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The Legal 500 Country Comparative Guides

Japan

BANKING & FINANCE

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This country-specific Q&A provides an overview of banking & finance laws and regulations applicable in Japan.

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JAPAN
BANKING & FINANCE

1. What are the national authorities for banking regulation, supervision and resolution in your jurisdiction?

Lead Bank Regulators

The principal regulator is the Financial Services Agency of Japan ("FSA"). Its authority to supervise banks in Japan is delegated by the Prime Minister.

The FSA is responsible for ensuring:

- The stability of Japan's financial system.
- Protection of depositors, insurance policyholders and securities investors.
- Orderly financial operations.

This is done through measures including:

- Planning and policy-making concerning the financial system.
- Inspection and supervision of private-sector financial institutions, including banks.

Other Authorities

A portion of the FSA's authority is delegated to the Securities and Exchange Surveillance Commission (SESC) in relation to onsite inspection and offsite monitoring of investment banking activities and other securities businesses.

The Deposit Insurance Corporation is a quasi-governmental organisation established under the Deposit Insurance Act, for the purpose of operating Japan's deposit insurance system. If a bank becomes insolvent, the Deposit Insurance Corporation's main role is to protect the depositors and the entire financial system.

2. Which type of activities trigger the requirement of a banking licence?

The following activities trigger the requirement of a banking license:

- Acceptance of deposits or instalment savings.
- Loans of funds or discounting of bills. As an exception, this can be carried out by a non-bank financial institution registered as a money lender.
- Remittance of funds. As an exception, this can be carried out by a non-bank financial institution registered as a fund transfer businesses operator.

Please note that investment banking activities do not require a banking license in Japan. Such activities are regulated under the Financial Instruments and Exchange Act ("FIEA"). It is securities firms, rather than banks, who mainly engage in investment banking business in Japan.

3. Does your regulatory regime know different licenses for different banking services?

As described in No.2, the following services can be carried out without a banking license:

1. Loans of funds or discounting of bills (if the business operator I registered as a money lender under the Money Lending Business Act); and
2. Remittance of funds (if the business operator i registered as a fund transfer businesses operator under the Payment Services Act ("PSA")).

4. Does a banking license automatically permit certain other activities, e.g., broker dealer activities, payment services, issuance of e-money?

With regard to securities business, banks may sell and purchase securities (including engaging in initial investment in and acquisition of securities) for the purpose of investment, as one of the permitted ancillary

business activities (Article 10, paragraph 2, item 2 of the Banking Act). Banks also may engage in brokerage and underwriting of certain securities such as Japanese government bonds, provided that the banks obtain registration pursuant to the FIEA. For historical reasons, however, banks are generally prohibited from engaging in certain categories of securities business, including brokerage and underwriting of corporate shares and corporate bonds under the FIEA.

Issuance of e-money requires registration under the PSA in the event that the e-money is not redeemable and therefore falls within the definition of Prepaid Payment Instrument. A banking license does not exempt the issuer from such registration.

5. Is there a "sandbox" or "license light" for specific activities?

In June 2018, the Headquarters for Japan's Economic Revitalization, under the Cabinet Secretariat, opened a cross-governmental one-stop desk for the regulatory sandbox (the "Regulatory Sandbox") within the Japan Economic Revitalization Bureau. The Regulatory Sandbox can be utilized by both Japanese and overseas companies. It enables companies intending to apply and receive approval for projects not yet covered by present laws and regulations and to carry out a demonstration under certain conditions without the need for amendment of existing laws or regulations. There is no limitation on the area of business that companies can apply for under the Regulatory Sandbox; however, AI, IoT, big data and blockchain projects are explicitly mentioned as the most likely prospects and suitable areas.

As described in No. 3 above, a registered money lender and registered fund transfer business operator can carry out their business to the extent permitted by the registrations with a less restrictive regulation compared to the regulations that apply to banks.

6. Are there specific restrictions with respect to the issuance or custody of crypto currencies, such as a regulatory or voluntary moratorium?

In Japan, there is no omnibus regulation governing blockchain-based tokens. The legal status of tokens under Japanese law is determined based on their functions and uses.

For example, cryptocurrencies such as BTC and ETH, and utility tokens are regulated as "Crypto Assets" under the PSA. Business operators who engage in the business of buying, selling or exchanging Crypto Assets (as well as in the intermediation of such activities), or in the management of Crypto Assets for the benefit of others, are required to undergo registration as a provider of Crypto Asset Exchange Services ("CAES").

The so-called "security tokens", which represent shares, bonds or fund interests in tokens, are regulated under the FIEA as electronically recorded transferable rights to be indicated on securities, etc. ("ERTRIS, etc."). A business operator who engages in the business of offering (including the handling of such offers), buying, selling or exchanging ERTRIS, etc. (as well as in the intermediation of such activities) is required to undergo registration as a Type I Financial Instruments Business Operator.

Currency denominated stablecoins such as USDC and USDT are regulated as "Electronic Payment Instruments" ("EPIs") under the PSA. Business operators who engage in the business of buying, selling or exchanging EPIs (as well as in the intermediation of such activities), or in the management of EPIs for the benefit of others, are required to undergo registration as an Electronic Payment Instruments Exchange Service Provider ("EPIESP"). Those who are permitted to issue EPIs directly to Japanese residents are limited to banks, fund transfer service providers, trust banks or trust companies that are licensed in Japan. This is because the issuance and redemption of EPIs constitute "fund remittance transactions".

7. Do crypto assets qualify as deposits and, if so, are they covered by deposit insurance and/or segregation of funds?

No, Crypto Assets, security tokens and stablecoins do not qualify as deposits, and they are not covered by the deposit insurance under the Deposit Insurance Act. Business Operators who engage in the management of such assets are subject to the segregation requirements under the PSA or the FIEA, as applicable.

8. If crypto assets are held by the licensed entity, what are the related capital requirements (risk weights, etc.)?

The FSA is considering new regulations on risk weights, etc. in line with the consultation document on disclosure of cryptoasset exposures issued by the Basel Committee on Banking Supervision in October 2023, but has not yet issued the corresponding regulation as of February 2024.

9. What is the general application process for bank licenses and what is the average timing?

Anyone seeking a banking license must apply and submit supporting materials (such as articles of incorporation and a certificate of registered matters of the company) to the Prime Minister through the Commissioner of the FSA. An applicant must pay JPY150,000 as registration fee and the license tax for each application.

The Prime Minister must endeavor to provide a decision on an application within one month after receiving the official application. However, in practice, a preliminary consultation and review is already conducted before the official application. During the preliminary consultation and review process, the government closely examines the applicant from the perspective of whether they meet the relevant requirements. There is no statutory period for a preliminary consultation and review before formally submitting the application.

10. Is mere cross-border activity permissible? If yes, what are the requirements?

Foreign banks may not, in principle, enter into banking businesses in Japan or with persons in Japan without first establishing a branch in Japan and obtaining a banking license as a foreign bank branch.

Under the "foreign bank agency business" framework, both overseas banks without a licensed foreign bank branch and the unlicensed branches of an overseas bank may conduct core banking business with persons in Japan through either a licensed local bank entity within the same group in Japan, or a licensed foreign bank branch of the bank in Japan acting as an agent or intermediary. Both these options require the local bank entity or foreign bank branch to obtain a separate approval from the FSA.

11. What legal entities can operate as banks? What legal forms are generally used to operate as banks?

All banks organised in Japan must be stock corporations (*kabushiki kaisha*) except for cases where a foreign bank obtains a license from the Prime Minister through the Commissioner of the FSA by establishing a branch office in Japan (see No. 10).

12. What are the organizational requirements for banks, including with respect to corporate governance?

Under the Banking Act, a bank must have in place the following organs:

i. a board of directors;
ii. a board of company auditors, a supervisory committee, or a nominating committee, etc.;
iii. a financial auditor.

In addition, the Banking Act and the Comprehensive Guidelines for Supervision of Major Banks, etc. require Globally Systemically Important Banks (see No. 22) to establish higher corporate governance standards, such as the three committee structure.

13. Do any restrictions on remuneration policies apply?

If a bank issues publicly traded securities, it must disclose publicly the officers' names and amounts of remuneration given to them if the aggregate annual remuneration is in excess of JPY100 million under the FIEA.

The Banking Act does not have any express requirement with respect to remuneration. Nevertheless, the Comprehensive Guidelines for Supervision of Major Banks, etc. impose general requirements on major banks established in Japan and branches of foreign banks to establish systems which ensure appropriate remuneration of management and employees in light of the need to avoid excessive risk-taking. All banks (including branches of foreign banks) must also disclose matters concerning remuneration in their business reports, including:

- The organization which determines or otherwise supervises the determination of remuneration.
- Matters concerning the evaluation of remuneration systems and their operation.
- Consistency of the remuneration systems and risk management, and performance-linked remuneration.
- Other matters concerning remuneration systems.

14. Has your jurisdiction implemented the Basel III framework with respect to regulatory capital? Are there any major

deviations, e.g., with respect to certain categories of banks?

The framework for regulating local banks' capital adequacy under the Banking Act has been amended in line with the implementation of Basel III.

Local banks with international operations are required to maintain a minimum common equity Tier I ratio of 4.5%, Tier I ratio of 6% and a capital adequacy ratio of 8.0%. This is in accordance with the FSA administrative notice, which is in line with the Basel III regulatory framework.

Meanwhile, local banks without international operations are required to have a core capital ratio of 4% (on both a non-consolidated and consolidated basis), and those banks employing the IRB approach are required to have a core capital ratio of 4.5%.

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

15. Are there any requirements with respect to the leverage ratio?

The leverage ratio is required to be kept at 3% or higher, and if a bank's ratio falls below this level, the FSA may require the bank to prepare and implement a capital reform plan. The leverage ratio must be disclosed on a semi-annual basis. These requirements apply only to local banks with international operations.

16. What liquidity requirements apply? Has your jurisdiction implemented the Basel III liquidity requirements, including regarding LCR and NSFR?

Liquidity requirements regarding LCR and NSFR have been introduced in line with the implementation of Basel III. Both LCR and NSFR must be kept at 100% or higher. These requirements apply only to local banks with international operations.

17. Do banks have to publish their financial statements? Is there interim reporting and, if so, in which intervals?

Banks are required under the Banking Act to publish financial statements quarterly. In addition, they are required to publish financial statements in accordance with financial accounting rules applicable to ordinary joint stock companies pursuant to the Companies Act and the FIEA. If those banks are listed, they must also publish financial statements in accordance with the rules of the exchange on which they are listed.

18. Does consolidated supervision of a bank exist in your jurisdiction? If so, what are the consequences?

Any person who wishes to become a bank holding company needs to obtain prior approval from the FSA. A holding company here is, in principle, a company whose value of shareholding in its subsidiaries in Japan exceeds 50% of the value of its total assets.

In addition, the FSA has the authority to order such holding company to submit reports or to conduct on-site inspections in accordance with the Banking Act.

19. What reporting and/or approval requirements apply to the acquisition of shareholdings in, or control of, banks?

Any person who acquires more than 5% of the voting rights of a bank or a holding company of a bank is required to file a notification within five business days with the FSA. If there is an increase or decrease in voting rights of 1% or more after this notification is filed, a notification of the change must be filed within five business days (Article 53 (1), Banking Act) with the FSA.

Any person wishing to become a principal shareholder of a bank must obtain prior approval from the FSA. A principal shareholder is any shareholder who holds voting rights exceeding 20% of all voting rights in the relevant bank.

20. Does your regulatory regime impose conditions for eligible owners of banks (e.g., with respect to major participations)?

Any person wishing to become a principal shareholder of a bank must obtain prior approval from the FSA as described in No. 19. There is no eligibility requirement to apply for approval to be a principal shareholder of a bank, regardless of the percentage of the voting rights.

In addition, any person wishing to become a principal shareholder must obtain prior approval from the FSA as described in No. 18. Authorization is at the sole discretion of the FSA. The requirements for approval generally include a sound and appropriate management of the services of the bank, and appropriate:

- property and income and expenditures.
- purpose of holding the voting rights.
- understanding of the public nature of banks' services.

21. Are there specific restrictions on foreign shareholdings in banks?

There is no specific restriction on foreign shareholdings in banks. However, foreign investors are subject to the filing requirement described below.

An ordinary foreign investor that acquires shares of a listed Japanese bank, and as a result holds 1% or more of all outstanding shares of the bank must file a "direct inward investment report". This must be filed with the Ministry of Finance ("MOF") through the Bank of Japan ("BOJ") by the 15th day of the month following the month of acquisition.

Any foreign investor who acquires shares of a non-listed Japanese bank from a non-foreign investor will also be required to file a direct inward investment report with the MOF through the BOJ by the 15th day of the month following the month of acquisition.

22. Is there a special regime for domestic and/or globally systemically important banks?

There are three Globally Systemically Important Banks (G-SIBs) and four Domestic Systemically Important Banks (D-SIBs) in Japan, and they must prepare and submit recovery and resolution plans annually. They are further required to maintain an additional capital buffer (i.e., G-SIBs buffer or D-SIBs buffer). In addition, G-SIBs and one of the D-SIBs are subject to regulations under the TLAC framework.

23. What are the sanctions the regulator(s) can order in the case of a violation of banking regulations?

If the FSA finds it necessary to ensure the sound and appropriate management of a bank's business in light of the status of the bank's business activities and properties, the FSA can order the bank to:

- Improve its management.
- Suspend its business in whole or in part.
- Take other remedial actions necessary for purposes of supervision.

In addition, if the FSA finds a serious violation (e.g., one that would be harmful to the public interest), the FSA can revoke the banking license of the bank.

24. What is the resolution regime for banks?

In principle, the ordinary procedure should be used unless failure of the relevant bank is systemically important. In the ordinary procedures, only a certain amount of the deposits (usually JPY10 million per depositor) is protected under the deposit insurance system. Ordinary procedures fall into two categories:

- Payout method. Deposits are paid off directly to the depositors by the Deposit Insurance Corporation's deposit insurance. The failed bank is subject to bankruptcy procedures, such as civil rehabilitation proceedings or corporate reorganization proceedings.
- Purchase and assumption method. All or part of the operation (business) of a failed bank is transferred to an assuming financial institution. Under this method, a financial administrator is appointed to manage the failed bank until the operation of the failed bank is transferred. The Deposit Insurance Corporation gives financial assistance (including monetary grants) within the scope of payout costs, to ensure the smooth transfer of the business.

The purchase and assumption method is preferred over the payout method, as it is less costly.

A new regime called "Orderly Resolution Regime" was introduced by the amendments to the Deposit Insurance Act in March 2014, in order to implement some of the "Key Attributes of Effective Resolution Regimes for Financial Institutions" adopted by the Financial Stability Board.

Under this regime, the Prime Minister can implement certain measures to prevent serious financial turmoil. It is generally interpreted that this regime is mainly for the purposes of resolution of systemically important banks.

For financial institutions that are not in deficit, the Prime Minister can:

- Order oversight of the management by the Deposit Insurance Corporation.
- Provide liquidity support to fulfil the obligations of the financial institution.
- Order a capital injection.

For financial institutions that are in deficit, the Prime

Minister can:

- Order oversight of the management by the Deposit Insurance Corporation.
- Take over the management of the business and assets of financial institutions under certain circumstances specified in the Deposit Insurance Act.
- Transfer contracts that are necessary to maintain the stability of the financial system to a bridge bank, and provide financial assistance to the bridge bank to enable it to perform the obligations under those contracts.

25. How are client's assets and cash deposits protected?

The deposit insurance system in Japan protects depositors and other parties against the insolvency of banks in Japan. The Deposit Insurance Act governs the deposit insurance system. The Deposit Insurance Corporation, which was established pursuant to the Deposit Insurance Act, provides a public safety net to protect depositors. The deposit insurance system covers banks whose headquarters are located in Japan. Insured banks pay insurance premiums to the Deposit Insurance Corporation on an annual basis.

There are certain limitations to the coverage. For example, while ordinary deposits are covered under the deposit insurance system, foreign currency deposits and derivative deposits are not covered. Furthermore, while deposit accounts for settlement purposes will generally receive full coverage, other insured deposit accounts are generally covered by up to JPY10 million per person and per bank.

26. Does your jurisdiction know a bail-in tool in bank resolution and which liabilities are covered? Does it apply in situations of a mere liquidity crisis (breach of LCR etc.)?

The Prime Minister can trigger bail-in provisions (that is, write down the principal amount or the conversion of debt into equity) in the subordinated bonds, preferred stocks or subordinated loans issued by financial institutions in deficit. Such bail-in does not apply in situations of a mere liquidity crisis (breach of LCR etc.).

27. Is there a requirement for banks to hold gone concern capital ("TLAC")? Does the regime differentiate between different types of banks?

As described in No. 22, G-SIBs and one of D-SIBs ("4SIBs") are subject to regulations under the TLAC framework. According to the release titled "The FSA's Approach to Introduce the TLAC Framework", the preferred strategy for orderly resolution for 4SIBs is an SPE (Single Point of Entry) resolution regardless of the types of banks, in which resolution tools are applied to the ultimate holding company by a single national resolution authority.

28. In your view, what are the recent trends in bank regulation in your jurisdiction?

The amendment to the Payment Services Act, etc. for the purpose of establishing a stable and efficient payment and settlement system (the "Amended Act") was promulgated on June 10, 2022 with an aim to clarify and introduce regulations on the use of stablecoins. The Amended Act has entered into force as of June 1, 2023.

Under the Amended Act, an issuer of stablecoins is required to be a bank, a fund transfer business operator or a trust company that is licensed in Japan. In addition to that, under the Amended Act, registration as a provider of Electronic Payment Instruments Exchange Services are required for stablecoin exchange service providers.

Some banks are preparing for the issuance of stablecoins, including the establishment of schemes, with business partners seeking to obtain Electronic Payment Instruments Exchange Services licenses and/or with business partners issuing stablecoins abroad.

29. What do you believe to be the biggest threat to the success of the financial sector in your jurisdiction?

Regulations regarding AML/Sanctions have been tightened, as the deadline for full compliance with the FSA's AML/CFT Guidelines will arrive at the end of March this year, and the MOF's new guidelines (regarding regulations on fund transfer businesses, etc. under the Foreign Exchange and Foreign Trade Act) will become effective on April 1, 2024 as well.

A series of tightened regulations will impose a tremendous burden on financial institutions to develop frameworks and personnel structures, or to invest in systems. Financial institutions that fail to adapt to these tightened regulations will be exposed to regulatory risk,

such as receiving an improvement order from the authorities. Furthermore, their controls over AML/sanction risk will remain weaker than those of other financial institutions, and the risk that the services they provide will be abused for money laundering/terrorist financing will likewise increase.

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