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Briefing Note August 2013

Japan: Banking Regime Update – Deregulation on the 5% Rule etc.

Under new laws recently passed by the Japanese Diet, restrictions limiting the shareholding of a Japanese bank in a non-financial business – the so-called '5% rule' – will be deregulated and additional support will be given to banks seeking to act as equity investors in corporate restructurings, with Japanese banks expected to take a more central role in the restructuring of corporations as a result. Reforms will also allow Japanese banks to conduct intermediary activities on behalf of foreign banks, and to hold shares in foreign non-financial businesses acquired through M&A activity. The reforms and new regulation are expected to take effect around 1 April 2014.

Deregulation on the '5% Rule'

With limited exceptions, Japanese banks and their subsidiaries are not currently permitted to hold above 5% of the voting rights in a non-financial business (NFB Shares), excluding a large potential source of equity from deposit-rich Japanese banks that currently have a strong appetite for solid equity investments. As such, reforms relaxing the current restrictions are expected to see banks with strong balance sheets taking prominent roles as active equity investors.

Additional equity investments from Japanese banks will be facilitated by an expansion of the exceptions to the 5% rule allowing:

- Japanese banks (rather than only their investment subsidiaries) to hold 100% of the NFB Shares in a non-listed company subject to restructuring[1] (for up to 3 years[2]). Currently, a 100% shareholding of NFB Shares in a non-listed company subject to restructuring is only permitted for a Japanese bank's investment subsidiaries; and
- Japanese banks to acquire a 100% shareholding in NFB Shares as a result of a debt equity swap (for up to 3 years[3]). Currently, a bank may hold NFB Shares for only 1 year. If approval is granted by the Japanese Financial Services Agency (JFSA), banks may hold shares for up to 3 years but the shareholding is limited to only 50% following this extension of time.

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[1] For example, non-listed companies subject to a rehabilitation plan under the Civil Rehabilitation Act, a reorganisation plan under the Corporate Reorganisation Act or a business reconstruction plan under the Act on Special Measures for Industrial Revitalization Innovation.
[2] Time periods in the draft Cabinet Office Ordinance may be subject to change. "Explanatory Material on the Bill for Amendment of the Financial Instruments and Exchange Act, etc." (June 2013) (http://www.fsa.go.jp/common/diet/183/setsumei.pdf) and "Review of Regulations on Banks which Contribute to Stability of the Financial System, etc." (25 January 2013) (http://www.fsa.go.jp/singi/singi_kinyu/tosin/20130128-1/01.pdf).
[3] Time periods in the draft Cabinet Office Ordinance may be subject to change.

Prior to the introduction of the new laws, the JFSA proposed a series of reforms which it is now expected will be introduced in tandem with the new legislation, including:

- eliminating the 10-year limit on limited liability partnerships holding NFB Shares;
- expanding the scope of venture business companies and extending the maximum holding period from 10 to 15 years in relation to the shareholding in venture business companies; and
- eliminating the 1-year maximum period in the case of an acquisition of NFB Shares by a trust if voting rights in respect of such NFB Shares are exercised by the trustee.

All of the above proposals are expected to facilitate more equity investments from Japanese banks.

Deregulation on intermediary business for foreign banks

Currently, Japanese banks are not allowed to provide services to customers on behalf of banks that are operated outside of Japan (Foreign Banks) or act as an intermediary for Foreign Banks (Foreign Bank Agency Services) unless the Foreign Bank is the Japanese bank's parent, subsidiary or sister company. However, the new JFSA reforms are expected to permit Foreign Bank Agency Services even if a Japanese bank does not have a capital relationship with the relevant Foreign Bank (i.e., the Foreign Bank is outside of its group).

As a result of the reforms, Foreign Banks will be able to provide services (via Japanese banks) to mid-size Japanese companies with an overseas business but who do not have a direct relationship with a Foreign Bank.

Deregulation on scope of subsidiaries in respect of outbound M&A

Subsidiaries of Japanese banks are currently limited in the scope of their business. As a consequence, if a Japanese bank intends to acquire a Foreign Bank where its subsidiaries conduct business activities outside of the scope of the restrictions, Japanese banks are effectively required to request a vendor to exclude or hive off this out-of-scope business prior to an acquisition. This poses a disadvantage for Japanese banks in cross-border M&A.

However, under the new legislation, Japanese banks will be permitted to carry on the business of newly acquired subsidiaries for 5 years, with such 5-year period being extendable upon the JFSA's approval. It is expected that this amendment will help further boost outbound M&A by Japanese banks.

Conclusion

The new laws (and the relevant Cabinet Office Ordinances to be amended) are expected to become effective around 1 April 2014.

Amendments in respect of the 5% rule are expected to see Japanese banks taking a more central role in the restructuring of corporations, supported by their appetite for equity investments and a desire to put their strong balance sheets to work.

Deregulation of the restrictions on the intermediary business that can be conducted on behalf of Foreign Banks is expected to create new opportunities for Foreign Banks in providing services to mid-size Japanese companies through utilisation of Japanese banks as an intermediary.

Finally, as a result of the deregulation on the business activities of subsidiaries, the existing restrictions limiting Japanese banks' capacity to conduct outbound M&A will be eliminated and the new laws are thus expected to boost outbound M&A activity by Japanese banks.

Where Japanese legal concepts have been expressed in the English language, the concepts concerned may not be identical to the concepts described by the equivalent English terminology as they may be interpreted under the laws of other jurisdictions.

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TOKYO-1-283259