

# **ANDERSON MORI**

*Financial Services & Capital Markets Group*

## **MEMORANDUM**

March 26, 2002

### **RECENT AMENDMENTS TO THE BANKING LAW**

We wish to take this opportunity to provide a brief update to our clients regarding the recent amendments to the Banking Law of Japan and other relevant laws by "the Law Amending Part of the Banking Law, Etc." (Law No. 117 of 2001; the "Amending Law").

#### **Amendment of Banking Law**

The Amending Law was enacted on November 2, 2001, and will be in force from April 1, 2002.

#### ***Background***

Recently, there has been a move toward entry, by non-financial companies, into the banking business and establishment of new types of banks, differing from traditional banks. For example, Ito-Yokado, the biggest supermarket company in Japan, and 7-Eleven Japan, the largest convenience store corporation in Japan and a subsidiary of Ito-Yokado, established IY Bank in May 2001, and Sony Corporation, a Japanese major electronic company, established Sony Bank in June 2001. These banks primarily provide settlement services through ATMs placed in convenience stores, and offer services via the Internet. The backgrounds of such new entries include such factors as: (i) capital investments for computer systems and ATMs have been reduced due to development of information technology ("IT"), (ii) by adding banking settlement services, non-financial companies can strengthen their financial business, and (iii) non-financial companies, which have kept higher ratings by Moody's or S&P in this sluggish economy, will relatively hold good positions even after entry into the banking business, while conventional banks' ratings have depreciated due to their possession of large amounts of non-performing loans.

On the other hand, these new types of banks pose various issues and risks which are not assumed by conventional banks such as:

- (a) A risk that a non-financial company uses its subsidiary bank as a "wallet";
- (b) A risk that the parent company takes advantage of the customer information of its subsidiary bank without approval of the customers; and
- (c) The financial base of these banks are inherently fragile. For example, customers are likely to transfer their deposits because of low loyalty to such new banks. These banks' sales results will be affected by the growth of the business in which they specialize.

## **Rules regarding Shareholder of Bank**

The Amending Law includes a definition of a "Principal Shareholder" ("*ginko-shuyo-kabunushi*"), which means any shareholder holding 20% (if it has control or deciding influence over the determination of important operational and financial policy of the bank, the percentage is reduced to 15%) or more of the voting rights for its own account, which is in accordance with the standards of affiliation based on the "effective influence standards" in corporate accounting, and may presumably exert a material impact on the management policies of the bank (Article 2, Paragraph 9 of the Banking Law).

### ***Approval, Inspection and Supervision***

To be a Principal Shareholder requires the approval of the Authority<sup>1</sup> in advance, for which sound financial condition, knowledge regarding public nature of banking business, and social trustworthiness are required (Articles 52-9, 52-10). The Authority may request the Principal Shareholder to submit reports which are helpful to know the business and the financial condition of the subsidiary bank, or may enter the premises of and inspect the Principal Shareholder in order to maintain sound and appropriate banking operations (Articles 52-11, 52-12). The Authority may request the Principal Shareholder to take any required measures to achieve the standards of approval, if they are considered not to meet the standards (Article 52-13). The Authority may request a Principal Shareholder who owns more than 50% of all voting rights of the bank to submit a plan for improvement to the extent necessary in order to secure the sound operation of the bank, when it is judged necessary in light of the condition of the business, or the assets of the bank (Article 52-14). The Authority may revoke the Approval for a Principal Shareholder who violates laws, or who acts against the public interest (Article 52-15).

As a transitional measure, with respect to a Principal Shareholder at the time the Amending Law takes effect (i.e., as of April 1, 2002), a grace period of at least one (1) year is granted.<sup>2</sup>

Similar amendments will be introduced into the Insurance Business Law.

### ***Notification and Report***

A shareholder (including an approved Principal Shareholder) who comes to control more than 5% of all voting rights of a bank or a bank holding company is required to file a notification, and if there are any changes in important items which are mentioned

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<sup>1</sup> The "Authority" as used in this memorandum means the Prime Minister or the Commissioner of the Financial Services Agency, as the case may be.

<sup>2</sup> A Principal Shareholder at the time the Amending Law takes effect (i.e., as of April 1, 2002) will be required to obtain the approval within one (1) year from the end of the fiscal year of the subject bank during which April 1, 2002 falls. (If the fiscal year of the bank is from April 1 to next March 31, the last date for obtaining the approval will be March 31, 2004).

in such notification, they are required to file a modification report with the Authority, in each case within five (5) business days (one (1) month in the case of foreign shareholders) (Articles 52-2, 52-3). The Authority may request reports or enter the premises and inspect the affairs of the shareholder, if there are any misrepresentations regarding important items, or if there are any doubts about the omission of important items in a notification or a modification report (Articles 52-7, 52-8).

A shareholder of a bank who falls under the above at the time the Amending Law takes effect (i.e., as of April 1, 2002) will be required to file the notification within five (5) business days (one (1) month in the case of foreign shareholders) from such date.

The above approval and notification/reporting requirements regarding a shareholder of a bank do not apply to foreign banks licensed under the Banking Law.

### **Other Major Amendments**

The Banking Law has also been amended in other parts as follows:

#### ***Registration of Branch and Sales office***

Corresponding to the development of information technology, banks will be able to establish branches and sales offices or change their locations only through the filing of a prior notification with the Authority, in which case, at present, banks are required to obtain the approval of the Authority (Article 8).

#### ***Bank's Subsidiary***

A bank will be able to cause its subsidiary to conduct both the bank's ancillary business and finance-related business by the same single entity, which is prohibited at present (Article 16-2).

#### ***Derivatives Transaction Account***

Financial institutions have become able to adopt "derivatives transaction accounts" ("*tokutei-torihiki-kanjyo*") from December 9, 2001 by their own decision, which formerly required an approval of the Authority (Article 17-2).

#### ***License for Branch of Foreign Bank***

A foreign bank, which must, at present, obtain a license from the Authority for each branch office in Japan, and designate a representative for each of them, will only need to obtain a license for the principal branch in Japan, and obtain approval from the Authority for establishment of subordinate branches in Japan (Article 47).

#### ***Trust business by City banks***

So-called city banks became able to conduct trust business, on February 1, 2002, with a view to the greater convenience of customers. However, the activities relating to real estate are fairly limited. According to the Financial Services Agency, a foreign bank

will not be permitted to engage in trust business.<sup>3</sup> However, of course, a foreign bank can engage in trust business by establishing a trust bank subsidiary after receiving a license.

### **Another New Law regarding Bank's Shareholding**

On November 28, 2001, the "Law regarding Restriction of Bank's Shareholding" was promulgated, which aims to ensure the soundness of banks by limiting the price fluctuation risk arising from the shareholding of banks within the risk management capacities of banks. This law limits the shareholdings of a bank, except subsidiaries' stocks, unlisted stocks and stocks obtained through debt equity swaps, to the combined net worth equity capital level of the bank and its subsidiaries, and allows establishment of the Bank's Shareholding Acquisition Corporation<sup>4</sup> which purchases shares held by its member banks. According to the law, banks shall dispose of their excessive shares until September 30, 2004.

*\* For further advice or information on this subject, please confer with your usual contact at or any of the partners of the Financial Services & Capital Markets Group at ANDERSON MORI.*

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<sup>3</sup> Our firm recently submitted an inquiry to the Financial Services Agency as to whether a foreign bank branch would be able to engage in trust business, in the Public Comment procedure, however, the answer was negative. The Public Comment is a procedure by which the ministries and the agencies of the government hear public opinion before they establish or abolish regulations.

<sup>4</sup> The Bank's Shareholding Acquisition Corporation was established on January 29, 2002.