

## Establishment of orderly resolution regime for financial institutions

- During the global financial crisis triggered by the failure of Lehman Brothers, etc., it was revealed that there is a potential risk that distress and failure of systemically important financial institutions may spread across financial markets and cause a serious impact on the real economy. In response to this, a framework for new effective resolution regimes for financial institutions has been discussed internationally and the agreement was reached on this issue at the G20 Summit.

In parallel with the progress of the international discussions, new comprehensive effective resolution regimes for financial institutions have been established in various countries.

- In Japan, reflecting these global trends, it is necessary to establish a framework for orderly resolution regime of financial institutions (described below), in order to address risks that may spread across financial markets.

### (Scope)

- Financial institutions including deposit-taking financial institutions, insurance companies, financial instruments business operators, financial holding companies.

### (Procedure for initiating the orderly resolution mechanism of financial institutions)

- The Prime Minister confirms the need to implement the orderly resolution mechanism of financial institutions, following the deliberations by the Financial Crisis Response Council.

### (Measures)

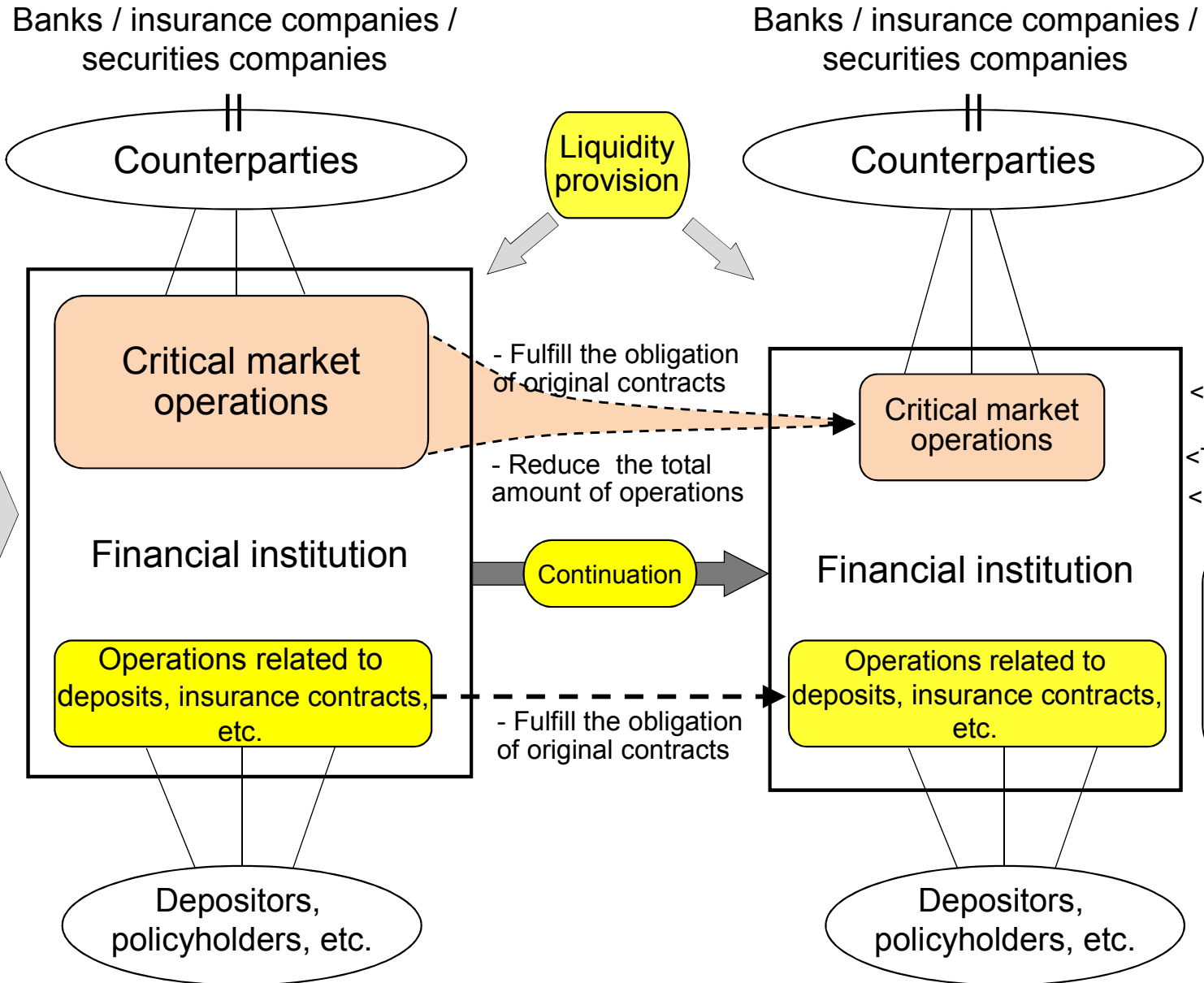
- Where it is considered necessary to prevent the severe market disruption:
  - ⇒ Oversight by the Deposit Insurance Corporation
  - ⇒ Provision of liquidity and financial assistance
    - Capital enhancement may be undertaken as necessary, when the financial institutions are not in the state of insolvency.
    - Reduce market transactions, while ensuring the performance and continuation of obligations which are critical for stabilization of the financial system.
    - Realize the orderly resolution of financial institutions and prevent the severe market disruption.
    - When above measures are implemented, contractual bail-in options (writing down of unsecured debts or converting unsecured debts into equity) are exercised.

### (Funding)

- Provide government guarantee for the Deposit Insurance Corporation's financing.  
Should losses be incurred, the expenses shall be in principle borne ex post by the financial industry.  
The government may provide financial support in exceptional cases. The Deposit Insurance Corporation shall record its expenses in the Crisis Management Account.

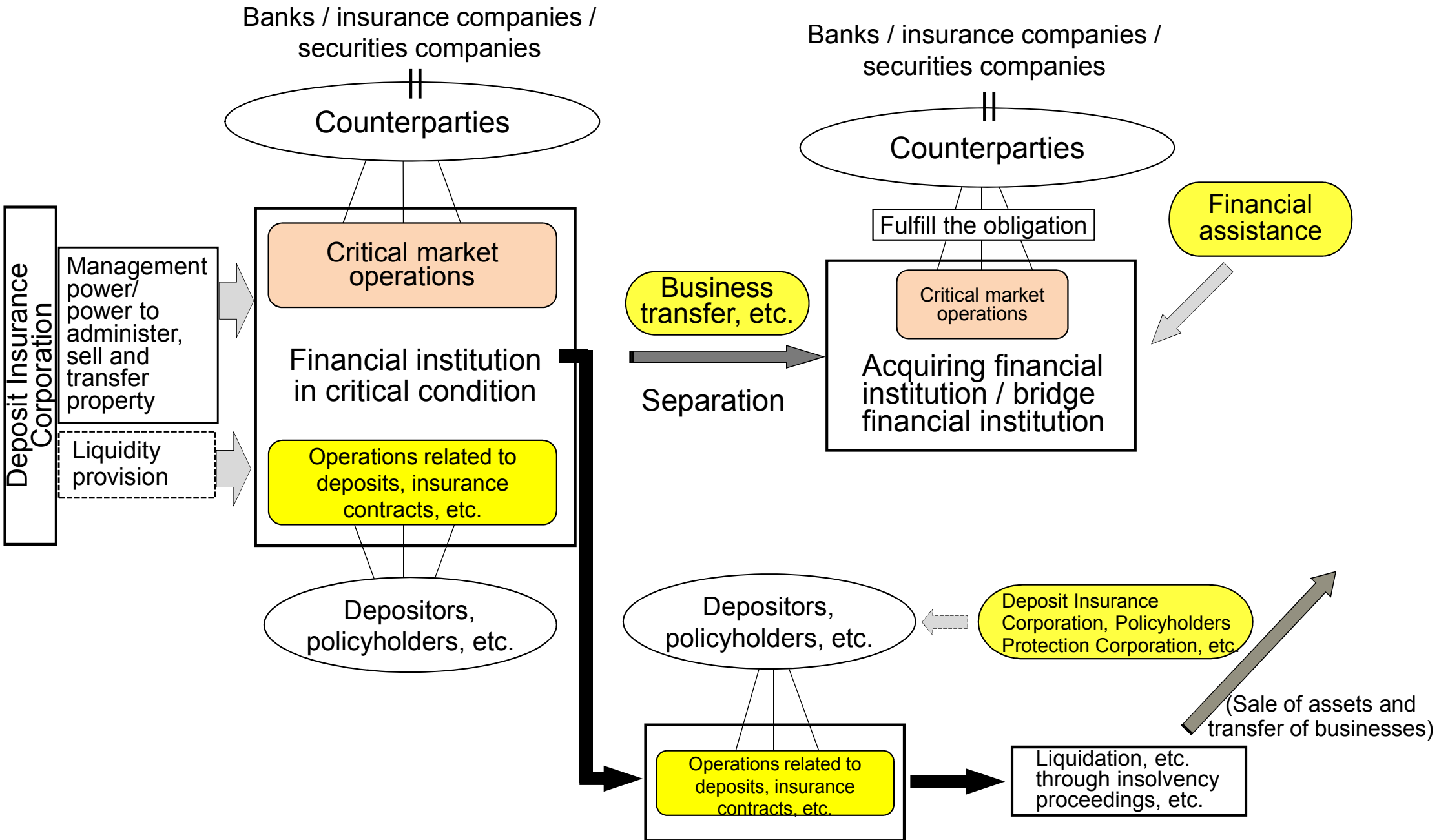
# Orderly resolution of financial institutions (1)

(In the case of a financial institution that is not in the state of insolvency)



# Orderly resolution of financial institutions (2)

(In the case of a financial institution such as an insolvent one)



# Review of regulations governing foreign bank branches

## Current status

- A foreign bank is permitted to accept retail and wholesale deposits in the Japanese market through both branches and subsidiaries. The scope of approved business does not depend on whether they are branches or subsidiaries (committed internationally).
- Foreign bank branches are not subject to the regulations related to the stated capital.
- They are not subject to the application of Act on Special Measures Concerning Reorganization Proceedings of Financial Institutions, etc. (Act on Special Measures for Reorganization); and the supervisory authority does not have the right to file a petition for commencement of bankruptcy or reorganization proceedings or right to file a petition for temporary restraining order.
- The penalty for the violation of orders to maintain assets in Japan is low (non-penal fine of up to one million yen).

## Direction of review

<License>	<Regulation and supervision in ordinary times>	<Response in times of crisis or bankruptcy>
<ul style="list-style-type: none"> <li>○ <u>Clarify licensing standards</u> ⇒ Review the bank's application for the license <u>from prudential viewpoints</u> concerning accepting of retail deposits through a branch and fund management including fund transfer to head office.</li> </ul>	<ul style="list-style-type: none"> <li>○ Require foreign bank branches to <u>reserve assets in an amount equivalent to the minimum capital requirement for domestic banks (2 billion yen).</u></li> <li>○ The clarified licensing standards shall be applied as daily supervisory viewpoints.</li> <li>○ <u>Require explanation to depositors that the deposits held by foreign bank branches are not protected under the deposit insurance system in Japan.</u></li> </ul>	<ul style="list-style-type: none"> <li>○ <u>Apply the Act on Special Measures for Reorganization to foreign bank branches</u> (grant the supervisory authority the right to file a petition for commencement of bankruptcy or reorganization proceedings or right to file a petition for temporary restraining order).</li> <li>○ <u>Increase the penalty for the violation of orders to maintain assets in Japan.</u></li> </ul>

# Review of large exposure rules

## Current status

- From the perspective of ensuring diversification of risks associated with bank assets large exposure rules set an upper limit on the total amount of credit exposures to a single counterparty or a group of connected counterparties.
- ⇒ There are some differences between current Japanese regulations and the international standards (“The Basel Core Principles”); and the IMF FSAP (Financial Sector Assessment Program) seeks strengthening of the rules.

## Direction of review

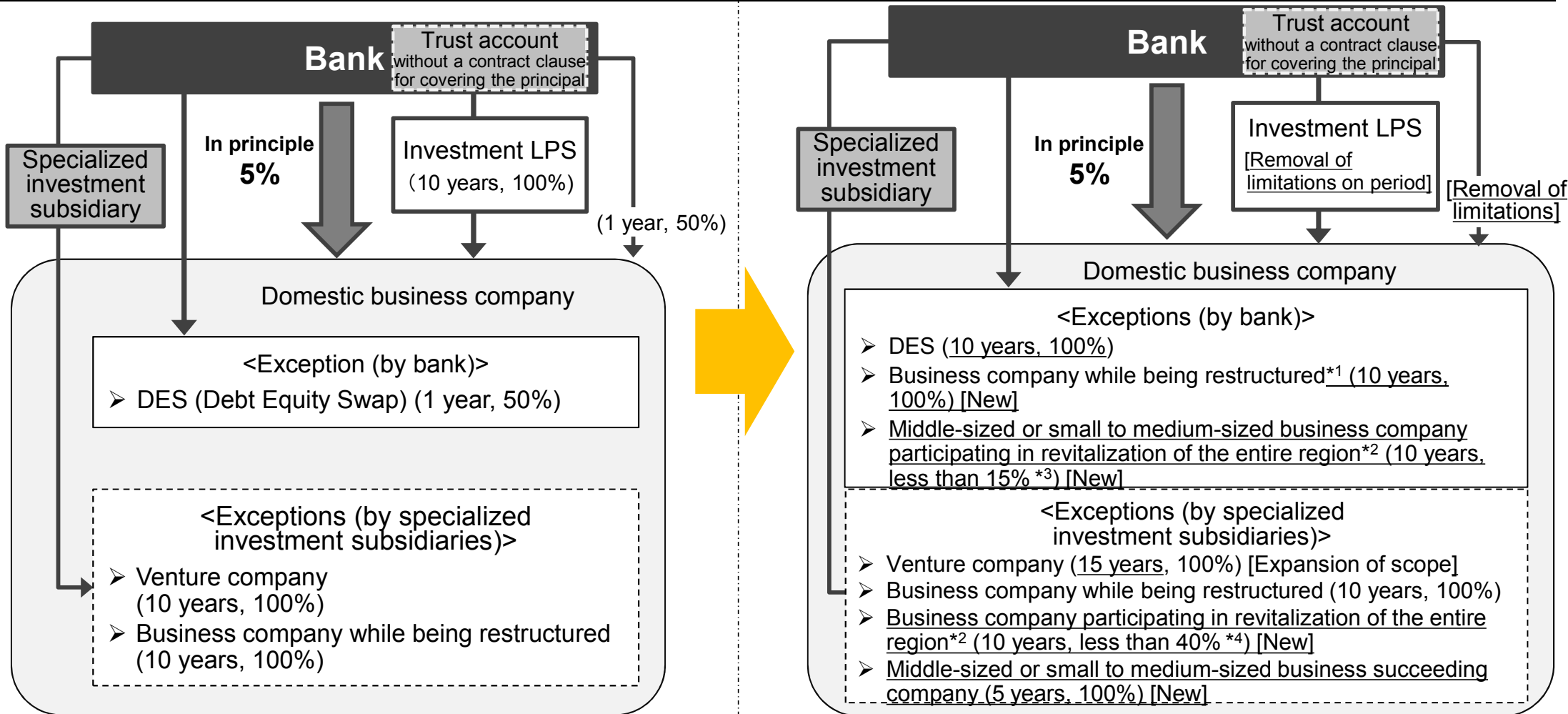
	Japanese regulations	(Reference) International standards
Scope of credit exposures	Inter-bank transactions (e.g. call loans, deposits), commitment lines, derivative transactions, publicly offered corporate bonds, etc. are <u>excluded from the scope of application</u> . ⇒ <u>In principle , above exposures are to be included within the scope of regulations</u> .	In principle, <u>all of the on-balance sheet and off-balance sheet transactions and claims are within the scope</u> .
Limit on the amount of credit exposures to a group of connected counterparties	<u>40%</u> of the amount of a bank’s (or a bank group’s) capital ⇒ <u>25%</u>	<u>25%</u> of the amount of a bank’s (or a bank group’s) capital
Scope of a group of connected counterparties	A counterparty (a single entity), its subsidiaries, and parent/sister companies ( <u>identified based on control through voting rights: ownership of over 50% of voting rights</u> ). ⇒ To be identified based on the <u>economic interdependence</u> , as well as on the control through voting rights (effective control basis).	Identified based on the <u>economic interdependence</u> , as well as on the control through voting rights.

# Review of restriction on holding of voting rights by a bank, etc.

○ It is provided that a bank, etc. and its subsidiaries shall not hold in total more than 5% (\*) of voting rights in a domestic business company held by all of the shareholders, etc..

(\*) 15% for a bank holding company, and 10% for cooperative financial institutions.

⇒ To strengthen financial functions of banks, etc., while basically maintaining the current regulatory framework, in cases where contributions to the corporate restructuring or revitalization of region can be expected, allow banks, etc. to flexibly provide capital.



\*1 Cases where third party organizations such as the Enterprise Turnaround Initiative Corporation of Japan or Small and Medium Size Business Rehabilitation Support Cooperative are involved; and business reconstruction plan including an equity investment by bank has been drafted.

\*2 Business company that participates in revitalization of the entire region, and realizes the integration and rebuilding of regional businesses.

\*3 When the equity method is applied, if not included within the scope of consolidation on an influence basis, less than 20%.

\*4 When the full consolidation method is applied, if not included within the scope of consolidation on an effective control basis, less than 50%.

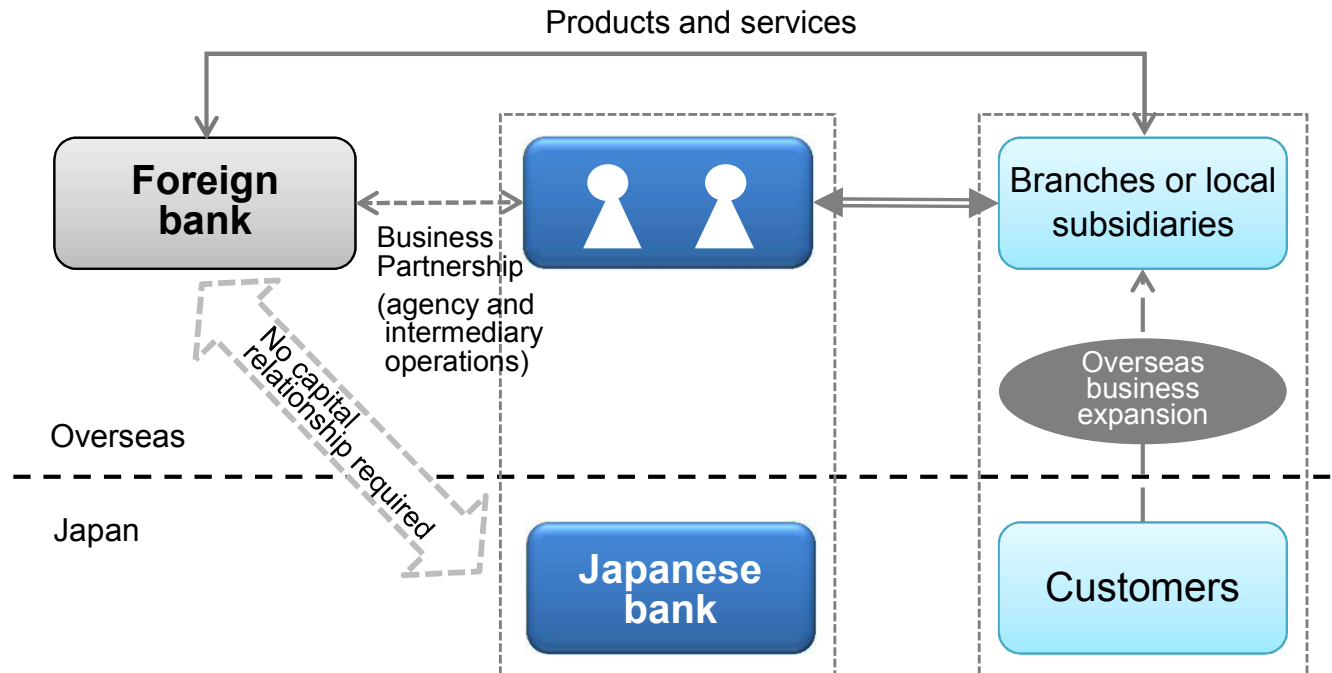
# Review, etc. of regulations concerning foreign bank agency services

## Current status

- Domestic banks are not allowed to provide services on behalf of foreign banks that are not their parent/subsidiary or sister companies.
- ⇒ In order to support the fact that SMEs, etc. operating overseas may smoothly raise funds and receive a variety of services, there are requests that domestic banks may provide financial products and services on behalf of partner foreign banks, with which there is no capital relationship.

## Direction of review

Allow domestic banks and cooperative financial institutions to provide the foreign bank agency services only when they are conducted overseas, regardless of whether there are capital relationships, under an approval by the authority.





# Review of regulation on scope of a bank's subsidiary company concerning overseas M&As

## Current status

- The scope of a bank's subsidiaries (including second-tier subsidiaries) is limited to certain entities (hereinafter "eligible subsidiary company"), such as banks, insurance companies and foreign companies that engage in banking business.
  - ⇒ It is pointed out that when a domestic bank and a foreign bank(s) compete to acquire a foreign financial institution, the former is put in a disadvantageous condition as it is essentially required to state in the terms and conditions of the bid that it will sell the target financial institution's subsidiary companies that are not allowed to be an eligible subsidiary company; this hinders the overseas business development of domestic banks.

## Direction of review

- Allow domestic banks to hold the acquired foreign financial institution's subsidiary companies that do not fall on an eligible subsidiary company for a while (in principle up to 5 years).
- In cases where it is not possible to dispose such companies or where there are other compelling reasons for not doing so, the holding period may be exceptionally extended under approval by the authority.

