# The Banking Regulation Review

Third Edition

Editor
Jan Putnis

Law Business Research

# The Banking Regulation Review

Reproduced with permission from Law Business Research Ltd.

This article was first published in The Banking Regulation Review,
3rd edition (published in May 2012 – editor Jan Putnis).

For further information please email Adam.Sargent@lbresearch.com

# THE BANKING REGULATION REVIEW

Third Edition

Editor
Jan Putnis

Law Business Research Ltd

PUBLISHER
Gideon Roberton

BUSINESS DEVELOPMENT MANAGER
Adam Sargent

MARKETING MANAGERS
Nick Barette, Katherine Jablonowska

MARKETING ASSISTANT
Robin Andrews

EDITORIAL ASSISTANT
Lydia Gerges

PRODUCTION MANAGER
Adam Myers

PRODUCTION EDITOR
Caroline Rawson

SUBEDITOR
Charlotte Stretch

EDITOR-IN-CHIEF
Callum Campbell

MANAGING DIRECTOR
Richard Davey

Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK
© 2012 Law Business Research Ltd
www.TheLawReviews.co.uk
No photocopying: copyright licences do not apply.
The information provided in this publication is general and may not apply in a specific situation. Legal advice should always be sought before taking any legal action based on the information provided. The publishers accept no responsibility for any acts or omissions contained herein. Although the information provided is accurate as of April 2012, be advised that this is a developing area.
Enquiries concerning reproduction should be sent to Law Business Research, at the address above. Enquiries concerning editorial content should be directed to the Publisher – gideon.roberton@lbresearch.com

ISBN: 978-1-907606-30-4

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: +44 870 897 3239

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

ABDULAZIZ ALGASIM LAW FIRM
IN ASSOCIATION WITH ALLEN & OVERY LLP

AFRIDI & ANGELL

ALI BUDIARDJO, NUGROHO, REKSODIPUTRO

ANDERSON MŌRI & TOMOTSUNE

ARTHUR COX

BONELLI EREDE PAPPALARDO

BREDIN PRAT

BUGGE, ARENTZ-HANSEN & RASMUSSEN

BUN & ASSOCIATES

CHANCERY CHAMBERS

CLAYTON UTZ

CONSORTIUM CENTRO AMÉRICA ABOGADOS

CONSORTIUM – TABOADA & ASOCIADOS

DAVID GRISCTI & ASSOCIATES

DAVIES WARD PHILLIPS & VINEBERG LLP

DAVIS POLK & WARDWELL LLP

DE BRAUW BLACKSTONE WESTBROEK

DLA PIPER WEISS-TESSBACH RECHTSANWÄLTE GMBH

ELVINGER, HOSS & PRUSSEN

F.O. AKINRELE & CO

FORMOSA TRANSNATIONAL ATTORNEYS AT LAW

GERNANDT & DANIELSSON

GIDE LOYRETTE NOUEL AARPI

GORRISSEN FEDERSPIEL

HENGELER MUELLER

KADIR ANDRI & PARTNERS

KIM & CHANG

LENZ & STAEHELIN

LS HORIZON LIMITED

MARVAL, O'FARRELL & MAIRAL

MATTOS FILHO ADVOGADOS

MAYORA & MAYORA, SC

MORATIS PASSAS LAW FIRM

MOURANT OZANNES

MULLA & MULLA & CRAIGIE BLUNT & CAROE

MUÑOZ TAMAYO & ASOCIADOS ABOGADOS SA

NAGY ÉS TRÓCSÁNYI ÜGYVÉDI IRODA

NAUTADUTILH

PAKSOY

RUSSELL McVEAGH

RUŽIČKA CSEKES SRO

SCHOENHERR ŞI ASOCIAŢII SCA

SKUDRA & UDRIS

SLAUGHTER AND MAY

SYCIP SALAZAR HERNANDEZ & GATMAITAN

T STUDNICKI, K PŁESZKA, Z ĆWIĄKALSKI, J GÓRSKI SPK

URÍA MENÉNDEZ

VIEIRA DE ALMEIDA & ASSOCIADOS

WASELIUS & WIST

WEBBER WENTZEL

WONGPARTNERSHIP LLP

ZHONG LUN LAW FIRM

# CONTENTS

**Editor's Preface** ........ xvii
*Jan Putnis*

**Chapter 1** **International Initiatives** ........ 1
*Jan Putnis and Tolek Petch*

**Chapter 2** **Argentina** ........ 29
*Santiago Carregal, Martín G Vázquez Acuña and Josefina Tobias*

**Chapter 3** **Australia** ........ 41
*Louise McCoach and David Landy*

**Chapter 4** **Austria** ........ 76
*Wolfgang Freund*

**Chapter 5** **Barbados** ........ 86
*Trevor A Carmichael QC*

**Chapter 6** **Belgium** ........ 95
*Anne Fontaine*

**Chapter 7** **Brazil** ........ 107
*José Eduardo Carneiro Queiroz*

**Chapter 8** **Cambodia** ........ 113
*Bun Youdy*

**Chapter 9** **Canada** ....................................................................127
*Scott Hyman, Carol Pennycook, Derek Vesey and Nicholas Williams*

**Chapter 10** **Cayman Islands** ....................................................................143
*Richard de Basto*

**Chapter 11** **China**....................................................................154
*Wantao Yang, Emily Xiaoqian Wang and Carol Dongping Cao*

**Chapter 12** **Colombia**....................................................................175
*Diego Muñoz-Tamayo*

**Chapter 13** **Denmark** ....................................................................191
*Tomas Haagen Jensen and Tobias Linde*

**Chapter 14** **El Salvador** ....................................................................203
*Aquiles A Delgado and Oscar Samour*

**Chapter 15** **European Union** ....................................................................214
*Jan Putnis and Benjamin Hammond*

**Chapter 16** **Finland** ....................................................................236
*Tarja Wist and Jussi Salo*

**Chapter 17** **France**....................................................................247
*Olivier Saba, Samuel Pariente, Jennifer Downing, Jessica Chartier and Hubert Yu Zhang*

**Chapter 18** **Germany**....................................................................278
*Thomas Paul and Sven H Schneider*

**Chapter 19** **Greece**....................................................................292
*Dimitris Passas and Vassilis Saliaris*

**Chapter 20** **Guatemala** ........ 312
*María Fernanda Morales Pellecer*

**Chapter 21** **Guernsey** ........ 325
*John Lewis and Jeremy Berchem*

**Chapter 22** **Hong Kong** ........ 337
*Laurence Rudge and Peter Lake*

**Chapter 23** **Hungary** ........ 353
*Zoltán Varga and Tamás Pásztor*

**Chapter 24** **India** ........ 366
*Shardul Thacker*

**Chapter 25** **Indonesia** ........ 379
*Ferry P Madian and Yanny Meuthia S*

**Chapter 26** **Ireland** ........ 398
*Carl O'Sullivan, William Johnston, Robert Cain and Eoin O'Connor*

**Chapter 27** **Italy** ........ 410
*Giuseppe Rumi and Andrea Savigliano*

**Chapter 28** **Japan** ........ 421
*Hirohito Akagami, Toshinori Yagi and Wataru Ishii*

**Chapter 29** **Jersey** ........ 432
*Simon Gould and Sarah Huelin*

**Chapter 30** **Korea** ........ 444
*Sang Hwan Lee, Chan Moon Park and Hoin Lee*

**Chapter 31** **Latvia** ........ 457
*Armands Skudra*

**Chapter 32** **Luxembourg** ........ 468
*Franz Fayot*

**Chapter 33** **Malaysia** ........ 485
*Andri Aidham bin Dato' Ahmad Badri, Julian Mahmud Hashim and Tan Kong Yam*

**Chapter 34** **Malta** ........ 495
*David Griscti and Clint Bennetti*

**Chapter 35** **Netherlands** ........ 506
*Joost Schutte, Annick Houben and Mariken van Loopik*

**Chapter 36** **New Zealand** ........ 519
*Debbie Booth and Guy Lethbridge*

**Chapter 37** **Nicaragua** ........ 533
*Rodrigo Taboada R*

**Chapter 38** **Nigeria** ........ 545
*Adamu M Usman and Jumoke Onigbogi*

**Chapter 39** **Norway** ........ 560
*Terje Sommer, Markus Nilssen and Mats Nygaard Johnsen*

**Chapter 40** **Philippines** ........ 571
*Rafael A Morales*

**Chapter 41** **Poland** ........ 586
*Tomasz Gizbert-Studnicki, Tomasz Spyra and Michał Bobrzyński*

**Chapter 42** **Portugal** ........ 600
*Pedro Cassiano Santos*

**Chapter 43** **Romania** ........ 615
*Adela-Ioana Florescu and Diana-Maria Moroianu*

**Chapter 44** **Saudi Arabia** ........ 626
*Johannes Bruski and Julian Johansen*

**Chapter 45** **Singapore** ........ 635
*Elaine Chan*

**Chapter 46** **Slovakia** ........ 649
*Sylvia Szabó*

**Chapter 47** **South Africa** ........ 663
*Johan de Lange and Matthew Gibson*

**Chapter 48** **Spain** ........ 677
*Juan Carlos Machuca*

**Chapter 49** **Sweden** ........ 699
*Niclas Rockborn and Nils Unckel*

**Chapter 50** **Switzerland** ........ 715
*Shelby R du Pasquier, Patrick Hünerwadel, Marcel Tranchet and Valérie Menoud*

**Chapter 51** **Taiwan** ........ 736
*Chun-yih Cheng*

**Chapter 52** **Thailand** ........ 749
*Montien Bunjarnondha and Rahat Alikhan*

| | | |
|---|---|---|
| **Chapter 53** | **Turkey** <br>*Serdar Paksoy and Nazlı Bezirci* | 763 |
| **Chapter 54** | **United Arab Emirates** <br>*Amjad Ali Khan and Stuart Walker* | 775 |
| **Chapter 55** | **United Kingdom** <br>*Jan Putnis, Michael Sholem and Nick Bonsall* | 783 |
| **Chapter 56** | **United States** <br>*Luigi L De Ghenghi and Reena Agrawal Sahni* | 821 |
| **Chapter 57** | **Vietnam** <br>*Samantha Campbell, Pham Bach Duong and Nguyen Thi Tinh Tam* | 887 |
| **Appendix 1** | **About the Authors** | 907 |
| **Appendix 2** | **Contributing Law Firms' Contact Details** | 942 |

# EDITOR'S PREFACE

*Jan Putnis*

When the first edition of this book was published in mid-2010, banking regulation seemed to be undergoing a transformation driven by a reasonably coherent international agenda. There were questions about how long it would be before nationalist and protectionist tendencies fractured the broad consensus that seemed to have built up on such issues as the need for more and better quality capital resources, liquidity requirements and the strengthening and reform of vital market infrastructure. However, there appeared to be a reasonable degree of certainty about the direction and speed of reform, at least among the G20 countries.

Events, as they always do, have since conspired to make the position considerably more complicated, in two separate ways. First, achieving many of the regulatory reforms agreed in principle at the meeting of G20 leaders in London in 2009 has proved to be a far more complex and difficult task than even those expert in the field of banking regulation had expected. Secondly, as concerns about solvency have spread to governments, sovereign debt has assumed centre stage. The eurozone crisis, as it has come to be known, rumbles on with no obvious short-term solution that would avoid significant economic and social upheaval in parts of the European Union. There is also the potential existential threat that sovereign defaults of eurozone countries would pose to banks that are either established in those countries or have significant exposure to banks or assets in those countries. Events in the eurozone have given the frenetic activity in the area of financial regulatory reform in the European Union a slightly surreal quality against the backdrop of the consequences of potential economic and financial upheaval in one or more eurozone countries. Meanwhile, in the United States, the rule-making process under the Dodd-Frank Act has continued, behind its original schedule, and banks continue to digest the consequences of the Volcker rule.

On both sides of the Atlantic the volume and complexity of new and proposed rules has continued to be a cause of criticism and frustration. A banking sector that was roundly blamed for creating the complexity in products, markets and business structures that exacerbated aspects of the financial crisis is facing the irony of a wall of

new regulation of such complexity that the complexity itself might end up being the main reason that the new regulation fails to achieve its objectives.

Separately, in many Asian financial centres reforms are underway but are, in general, far behind those proposed and enacted in the United States and the European Union. Many governments, regulators and bankers in Asia saw (and continue to see) the western financial crisis of 2007–2009 as exactly that, a western financial crisis, and view the gradual liberalisation of the Chinese banking system and greater convertibility of the renminbi as the greater challenge and opportunity.

If we set ourselves the task of summarising the positive things that have emerged for banking regulation from that western financial crisis, what would we say now, three years on? There is little doubt that there is now much greater awareness among policymakers and regulators in all major jurisdictions of two important factors that will probably dominate any future international banking crisis:

*a* Banks, however well capitalised, risk collapse in sufficiently extreme circumstances and the crisis demonstrated that those circumstances should never be regarded as too extreme to contemplate. Assumptions about the credit quality and liquidity of assets, and about withdrawal of sources of funding (including deposits), may cease to apply in stressed market conditions. That means that the maturity transformation role of banks ('borrowing short term and lending long term', as it is often simplistically described) makes them subject to existential threats that are, by their very nature, difficult to anticipate and address accurately.

*b* Contagion can spread through financial systems in unexpected ways, or at least in ways that are unexpected by governments and regulators. Studying the potential routes of contagion and considering whether there are ways of closing down those routes without adverse unintended consequences for economies that are recovering from recession is therefore an important aspect of regulatory endeavour.

It might seem incredible now that these points were not appreciated sufficiently by governments and regulators before the financial crisis first erupted in the United States in 2007 and then spread to Europe in the following year. But that was undoubtedly the case.

The past year has seen international banking groups grappling with the practical realities of regulatory reform. Doubts about the ability of some banks to raise the additional capital (particularly Tier I capital) that they will require in order to meet the gradually increasing capital requirements set out in the Basel III agreement are feeding concerns about the long-term viability of some banks' business models and, more generally, about previously long-held expectations as to returns on equity of banking groups. Banks have begun to respond to actual and prospective higher capital requirements, in some cases by raising equity with varying degrees of success (which has been difficult in the market conditions prevailing in most of the world in the past year) and in other cases by selling or preparing to sell assets and business units, or simply by closing down business lines.

Politics have intervened in banking in the past year in ways that have made the debate about the direction of regulatory reform in the banking sector more complicated. In some countries, concern about the remuneration of senior management of banking groups has reached fever pitch in the media while, at the same time, a less emotive and

generally more thoughtful debate has continued on the need for more financing for businesses, particularly small and medium-sized enterprises.

The apparent shortage of finance for businesses in many economies, coupled with expected further pressure on the ability of banks to provide that finance as their capital requirements continue to increase, has led to concerns about the development of other sources of finance. Is credit risk, and the contagion to which it can give rise if borrowers default, shifting in dangerous ways out of the banking sector into the so-called 'shadow banking sector'? The European Commission looks set to start investigating this topic in earnest in 2012. The consequences of regulatory intervention in this area are currently very difficult to predict, not least because any attempt to regulate non-bank sources of finance more heavily is bound to attract criticism from those who claim that it will only reduce further the sources of finance available to the 'real' economy.

Another area of regulatory reform that banking groups continue to grapple with in 2012 is transparency with regulators. There are various examples of the ways in which this is starting to affect the sector. The most immediate and relevant example concerns the work that many of the largest banking groups in the United States and Europe are currently involved in to draw up 'recovery plans' and to draw up, or to assist their regulators in drawing up, 'resolution plans', those plans being collectively (and somewhat misleadingly) referred to as 'living wills'. The phrase of the moment is 'barriers to resolution', describing factors that would prevent or inhibit the orderly resolution of a bank at or close to its collapse. Plenty of barriers to resolution are being identified as recovery and resolution plans are prepared. The second half of 2012 and 2013 will likely be an interesting period in which regulators ponder these barriers and deepen their discussions with banking groups as to what might be done about them.

Fears of enforced structural reorganisations and changes to business models have led some banking groups to spend considerable amounts of time and resources developing their own solutions to perceived barriers to resolution. More immediately, the process of preparing recovery and resolution plans has proved difficult, the main challenges including how to reconcile differences between the statutory resolution and insolvency procedures for banks in different jurisdictions and to understand the cross-border elements of those procedures. Fundamental questions about the availability of cross-border services to banking operations in a crisis, the treatment of banks' global hedging arrangements, and ultimately the resolvability of banking groups, are at stake. It seems likely that we are many years away from having recovery and resolution plans that carry the benefit of clarity around how regulators would operate them on a cross-border basis in a crisis. It also remains to be seen whether cross-border cooperation between regulators would work in such circumstances given the significant differences between national resolution and insolvency procedures and the desire in many jurisdictions to protect local depositors. Another major area of uncertainty concerns the proposals by some regulators that debt issued by banking groups be 'bailed in' (i.e., written off or converted into equity) in a crisis and how that could happen without spreading contagion through the banking system and the wider economy via the holders of that debt.

Meanwhile, scrutiny of the structure of banks themselves has continued in some countries. The likely implementation in the United Kingdom of proposals to require the 'ring-fencing' of retail banking activities within banking groups may be the start of a trend that spreads to other countries. Despite the prevalence of 'universal' banks,

combining retail and investment banking activities in single legal entities in many of the other Member States of the European Union, the European Commissioner for the Internal Market has commissioned a study into the structure of banks with a remit to consider ring-fencing of retail banking.

Liquidity has remained a central concern for many banking groups in the past year. Short-term liquidity problems at banks (arising, in particular, from concerns about the strength of some banks as counterparties) have resulted in an increase in the range of funding for which banks generally are now expected to provide collateral. This trend is expected to be exacerbated by longer-term developments such as the Basel III requirements on liquidity and the proposed introduction of depositor preference in some countries for the first time. Liquidity pressures have led to many banks engaging in new types of transactions, such as so-called 'liquidity swaps', to increase the amount of high-quality collateral that they have available for their funding operations. This ongoing search for liquidity, and for the collateral required to obtain liquidity, has made some financial regulators concerned about the potential spread of contagion within the banking sector and from the banking sector to other sectors. For example, some liquidity swap transactions have involved banks receiving liquid assets from insurers in return for assets that are less liquid.

This third edition of *The Banking Regulation Review* updates the position on important aspects of banking regulation in the countries covered, in most cases to February 2012. While the book is aimed principally at staff in the legal and compliance departments of banks, it is to be hoped that senior management also find it helpful. The book focuses most closely on the deposit-taking activities of banks. The constraints of space and time mean that it will never be possible to do full justice to all of the subjects covered in each chapter, but readers are of course welcome to contact me if they have any suggestions for future editions.

Preparing successive editions of this book continues to be an onerous task for the busy lawyers who contribute the chapters and who are otherwise much in demand. My thanks go to them for their dedication to the task. Significant changes to a book such as this also mean much more work than would otherwise be the case for the publisher. I am therefore very grateful to the publisher's team for their understanding, hard work and patience with a group of authors who often have many other commitments.

Finally, I would like to thank the partners and staff of the financial regulation group at Slaughter and May for appreciating this book's value and for encouraging our involvement in it for a third successive year.

**Jan Putnis**
Slaughter and May
London
April 2012

## Chapter 28

# JAPAN

*Hirohito Akagami, Toshinori Yagi and Wataru Ishii*[1]

## I INTRODUCTION

As the world's third largest economy, Japan has a well-developed banking industry of more than 200 banks. As a result of several mergers among the larger banks before 2005, there are currently four 'mega' banking groups: Mizuho, Sumitomo Mitsui, Mitsubishi UFJ and Resona. A further two large banks – Sumitomo Trust and Chuo Mitsui Trust – merged in April 2011. Approximately half of these 200 banks are so-called 'local banks', which provide more locally based banking services (principally in one or more specific prefectures). There are also around six internet banks providing services solely via the internet, and approximately 60 overseas bank branches.

Japan Post Bank, with ¥175 trillion of deposits, was formerly part of the Japanese government's postal division, and accepted deposits via its network of post offices scattered throughout the country. The bank, which is wholly owned by the Japanese government at this time, is in the process of privatisation. This process began in 2003 and was expected to be completed by 2017 by way of an initial public offering. However, this plan has been partially suspended following the change in administration after the elections in August 2009, and the privatisation plan is being reconsidered by the current administration.

## II THE REGULATORY REGIME APPLICABLE TO BANKS

### i The Banking Act and the Financial Instruments and Exchange Act

The principal source of regulation for banks engaging in business in Japan is the Banking Act (Act No. 59 of 1981), to which all banks are subject. This regulates their corporate

1 Hirohito Akagami is a partner and Toshinori Yagi and Wataru Ishii are associates at Anderson Mori & Tomotsune.

governance, banking business and capital adequacy as well as their principal shareholders ('the bank principal shareholders') and subsidiaries. The Banking Act also regulates holding companies that have banks as subsidiaries ('the bank holding companies').

An important note is that the Japanese regulatory framework regulates so-called commercial banking activities and investment banking activities separately. The Banking Act is, in principle, applicable only to the former activities of banks (i.e., (1) acceptance of deposits; (2) provision of loans; and (3) transfer of funds: 'the core banking business'). A large number of banks also engage in investment banking activities, which generally include securities and derivatives-related businesses. These activities are subject to separate restrictions discussed at Subsection iii, *infra*, and these banks are concurrently regulated under the Financial Instruments and Exchange Act (Act No. 25 of 1948 – 'the FIEA') for this purpose. Some banks also have affiliate securities companies engaging in the investment banking business, and these companies are also regulated by the FIEA.

**ii Regulators**

The principal regulator of the banking industry is the Financial Services Agency of Japan ('FSA'), whose authority to supervise banks in Japan is delegated by the Prime Minister. The Commissioner of the FSA also delegates a part of its authority to the directors of local finance bureaux in relation to local banks and the supervision of investment banking activities. The on-site and off-site inspection of investment banking activities is performed by the Securities and Exchange Surveillance Commission. The Bank of Japan ('BoJ') also has supervisory authority over banks, based primarily on its contractual agreements and transactions with them.

The regulator's powers as prescribed in the Banking Act include receipt of various reports, the ability to carry out on-site inspections (where a bank must, in practice, disclose any and all information it holds to the regulator) and the power to make orders of business improvement and suspension.

**iii Entry into banking industries**

Two organisational structures are available to overseas banks for establishing a core banking business in Japan. One scheme consists of the establishment of a joint-stock company with limited liability in Japan as a subsidiary or affiliate in accordance with the Companies Act of Japan (Act No. 86 of 2005). This subsidiary or affiliate must obtain a banking licence from the Prime Minister of Japan, pursuant to the Banking Act (a 'local entity bank'). The alternative consists of the establishment of branches of the foreign bank within Japan, and obtaining a 'foreign bank branch' banking licence. For the foreign bank branch scheme, the opening of subsequent branches (which are also known as sub-branches) is also subject to prior approval from the FSA.[2] The grant of the necessary licences and approvals is at the discretion of the relevant authority in each instance.

To engage in investment banking activities such as a securities and derivatives business, the bank must also be registered with the competent local finance bureau,

2 Article 47-2 of the Banking Act.

pursuant to the FIEA.[3] Registered banks are generally permitted to operate a wider range of derivatives and securities businesses, such as brokerage of Japanese government bonds and sales of unit trusts or non-discretionary investment advisory services. However, for historical reasons, banks are generally prohibited from engaging in certain categories of securities business, including brokerage and underwriting of corporate stocks and corporate bonds, and discretionary investment management services.[4] To conduct such activities, banks must establish a subsidiary or affiliate that is a separate legal entity, and register it pursuant to the FIEA as a financial instruments business operator ('FIBO').

### iv Cross-border activities by overseas banks not having a branch

Overseas banks may not, in principle, enter into any part of the core banking business or investment banking business in Japan or with persons in Japan without establishing a branch and obtaining a banking licence as a foreign bank branch. Even where an overseas bank has a licensed foreign bank branch in Japan, it is generally understood that the other, unlicensed overseas branches ('the unlicensed branches') of the bank are prohibited from engaging in transactions, or with persons, in Japan.

In connection with this, a new regulatory framework called the 'foreign bank agency business' was implemented in December 2008, under which both overseas banks without a licensed foreign bank branch, and the unlicensed branches of an overseas bank, may conduct a core banking business with persons in Japan through either a local entity bank within the same group, or a foreign bank branch of the bank acting as an agent or intermediary. Both of these options require the local entity bank or foreign bank branch to obtain separate approval from the FSA.[5]

## III PRUDENTIAL REGULATION

### i Relationship with the prudential regulator

Most banks have a close relationship with the regulators. We understand that the officials of the supervisory division of the FSA and local finance bureaux are each assigned to monitoring specific banks.

The regulators tend to focus their attention principally on appropriate management of banking businesses, maintenance of sufficient financial conditions including satisfaction of capital adequacy requirements, protection of customers, and the maintenance of robust internal control systems to ensure that the bank is always in compliance with applicable laws. It is fairly common that a bank will consult with regulators in advance of occasions when it expects to receive particular attention from regulators; for instance, if it launches a new business that is not covered clearly by existing legislation, or an issue has arisen that may affect the bank's financial condition.

3 Article 33-2 of the FIEA.

4 Article 33 of the FIEA.

5 Chapter 7-2 of the Banking Act.

### ii Management of banks

Under the Banking Act, a local entity bank must have a board of directors and accounting auditors; and also a board of corporate auditors or a subcommittee of the board of directors (comprising an audit committee, remuneration committee and appointment committee) pursuant to the Companies Act.[6] Directors and executive officers engaging in the ordinary business of a local entity bank must have the knowledge and experience to be able to manage and control the bank appropriately, fairly and efficiently and must have 'sufficient social credibility' (the Banking Act requires a bank to appoint directors who are trusted within society; however, what precisely is meant by this criterion is somewhat ambiguous).[7] For local entity banks that have a board of corporate auditors, the representative director shall take command of the establishment and maintenance of the internal compliance framework, make risk management a primary concern, establish a sufficient internal control framework to properly disclose the bank's corporate information to the public, and ensure that appropriate internal audits are performed.[8] The board of directors must proactively oversee the representative directors, establish and review business management plans in line with the bank's business objectives, establish a clear risk management policy by taking these objectives into consideration, and ensure appropriate performance and review of internal audits.[9]

For foreign bank branches, although there is no required specific corporate governance structure such as for local entity banks, the branch manager must also have the knowledge and experience to manage and control the branch appropriately, fairly and efficiently, and must also have sufficient social credibility (as referred to above). In addition, officers with sufficient knowledge and experience must be appointed to manage the branch, and the proper authority to do so must be delegated to those officers by the overseas head office. Of course, the head office is likely to wish to oversee the management of the branch, and it is permissible that it offer supervision and guidance. Therefore, it may be advisable to introduce appropriate systems for such oversight and approvals; for example, that any problematic issues occurring within the branch should immediately be reported to the head office as well as to the regulatory authority.

In addition, however, it must be kept in mind that oversight by the overseas branch or holding company must not undermine the governance framework, and the management responsibility for such, which must be established within the local entity bank or foreign bank branch to manage its business properly as a licensed financial institution. Administrative action (in the form of an order of suspension of a part of the business and an order of improvement of the business) taken against a local entity bank subsidiary of a US-based bank group illustrates the FSA's position on how each financial institution within the same group should be managed. An FSA press release dated 27 January 2006 regarding its action states that the US parent appointed a person who had

6 Article 4-2 of the Banking Act.

7 Article 7-2 of the Banking Act.

8 III-1-2-1 (1) of 'Comprehensive Guidelines for Supervision of Major Banks, etc.' of the FSA ('the FSA Supervisory Guidelines').

9 III-1-2-1 (2) of the FSA Supervisory Guidelines.

no directorship of the local entity bank but was given the title of 'Representative in Japan', and gave that person the primary management and control of the businesses of the local entity bank. This thereby undermined the authority and responsibility of each director of the local entity bank (despite the fact that such authority and responsibility is required under Japanese corporation law and the Banking Act). The FSA ordered the creation and development of 'independent' governance and internal control systems, and the establishment of a clear system of responsibility within the local entity bank, predicated upon a fundamental re-evaluation of the present state of managerial involvement and monitoring of the bank by the US parent.

There is no express provision under the Banking Act which directly restricts the amount, form and manner of remuneration paid to the management or employees of banks or their affiliates. However, the regulators have been placing greater emphasis on ensuring appropriate remuneration in light of the need to avoid excessive risk-taking and to conform with the consensus of the Financial Stability Board. More specifically, as part of general prudential regulations, banks are expected to (1) have an independent committee or other type of organisation to sufficiently monitor the remuneration of management and employees; (2) ensure financial sufficiency, appropriate risk control, consistency between incentive bonuses and actual performance (i.e., the level of incentive bonuses should substantially decrease in the event of the bank's poor financial performance) and contribution to long-term profits in determining remuneration structures; and (3) disclose important matters regarding remuneration.[10]

### iii Regulatory capital and liquidity

The framework for regulating local entity banks' capital adequacy under the Banking Act has been amended in line with the implementation of Basel II. By March 2008, the regulatory framework of Basel II had been fully introduced into Japanese banking laws through amendments of the FSA guidelines[11] including, *inter alia*, the internal ratings based approach ('IRB approach') and the advanced measurement approach (see below). Local entity banks are now permitted to employ, following approval by the FSA and the satisfaction of certain other conditions, an IRB approach that enables them to rely on their own measurements of counterparties' credit risks to determine their capital requirements (subject to strict data, validation and operational requirements). Of the IRB approaches, there are two subcategories: a foundation approach and an advanced approach. Local entity banks may now use not only the former approach but also the latter approach. This permits them to use their own measurements not only to estimate the possibility of default but also the loss which may be incurred in the event of default, among other things.

Local entity banks with international operations must have a minimum risk-adjusted capital ratio of 8 per cent, calculated in accordance with the internationally adopted standards under the Basel II framework, on both a consolidated and non-consolidated basis. Those banks without international operations are required to have

10 III-2-3-5 of the FSA Supervisory Guidelines.

11 FSA Guidelines No. 19 of 2006 and No. 20 of 2006.

a minimum risk-adjusted capital ratio of 4 per cent (on both a non-consolidated and consolidated basis). This is calculated in accordance with the domestic capital adequacy requirements, which are similar to those for banks with international operations. However, local entity banks employing the IRB approach must still maintain a capital ratio of 8 per cent. Similar capital adequacy regulations are also imposed on bank holding companies.

The status of the capital adequacy of banks, including the risk-adjusted capital ratio, must be reported and disclosed on a semi-annual basis.[12] If a bank's capital ratio falls short of the minimum mentioned above, the FSA may require the bank to prepare and implement a capital reform plan. In extreme cases, it may reduce the bank's assets, restrict the increase of its assets, prohibit the acceptance of deposits, or take any other measures it deems necessary.[13]

The regulatory capital framework mentioned above does not apply to foreign bank branches, on the grounds that the capital adequacy of these banks must be reviewed by their principal overseas regulators.

It should be noted that on occasion, a large transaction with any one bank may be restricted due to the 'large lending limit regulation'. Pursuant to this regulation, aggregate exposure of a local entity bank to a single person (including that person's group companies) by means of extending loans, purchasing debt instruments or equity investments, shall not exceed, in principle, 40 per cent of the amount of non-consolidated regulatory capital (with certain adjustments) of the local entity bank.[14]

The Banking Act does not contain an express provision which directly regulates banks' liquidity or any quantitative standards of liquidity. However, the FSA Supervisory Guidelines provide some guidance on this point from a regulatory monitoring perspective. These guidelines require a bank, *inter alia*, to (1) establish an internal framework to appropriately control liquidity risk (e.g., by separating the treasury division from the liquidity risk control division); (2) maintain control methods as well as internal reporting procedures regarding the bank's liquidity that are subject to the approval of the board of directors; and (3) monitor the status of its liquidity and be prepared for emergency circumstances.[15]

The Inspection Manual for Deposit-taking Institutions, which has been prepared by the FSA for use by their inspectors, also includes detailed checklists for banks' self-regulation as part of the framework for managing liquidity risk. These requirements apply not only to local entity banks but also to foreign bank branches. For the latter, however, it is understood that there will be broad variations as what constitutes acceptable levels of, and procedures for, liquidity risk management given that the business of foreign bank branches varies greatly from one to another.

12 Article 19 of the Banking Act.

13 Article 26, Paragraph 2 of the Banking Act.

14 Article 13 of the Banking Act.

15 III-2-3-4 of the FSA Supervisory Guidelines.

## IV CONDUCT OF BUSINESS

The Banking Act obliges banks to carry on their business in compliance with various regulations including a prohibition on abuse of a dominant bargaining position; management of conflict of interests; provision of explanation of risks associated with their products and other information to customers; and appropriate handling of personal information.

However, Japanese banking laws do not provide such comprehensive and strict banking confidentiality frameworks as those adopted in some jurisdictions. Questions of how and to what extent banks should protect and use their customers' information have been governed by general confidentiality laws and contractual arrangements between banks and their customers (including implicit agreements), the contents of which have been clarified and developed by court decisions made upon individual lawsuits alleging misconduct on the part of the relevant bank and by discussion within the banking industry.

The handling of customer information of individual clients is mainly governed by a general law applicable to all industries, entitled the Personal Information Protection Act of Japan (Act No. 57 of 2003 – 'the PIPA'), although general principles thereof have been brought into the Banking Act. Under the PIPA, personal information may not, in general, be disclosed to third parties without the relevant individual's consent or providing that individual with the right to prohibit the disclosure (an 'opt-out' system).[16]

How banks should treat information held on corporate clients is discussed in the Study Group Report on Desirable Sharing of Corporate Customer Information between Banking and Securities Businesses published by the Japanese Bankers Association ('JBA') on 15 April 2008. This suggests that such information may be disclosed when (1) the explicit or implicit consent of the customer has been obtained; (2) the information is public information; or (3) the disclosure may be deemed legitimate, taking its necessity into account (leading to the conclusion that a rather wider range of disclosure to other companies within the same group for the purpose of, for instance, marketing activities, is permissible without the client's consent).

However, it should be pointed out that banks may disclose the confidential information of both individual and corporate clients to Japanese governmental authorities without their consent, if it is deemed necessary and appropriate. This could also apply to foreign governmental authorities, but this may not necessarily be the case (for instance, the PIPA provides that it is permitted to disclose personal information if such disclosure is 'based on laws', and the term 'laws' for this purpose is interpreted to mean Japanese law only).

16 Article 23 of the PIPA.

## V FUNDING

Substantially, all types of funding methods, including equity and debt financing, call loans, repurchase transactions and central bank funding principally by way of open market operations, are available to banks.

In line with the current trend of emphasis on banks' capital adequacy, a large number of local entity banks and bank holding companies recently conducted capital increases through public offerings. During the fiscal years ending March 2010 and 2011, capital increases of approximately ¥1,800 billion, ¥1,000 billion and ¥500 billion on aggregate were conducted through public offerings by Sumitomo Mitsui, Mitsubishi UFJ and Mizuho, respectively. In January 2011, Resona Holdings launched a global offering of its common stock of approximately ¥600 billion, the proceeds of which were used for repayment of public funds. Straight (plain vanilla) bonds/notes and Tier I eligible hybrid debt capital instruments are also commonly adopted as funding methods.

Open market operations are provided by the BoJ. Both local entity banks and foreign bank branches may participate, to the extent they satisfy certain requirements prescribed by the BoJ.

## VI CONTROL OF BANKS AND TRANSFERS OF BANKING BUSINESS

### i Control regime

Shareholders of local entity banks may be subject to regulation pursuant to the Banking Act if they qualify as a 'bank principal shareholder' or 'bank holding company'.

A bank principal shareholder is generally defined as a shareholder having 20 per cent (or, in certain cases, 15 per cent) or more of the voting rights of a local entity bank.[17] A bank holding company is defined as a company that has paid an acquisition price for its Japanese subsidiaries' shares exceeding 50 per cent of the total assets of the company, and that holds more than 50 per cent of the voting rights in a local entity bank.[18] Once the shareholder qualifies as a bank holding company, it will be subject to regulations applicable to a bank holding company rather than a bank principal shareholder.[19]

Any person who wishes to become a bank principal shareholder must obtain prior approval from the FSA.[20] A bank principal shareholder may be required by the FSA to submit reports or materials, may be inspected by the FSA at its offices and have to answer questions put by an FSA officer, and have to present accounting books and other documents.[21] If a bank principal shareholder fails to satisfy any conditions given by the FSA in conjunction with the approval, the FSA may order the bank principal

---

17 See Article 2, Paragraph 9 of the Banking Act.

18 See Article 52-17, Paragraph 1 and Article 2, Paragraph 12 of the Banking Act.

19 Article 52-9, Paragraph 1 and Article 55, Paragraph 2 of the Banking Act.

20 Article 52-9, Paragraph 1 of the Banking Act.

21 Article 52-11 and 52-12 of the Banking Act.

shareholder to take any actions the FSA considers necessary.[22] Further, a bank principal shareholder having more than 50 per cent of the voting shares of a local entity bank may be ordered by the FSA to submit an improvement plan or otherwise take necessary measures to ensure the sound and appropriate management and operation of the local entity bank.[23] 'Necessary measures' is interpreted to include certain kinds of 'keep well' directions aimed at the local entity bank, for instance, capital support to the local entity bank if it has any problems with capital adequacy.

The regulations applicable to a bank principal shareholder are generally applicable in the same way to a bank holding company.[24] Improvement plans and 'keep well' directions are also applicable to both. Further, the scope of business of a bank holding company and its subsidiaries is restricted to certain financial businesses.[25] The maximum amount of credit that may be extended to a single group of persons by a bank holding company and its subsidiaries is the amount calculated in accordance with a formula specified in the Banking Act.[26]

### ii Transfers of banking business

Local entity banks may transfer their banking businesses in one of three ways: (1) a business transfer for all or part of the bank's business; (2) a corporate merger of the whole business; or (3) a corporate split for part of its business. For foreign bank branches, the business transfer is commonly used to amalgamate the Japanese operations of two or more foreign banks. Other procedures of transfer may also be available pursuant to the laws of their home countries, but there is some ambiguity in how the special procedures required under the Banking Act to protect customers will apply to transfers conducted pursuant to foreign laws. Both local entity banks and foreign bank branches may be a transferee of the banking business of another bank. A banking business cannot be transferred to an entity other than a bank unless that entity obtains a banking licence prior to the closing of the transfer.

#### *Business transfer*

In summary, the procedure for a business transfer under the Banking Act is: (1) the execution of the business transfer agreement between the transferor and transferee; (2) in case of a transfer of a whole business, the completion of procedures for the creditors' protection (among other procedures);[27] (3) application to the FSA by both the transferor and the transferee for approval of the business transfer;[28] and (4) after approval has been obtained, closing can take place. Step (2) is performed by way of publishing a notice over a period of at least one month to creditors of the effect of the business transfer. This step

22 Article 52-13 of the Banking Act.

23 Article 52-14 and 52-15 of the Banking Act.

24 Article 52-31 to 52-34 of the Banking Act.

25 Article 52-21, Paragraph 1, Article 52-23, Paragraph 1 of the Banking Act.

26 Article 52-22 of the Banking Act.

27 Article 34 of the Banking Act.

28 Article 30, Paragraph 3 of the Banking Act.

essentially enables the transferor bank to replace individual consents (as would usually be required under the Civil Code) with the public notice.[29]

***Corporate split and corporate merger***

Corporate split and corporate merger procedures are similar to that of a business transfer: (1) the execution of the corporate split/corporate merger agreement; (2) procedures for creditors' protection as mentioned above;[30] (3) application for approval from the FSA;[31] and (4) the closing after FSA approval has been obtained. Step (2) must also be performed by way of making a public notice to creditors. By application of the provisions of the Companies Act, all contractual relationships pertaining to the transferred business are transferred to the transferee bank without individual consent of the counterparties;[32] All of the relevant steps required under the Companies Act and securities laws, as well as the rules of securities exchanges, remain applicable under these procedures.

## VII THE YEAR IN REVIEW

### i Financial ADR

Effective from 1 October 2010, a new regulatory framework for the resolution of customer complaints and disputes was introduced, which is known as the 'Financial ADR system'. Under the Financial ADR system, all banks are required to take appropriate measures to handle complaints and claims from its customers, as well as to resolve disputes with customers through alternative dispute resolution ('ADR') proceedings. Consequently, all banks (both local entity banks and foreign bank branches) are required to enter into a contractual arrangement with the JBA, which provides that disputes between such bank and its customers may be referred to ADR proceedings presided over by the JBA.[33]

### ii Consolidated regulation on investment banking sectors

Following the worldwide trend of regulating the investment banking sector after the market disruption in 2008, an amendment to the FIEA, which was passed by the National Diet in May 2010 ('the 2010 FIEA Amendment'), introduced a new framework for the supervision of securities companies at a group level, which were only regulated on a non-consolidated basis (i.e., at entity level). Under this new framework, which took effect on and from 1 April 2011, securities companies having assets of ¥1 trillion or more (calculated on a non-consolidated basis) are subject to, *inter alia*, periodical reporting obligations as well as capital adequacy/leverage ratio regulation on a consolidated basis.[34]

29 Article 34, Paragraphs 3 and 4 of the Banking Act.

30 Article 789, Paragraph 2; Article 799, Paragraph 2; Article 810, Paragraph 2; and Article 789 of the Companies Act; Article 33 and 33-2 of the Banking Act.

31 Article 30, Paragraphs 1 and 2 of the Banking Act.

32 Article 750, Paragraph 1; Article 754, Paragraph 1; Article 759, Paragraph 1; and Article 764, Paragraph 1 of the Companies Act.

33 Article 12-3, Paragraph 1, Item 1 of the Banking Act and Chapter 7-5 of the Banking Act.

34 Article 57-3 to 57-5 of the FIEA.

In addition, certain parent companies of securities companies having this value of assets will be designated by the FSA, and as such will itself be subject to, *inter alia*, periodical reporting and similar capital adequacy/leverage ratio regulation on a consolidated basis.[35]

### iii Clearing of OTC derivatives contracts through CCPs

Following the Leaders' Statement at the Pittsburgh Summit in September 2009, and in line with legislation in the US and EU, the 2010 FIEA Amendment introduced new regulations on over-the-counter ('OTC') derivative transactions effective no later than November 2012. Under this amendment, banks registered under the FIEA (see Section III.iii, *supra*) as well as FIBOs will be obliged to ensure that certain OTC derivative transactions (to be specified by a Cabinet Office Ordinance) are cleared through central counterparties ('CCPs').[36] The exact scope of the Cabinet Office Ordinance has not been made public, but it is expected that interest rate swaps (plain vanilla) and iTraxx Japan CDS will fall under this regulation, and further that iTraxx Japan CDS will be required to be cleared through CCPs licensed in Japan.

### iv Finance lease business

An amendment to the Banking Act was passed by the National Diet in May 2011, allowing banks to conduct leasing business in accordance with a lease agreement upon the satisfaction of all of the following requirements: (1) the agreement must not be cancellable during the lease term; (2) the lesser recovers the cost of purchases and other expenses as lease payments; and (3) the agreement is not drafted so as to facilitate transfer of the ownership of the lease asset at the end of the lease period.

## VIII OUTLOOK AND CONCLUSIONS

For more than a decade, the Japanese government has proceeded with a relaxation of regulations on financial institutions, aiming to increase the competitiveness of Japan's financial industries. However, in step with the worldwide movement to impose tougher constraints on the financial sector following the global financial crisis, the Japanese government also seems to be turning to stricter regulation.

Given the change in government in August 2009 from the Liberal Democratic Party (which had held power in Japan almost continuously since the 1950s), to a coalition led by the Democratic Party of Japan, it has become more difficult to predict the direction of banking regulation policies, particularly when coupled with the changes in financial regulatory environments worldwide. All participants in the Japanese banking industry are strongly recommended to closely observe any trends and changes in Japan's financial regulations.

35 Article 57-15 to 57-17 of the FIEA.

36 Article 156-62 of the FIEA.

# Appendix 1

# ABOUT THE AUTHORS

**HIROHITO AKAGAMI**

***Anderson Mori & Tomotsune***

Hirohito Akagami is a partner at Anderson Mori & Tomotsune, engaged principally in the fields of financial, corporate and commercial law, with an emphasis on securities work and M&A. Typically, these transactions involve Akagami representing the purchasers for a number of tender offers, which he has been doing for more than 10 years. He also advises clients on a number of domestic and cross-border syndicated loans, securities and other financial transactions, as well as on corporate governance-related matters and regulatory issues.

He graduated from Tokyo University in 1986 and received his LLM from University of London, London School of Economics and Political Science in 1993. He was also seconded to Slaughter and May in London and Brussels in 1993 and 1994.

He is a member of the Dai-ni Tokyo Bar Association in Japan (1988 to present). He speaks Japanese and English.

**TOSHINORI YAGI**

***Anderson Mori & Tomotsune***

Toshinori Yagi is an associate of Anderson Mori & Tomotsune, engaging in a wide range of general corporate issues. He focuses his practice on financial transactions including financial regulatory matters. He served as an officer of the Financial Services Agency of Japan from 2008 to 2009, where he was in charge of planning financial regulations principally related to securities exchanges, ETFs and REITs.

Yagi received his LLB from Tokyo University in 2004 and has been a member of the Dai-ni Tokyo Bar Association in Japan since 2005. He speaks Japanese and English.

**WATARU ISHII**

***Anderson Mori & Tomotsune***

Wataru Ishii is an associate at Anderson Mori & Tomotsune, engaging in a wide range of general corporate issues. He focuses his practice on financial transactions, including financial regulatory matters.

He received his LLB from Tokyo University in 2002 and his JD from the University of Tokyo School of Law in 2009. He is a member of the Dai-ni Tokyo Bar Association in Japan (2010 to present). He speaks Japanese and English.

**ANDERSON MŌRI & TOMOTSUNE**

Izumi Garden Tower
6-1, Roppongi 1-chome, Minato-ku
Tokyo 106-6036
Japan
Tel: +81 3 6888 1000
inquiry@amt-law.com
www.amt-law.com/en/