial Institutions" targeted under the Moratorium Bill do not include the Japanese branches of foreign banks, registered moneylenders or insurance companies. Consequently, foreign financial institutions who operate money lending businesses in Japan through a Japanese branch office (and not through a Japanese subsidiary), a registered moneylender or an insurance company will not suffer any material direct impact from this Act.
Further, even where lending is conducted through a subsidiary established as a bank in Japan, as the scope of the Moratorium Bill is limited to loans to Small and Medium Sized Businesses and to Borrowers of Residential Housing Loans, unless you engage in such activities, the direct impact of the Act can be expected to be limited[9].

6.2. Impact on Financial Institutions Operating in Japan in General

Under the Moratorium Bill, contrary to what was initially feared, Financial Institutions are not under any legal obligation to offer new credit or to offer a moratorium on existing loans and are only required to take measures in relation to these issues on a best efforts basis.
Nevertheless, Financial Institutions are under legal obligation to establish a framework to facilitate the postponement of repayment of certain debt. In addition, the FSA inspection manuals and supervisory guidelines are expected to be amended along the lines indicated above. The cumulative effect, therefore, may be that the competent regulatory authorities will, as a matter of practice, exert considerable influence on financial institutions to offer a moratorium on certain debt.
Therefore, we need to follow carefully how the supervisory authorities intend to implement the Act.

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[8] Summary of Moratorium Bill (Japanese):
http://www.fsa.go.jp/common/diet/173/01/gaiyou.pdf
October 30 Press Conference (Japanese):
http://www.fsa.go.jp/common/conference/minister/2009b/20091030-1.html
October 16 Press Conference (Japanese):
http://www.fsa.go.jp/common/conference/minister/2009b/20091016-1.html

[9] Nevertheless, according to the letter of the Moratorium Bill, it seems that the legally binding obligations outlined in 4.3(b) above also apply to such banks.

or services. Both fee collection services and cash-on-delivery services have been conducted without any specific regulations.

It has been argued that these services may theoretically fall under the definition of "Money Remittance Transactions" (see 1.1 above). There is also an argument that some measures to protect customers' funds should be taken to prepare for the insolvency of the providers as well as to prevent fraudulent acts by providers.

The Japanese government took into consideration the strong criticism that there has never been any material issue for these services in terms of consumer protection and that the regulation of these services may harm the convenience of customers. At the Diet, the Japanese government advised that the PSA is not intended to be applied to such services; however, the Japanese government has not expressed a clear view as to whether or not these services fall under the category of "Money Remittance Transaction".

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Appendix

Scope of "Small and Medium Sized Businesses"
(Article 2, Paragraph 2)

Type of Business	Criteria
Wholesale	100 or fewer employees; or JPY 100 million or less of paid in capital
Retail	50 or fewer employees; or JPY 50 million or less of paid in capital
Service	100 or fewer employees; or JPY 50 million or less of paid in capital
Other	300 or fewer employees; or JPY 300 million or less of paid in capital

- ✓ Small and Medium Sized Businesses also include certain small or medium sized cooperative unions (*kyodo kumiai*) and medical corporations (*iryo hojin*).
- ✓ Those engaged in financial services or such other businesses, as shall be stipulated in the relevant Cabinet Order, are excluded from the definition of Small and Medium Sized Businesses.

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