



Financial Services Agency

**Institutional Framework
for Financial Groups**

Final Report

by the Financial System Council



Final Report:

Institutional Framework for Financial Groups

Presented to the Minister for
Financial Services by the chairman
of the Financial System Council

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INTRODUCTION

The business environment surrounding Japanese financial groups centered on banks is exposed to drastic changes. Rapid progress of IT (information technology) innovation represented by so-called FinTech¹ that integrates finance and IT can significantly impact the future of financial services including payments. While Western financial institutions are stepping up strategic responses to these environmental changes, it has become a key issue for Japanese financial groups to make efforts toward the promotion of innovation in various financial service sectors in order to keep up with these global competitors.

In view of the situation of financial groups, megabank groups show that their domestic subsidiaries in non-banking businesses and foreign subsidiaries tend to increase their shares in the group income, while turning to local regions, some regional banks are moving toward a cross-prefectural bank integration, leveraging their holding companies. Both megabanks and regional banks are entering a new phase respectively in response to these global and local changes in economic and financial environments.

Furthermore, in a global view of financial groups operating worldwide, there is a trend that the soundness of the entire financial group should be supervised through its holding company in a responsible manner by home regulatory authorities in the country where the holding company is located.

In view of these circumstances, on March 3, 2015, the Minister of State for Financial Services referred the following issue to the general meeting of the Financial System Council: “Based on the environmental changes, including the progress of diversification and internationalization of financial groups, the study of the institutional framework on financial group should be made.” In response to this, the Financial System Council set up “the Working Group on Financial Group of the Financial System Council” and has held nine meetings since May 2015. Interviewing concerned parties, they discussed the issue from perspectives of the enhancement of business management functions of financial groups and their strategic and flexible business operations on a group-wide basis. This report summarizes the results of the study by the Working Group.

¹FinTech is a coined word that combines “Finance” and “Technology,” referring mainly to innovative IT-based financial services. Particularly in recent years, IT venture businesses mainly in overseas markets are becoming more active in providing innovative financial services, utilizing their IT. These services are not provided by conventional banks and other financial institutions.



Chapter 1: Business Management of Financial Group

1. Situation around business management of financial group

Financial groups formed under a structure with the holding company as top-tier company in their organization can be categorized into two main types. One is megabank groups whose structure is topped by the holding company that has a variety of business subsidiaries at home and abroad, including banks, securities companies, and trust companies. The other is regional bank groups that have several banks and subsidiaries under the holding company.

(1) Megabank groups

Among large-scale financial groups typified by megabanks, each group makes efforts toward enhancing group-wide business management functions².

Meanwhile, the specific styles of business management of each group are not necessarily identical.

When it comes to the group structure (comprising entities), one example is that the holding company plays a central role in a

group-wide business management by placing main companies such as banks, securities companies, and trust companies in parallel under the holding company and becoming the direct shareholder of those companies. Another example is that although main companies are placed under the direct umbrella of the holding company, some other main companies are placed under a core bank as the core bank's subsidiaries (i.e. sub-subsidiaries to the holding company), and the core bank plays somewhat a prominent role in business management. In addition, as to small- or medium-sized subsidiaries in a group, it depends on each group whether they are placed under the direct umbrella of the holding company or placed as sub-subsidiaries.

In view of forms of corporate structure of the holding company and its subsidiary banks of each group, some holding companies have a nominating committee, whereas others have a committee of board of auditors. Besides, some of financial groups have an optional committee not based on laws. Subsidiary banks of every group are a company with a committee of board of auditors.

With respect to groups' actual operations, to a greater or lesser extent, there are many cases where officers and employees concurrently serve several companies within a group to share information and adjust decision making between the holding company and its subsidiaries or between subsidiaries for planning a management strategy and other measures.

(2) Regional bank groups

Among regional bank groups whose management styles are different from those of megabanks, many banks are under the direct umbrella of the holding company against the backdrop of the maintenance of brand power and customer base in each business area.

Although, in most cases, banks under their holding company maintain their independence to some extent in the background of their brand power, it depends on each group to what extent the holding company plays its role, how subsidiary banks and other subsidiaries play their roles, and how their corporate structure and group structure is. In view of forms of corporate structure of holding companies and its subsidiary banks, there are types of companies including a company with a nominating committee, a company with an audit and supervisory committee, and a company with a committee of board of auditors.

Some groups may see the group structures of regional bank groups as a transitional form with a view to further integration and reorganization in the future.

2. Principle of desired business management style

Differences in styles of business management of each financial group may result from business area differences between some groups that develop international businesses and the other groups that focus only on domestic businesses, differences in advantageous (or striving) business sectors that each group has, differences in scales and risk profiles of each business sector, or differences in management strategies of each group, including personnel and capital policies. In addition, they may reflect a historical background to form a group.

In consideration of these points, it is crucial to consider how to establish an effective management control system in each group, rather than to have a single role model in mind given that a desired style of business management of financial group depends on operating base, scale, risk profiles, and business strategies.

For a desired business management style for each financial group, dialogues between each group and relevant authorities take place on a daily basis based on the actual conditions of each group. Bank regulations formulate rules that every financial group operating banking business must commonly comply with, and, therefore, regulations should be basically neutral for financial groups in selecting a business management style based on their actual conditions.

² For instance, in addition to entity-based (corporate unit) business management, they implement a so-called "Matrix Management," which is commonly used by Western financial institutions, that carries out a cross-entity management by business segment (business type unit) such as retails and wholesales.

3. Ensuring the effectiveness of group-wide business management

(1) Functions required for group-wide business management

A financial group has an aspect that each entity with a different legal personality collectively forms an aggregation, which moves beyond each entity and develops a variety of business activities on a group-wide basis. In consideration of this, given that a financial group has its own “management style,” when it comes to the “function” of business management of financial group, a financial group should clearly set up its group-wide management policies, which will be widely and thoroughly accepted and understood within each entity of the group to perform fully effective business management of each financial group. Each group should also establish and operate a system to correctively identify various risks in implementing the management policies and appropriately respond to actualization of risks.

In light of these points and on the basis of international discussions on financial groups³, the following items, for example, will be appropriate to be required for business management of groups.

- Develop group management policies
- Develop group policies including those on revenue, risk-taking, and capital management
- Establish and operate group business management structure

- Establish and operate group compliance system and manage conflicts of interest in a financial group
- Develop and implement group restructuring plans (particularly, in the case of G-SIFIs)

The current laws have no specific provisions on the contents of business management functions in a financial group that should be performed by holding companies and banks where a bank is top-tier company in its organization without a holding company. Thus, it is considered appropriate that business management functions of a group are clearly stipulated in laws.

(2) Issues associated with the Companies Act

In consideration of a desired business management of a financial group, the following findings are obtained in relationship with regulations by the Companies Act and the Banking Act.

- A holding company has shareholder’s rights to its subsidiary banks but no authority to specifically give instructions or orders to directors of subsidiary banks. Apart from exercising shareholder’s rights, is it necessary to institutionally ensure that the holding company can give instructions or orders to subsidiary banks? In addition, is it necessary to ensure that directors who have followed such instructions or orders will carry no responsibility for dereliction of duty?

³For instance, in “Corporate governance principles for banks (Basel Committee on Banking Supervision in July 2015),” “Principle 5: Governance of group structures” states that “In a group structure, the board of the parent company has the overall responsibility for the group and for ensuring the establishment and operation of a clear governance framework appropriate to the structure, business and risks of the group and its entities. The board and senior management should know and understand the bank group’s organizational structure and the risks that it poses.”

- Although management delegation contract may be used as a method of avoiding these problems, is there any problem to the validity of the contract?
- When a holding company is equipped with effective supervisory systems and performs group-wide management functions, should the subsidiary banks in the group be also required to establish another supervisory system, for instance, a board of auditors, which may result in confusion for its supervisory system? Is it an excessive requirement?

It is considered appropriate to continue to study these points, paying careful attention to the following: see whether there are special needs and requests to apply different principles from those business companies to financial groups; the legal personality of a holding company is different from that of its subsidiary banks; subsidiary banks have minority shareholders and creditors; and in the case of stipulating special provisions for a certain section, ensure whether they are consistent with the entire system of the Companies Act.

(3) Information sharing

For an effective group-wide business management, it may be necessary to consolidate and share relevant information in a financial group. In this regard, the current laws permit the sharing of information on “operations concerning business management of subsidiaries.”⁴ It can be considered that it will be flexibly permitted to share appropriate information on these operations in order to make effective group-wide business management more efficiently functional.

⁴ Refer to Article 153-1-7(i) and 153-3 of the Cabinet Office Ordinance on Financial Instruments Business, etc.



Chapter 2: Consolidating Common and Duplicate Operations within a Financial Group

1. Principle

Amid rapidly changing environments around Japanese financial groups at home and abroad, in order to respond to these changes in a strategic manner, it is important for them to ensure the effectiveness of business management as a group and implement more flexible and efficient business operations as a group as well.

Particularly in local regions, there is a progressive movement of cross-prefectural management integration among some regional banks under a holding company, where they find a key issue is to achieve synergetic and cost-reduction effects from the integration.

Under these circumstances, some financial groups, particularly regional banks, request that they would like to reduce costs by, for instance, consolidating common and duplicate operations in each entity within a group into the holding company or its subsidiary. Such consolidation has the aspect of contributing to achieving synergetic and cost-reduction effects in a

group-wide business operation and consequently to enhancing users' convenience. Thus, while taking into full consideration ensuring the effectiveness of business management as well as the purpose of related regulations, it is important to review legal framework in order to enable each financial group to promote these efforts.

2. Regulations on consolidation of common and duplicate operations

(1) Consolidating common and duplicate operations into holding company

Under the current Banking Act, a holding company may conduct only “business activities of management and control of its subsidiaries and those incidental thereto,” and may not conduct actual business operations itself⁵.

In this regard, with respect to common and duplicate operations in each entity within a group, including group-wide fund management and common system management, some financial groups claim that a holding company should be flexibly permitted to choose conducting such business operations on its own, given that it could reduce costs and facilitate a group-wide risk management that a holding company integrally and comprehensively conducts such common and duplicate operations.

On the other hand, if a holding company is permitted to unlimitedly conduct business operations, it could distract the holding company from exercising its expected function of business management and could cause conflicts of interest between the holding company and its subsidiaries.

On this point, a holding company may be allowed to conduct business operations provided that integral and comprehensive implementation of the common and duplicate operations by the holding company could contribute to an integral and efficient business management of its entire group, and the holding company can ensure to fulfill its efficient supervisory function for

its entire group with some effective means, for instance, incorporation of “outside perspectives” into its Board of Directors.

(2) Consolidating common and duplicate operations into a subsidiary

In cases where common and duplicate operations in a group are consolidated into a specific subsidiary within the group, the outsourcer bank is obligated to conduct management obligation of the outsourcee subsidiary⁶.

For this reason, in the case that banks under a group consolidate common operations into a subsidiary within the group, each outsourcer bank, which separately bears the management obligations of the outsourcee subsidiary, may carry a heavy burden when centralizing operations in the group.

In this regard, if the holding company comprehensively undertakes management obligation for the subsidiaries and these responsibilities and directions are centralized, it is considered to contribute to ensuring the effectiveness of business management of the entire group. Therefore, it is appropriate to allow the holding company that is responsible for management of the entire group to conduct centralized supervision, not to request each outsourcer bank to conduct management obligation to the outsourcee subsidiary respectively in a redundant manner.

⁵ Article 52-21 of the Banking Act.

⁶ Article 12-2 of the Banking Act.

(3) Facilitating financing within a group

Financial groups take various measures to realize synergetic effects from business integration. Under this situation, some financial groups request that in order to strengthen their group's profitability, they would like to enable an entity with surplus funds to finance another entity with shortage of funds within their group at an in-house interest rate.⁷

In this respect, under the current Banking Act, in cases where a bank conducts transactions with its specified related parties (fellow subsidiaries, subsidiaries, etc.), transactions with favorable terms for the specified related parties (i.e. disadvantageous terms to the bank)⁸ or at unreasonably unfavorable terms for them are prohibited in principle^{9, 10} (so-called "Arms-length Rules").

The purpose of the Arms-length Rules is to prevent a bank from benefiting its specified related parties, which harms the soundness of a bank and damages the interests of depositors and others. In addition, the Arms-length Rules aims to function as a method of risk management not only for a bank but for the entire group to prevent any cases where undisciplined and dishonest transactions among the group cause any problem with the soundness of the entire bank group.

On the contrary, while grouping of financial

institutions is progressing, it has currently become a key issue to maximize earnings of a financial group by effectively leveraging resources within the group to achieve synergetic effects. Meanwhile, there may be a case where transactions by multiple banks under a holding company in accordance with the current Arms-length Rules are not necessarily suitable for the achievement of maximization of group profits and appropriate allotment of the profits.

In this regard, as financial groups' businesses will become more and more flexible, it is considered more important to fully realize the aim of the Arms-length Rules. At the same time, for instance, in applying the Arms-length rules to financing within a group, a possibility of flexible application may be considered on the basis of the present issue of achieving synergetic effects in the group, while taking into account not to harm the purpose of the Arms-length rules.

In so doing, given that the Arms-length Rules were introduced from a perspective to prevent the harmful effects arising from a banks' foray into other business areas, it is considered appropriate that the Rules should be exempted only for transactions between banks in the same group under a holding company in order to prevent imbalances in competitive conditions with other business competitors outside the group.

⁷ For instance, a case may be assumed where there are A bank and B bank within the same group, and A bank, which manages surplus funds in the current account with the Bank of Japan, finances B bank at this base rate (lower than a rate that is set based on B bank's credit rating). B bank can provide financial services with the low-cost funds in its business-based areas, aiming at improving group profits.

⁸ The Ordinance for Enforcement of the Banking Act prohibits a bank from "transactions with a person regarded same as said specified relevant person in light of type, size, and creditworthiness of its business under a disadvantageous condition to the person, compared with conditions of a transaction that shall become effective in the cases where the bank carries out a transaction of the same type and the same amount under the same situation as the transaction with said specified relevant person."

⁹ Article 13-2 of the Banking Act.

¹⁰ The Arms-length Rules are regulations that were introduced from a perspective to prevent the harmful effects arising from cases where a bank enters into other businesses through "subsidiaries in different types of business," which was permitted by the revised Banking Act in 1992.

In addition, for internal finance within a group, it is considered necessary to pay attention to the relationship with the deposit insurance system and the Companies Act. To be more precise, it should be noted that subsidiary banks even in the same group are respectively subject to deposit insurance and furthermore each subsidiary bank has creditors. From these viewpoints, it is considered necessary to

- establish clear transaction rules in a group as alternative to the Arms-length Rules in order to avoid arbitrariness of profit and risk management, and
- ensure the bank has a sound financial position that cannot be impaired¹¹.

Furthermore, it also should be noted that subsidiary banks may have minority shareholders.

Thus, it is considered necessary that

- each bank has no minority shareholders in principle, and
- if banks have minority shareholders, the management of each bank (directors and auditors) can fulfill accountability for the transaction to minority shareholders.^{11,12,13}

On the conditions that the above points are all fulfilled, such flexible internal finance within a group may be allowed.

(4) Facilitating provision of banking services in an integrated manner by financial group

When Japanese banks and foreign bank branches conduct agency/intermediary services for foreign banks, the current Banking Act requires outsourcee bank to obtain approval for each outsourcer (foreign bank). Even if outsourced by multiple foreign banks in the same group, it is necessary for outsourcee bank to obtain approval at each time.¹⁴ Thus, some financial groups conducting global economic activities request a review of ex-ante regulations such as approval and registrations, including total abolishment of the regulations, because there are cases where the regulations make it difficult for them as an entire group to flexibly provide services to foreign branches and affiliated companies of a Japan-based corporate group by leveraging each business base of the financial group.

The purpose of the approval framework for foreign banks' agency/intermediary services is to prevent inappropriate services that may be provided by foreign banks that are outside the reach of Japan's supervisory authority with supervising parties who conduct agency/intermediary services in Japan on behalf of the foreign banks. In light of this, the approval system is considered still necessary.

In consideration that depending on foreign banks, there are various types of regulations and supervision by foreign regulatory authorities that are in charge of overseeing foreign bank outsourcers, as well as various

¹¹ When the soundness of its financial condition of a subsidiary bank that provides finance is judged and the bank explains it to minority shareholders, it may take into account not only how the transaction itself influences the bank's financial condition but how the achievement of synergetic effects in the group does as well.

¹² It should be noted that transactions for which sufficient accountability cannot be provided may require responsibility for Directors' managerial decision making based on private laws.

¹³ In addition, separate attention should be paid to tax matter for such transaction within a financial group.

¹⁴ Article 52-2 of the Banking Act.

types of business models and internal control systems of foreign bank branches, individual approval is required under the current Banking Act. However, it is considered not necessary to require individual approval of each foreign bank branch outsourcer, on the premise that the Japanese regulatory authority examines business models and internal control systems of an entire foreign bank outsourcer group and furthermore it appropriately conducts a day-to-day supervision of each outsourcee foreign bank branch.

For this reason, instead of individual approval by the outsourcer company unit, it is appropriate to introduce comprehensive approval system of an outsourcer group unit where an outsourcee bank is requested to register when a foreign bank within a group becomes a new outsourcer.

Chapter 3: IT and Payment-related Operations by Financial Group

1. Principle of regulations on permissible activities of financial group

In order to continue sustainable growth, it is considered important for Japanese financial groups to conduct business activities flexibly, incorporating IT innovation in a strategic manner.¹⁵

In this regard, financial groups centered on banks serve important public and economic infrastructural functions, providing payment functions in use of deposits, and facilitating the process of credit creation and financial intermediation. Therefore, these financial groups are required to put their efforts in playing their inherent roles, and the scope of businesses that banks can conduct as well as businesses that their subsidiaries and fellow subsidiaries can conduct are stipulated individually by relevant laws and regulations beside that the prohibition of engagement in other non-permissible businesses is imposed.

In consideration of the scope of permissible activities of financial groups centered on a bank, the following purposes of prohibition of other businesses should be taken into account:

- exertion of efficiency by focusing on their basic line of businesses;
- avoiding risks in other businesses;
- preventing conflicts of interest; and
- preventing the abuse of dominant bargaining positions.

Based on these, from today's perspective, it is also necessary to take into consideration whether engagement in various businesses could harm the simplicity of organizational structure, which makes it difficult to conduct an effective business management of the group.

¹⁵ It was also pointed out that financial instruments exchanges and clearing houses should be considered to be reviewed from the same perspective. These market infrastructures are generally not allowed for any business other than the inherent business such as market opening and incidental business, which may have been stipulated from the perspective of stable operation of business like market management with a high public profile. On the other hand, in foreign countries there are movements of cooperation in cross-border exchanges and collaboration with other businesses including IT related business. Study in consideration of recent environmental changes will be positioned as one of important issues.

Based on such understanding, in the case of adding a new business as permissible activities, which entity (bank itself, subsidiary, and fellow subsidiary) in a group is appropriate for the new business is supposed to be determined in light of the following:¹⁶

- functional closeness between the new business and bank's basic line of businesses;
- homogeneity of risks in the new business and risks that bank has already taken; and
- degree of ripple effect of risks on the bank itself.

2. IT and payment-related operations

(1) Facilitating investment in finance-related IT companies

In recent years, innovative financial services with the use of IT called FinTech have been rapidly expanding. For instance, new payment services with the use of smartphone and fund transfer services with the use of a cellphone number are being newly provided with a high level of convenience by mainly IT companies or other companies in cooperation with them. For the purpose of taking in such technologies, Western financial institutions are expanding their financial services through investment into and acquisition of IT companies, including those primarily conduct payment-related services, for example.

In addition, in Western financial institutions as well as business firms at home and abroad, there is a movement of investing into companies operating a so-called electronic commerce (EC) mall¹⁷ that is a place on the internet where IT technologies are utilized to consolidate and provide information on vendors and their products through which vendors and consumers can transact.

Since an EC mall can consolidate commercial information that is inextricably linked with the flow of funds, there is a view that new financial services could be provided,

¹⁶ Please refer to "the Report of the Second Subcommittee of the Financial System Council's Sectional Committee on Financial System - the regulations on the scope of businesses permitted to bank and/or insurance groups -" (December 18, 2007)

Based on the above-mentioned standpoint, the current the current framework of the Banking Act permits the following:

- In addition to businesses permitted to a bank, bank subsidiaries are permitted to operate securities business, trust business, insurance business, finance-related business (incidental or related to bank business), dependent business (business depends on a securities company, an insurance company and a trust company that belong to a bank or a bank group) etc.
- Fellow subsidiaries of a bank are permitted to operate commodities transactions in addition to business permitted to a bank subsidiary

¹⁷ In the US, the Code of Federal Regulations and others permit banks to run EC malls as a finder business in banking businesses.

utilizing such information for loan examination and others.^{18,19} In addition, some say an EC mall could be a new growth infrastructure for small and medium-sized companies in regional areas, which are unable to open shops in urban areas.

Under these circumstances, among Japanese financial groups, there has been an increasing demand for incorporating fruits of IT innovation into banking business through investments into these companies.

When a financial group makes an investment in accordance with movements of FinTech, the targeted company may engage in various types of businesses. For instance, if the company's business is clearly recognized as business dependent on the bank business, it becomes "Dependent Business"²⁰ and if it is recognized to evolve into finance-related services, it may become "Finance-Related Business."²¹

On the other hand, although the development of technologies and services of the targeted company has potential to grow at the time of investment, there may be a case where it is not sure in what area the fruits may be utilized. From these viewpoints, there may be some areas that do not necessarily fall under the current category of "Dependent Business" and "Finance-Related Business."

On this point, dealing with the movement in FinTech will require a strategic planning for future possibilities²² and it is considered appropriate to handle it in a flexible manner.²³

In addition, as seen in the case of investment in the EC mall mentioned above, it is foreseen that an increasing number of businesses that are currently categorized as non-permissible other businesses will be closely related to banking business and provide financial services with high degree of user convenience through combination with banking business.

Considering the above, in addition to listing permissible activities in the Act beforehand that a financial group can conduct, it is worth considering to set up a framework where more flexible business expansion is enabled with a view to a variety of business development in the future.

For this reason, for instance, it is considered that bank holding companies and banks can be authorized to invest into companies that implement "businesses that contribute or may contribute to improve services provided by a bank." In accordance with the purpose of prohibition of other businesses within a financial group centered on a bank, authorization will be given in consideration that

¹⁸ Some EC mall operators conduct not only "provision of a platform for business trading" but also functional logistic services with their own inventory. However, in light of closeness with banking business and risks of other businesses, it should be premise that financial groups centered on a bank will not be permitted to operate logistics services.

¹⁹ Functions of an EC mall business may be mainly divided into four areas: (1) introduce transaction parties, (2) provide advice on venders' sales strategy, (3) make payments after trading, (4) make loans, utilizing information on commercial distribution. Each of those is respectively considered to be businesses permitted for banks or close to them.

²⁰ At present, a bank's subsidiaries and fellow subsidiaries are permitted to carry out "Dependent Business" (businesses that are "specified by a Cabinet Office Ordinance as those being dependent on business of a bank or its subsidiaries and fellow subsidiaries."). However, "Dependent Business" is limited to a company that engages in it mainly for business operated by the bank or its subsidiaries and fellow subsidiaries). At present, these "Dependent Businesses" are stipulated as management of real estate for sale, purchase and management of stationary, system-related operations, maintenance of ATMs, worker dispatching, etc.

²¹ Presently, a bank's subsidiaries and fellow subsidiaries are permitted to carry out businesses that are incidental or related to bank business as "Finance-Related Business.

²² There is a view that if a future industry trend is very uncertain, it is important for management to expand its business range in order to retain rights of entering into new fields.

²³ With regard to this, there may be a case where technologies and services in which a bank has invested do not result in contributing to financial services of the bank in the end. It is pointed out that, in that case, it is appropriate to request the cancelation of investment when the case is realized, but not to close the door to investment and challenges in new businesses.

- there is no problem with the soundness of the group's financial condition,
- there is closeness between risks in the businesses and risks in banking businesses and degrees of ripple effects of risks on the bank is expected not high,
- there is no threat of abuse of dominant bargaining position and harmful effects resulting from conflicts of interest, and
- the investment is expected to contribute to expand financial services that the group provides or expand such opportunities.

With respect to specific limits on ownership in such targeted company resulting from the investment, in light of different effectiveness to block risks to bank between a subsidiary and a fellow subsidiary, there may be a difference in the limit of investment ratio between shares held by a bank holding company and shares held by a bank on a case-by-case basis depending on business area, risks, etc. of the targeted company.

(2) Facilitating commission of operations related to payments and transaction banking to a party within or outside a bank group

Presently, a bank's subsidiary or fellow subsidiary that conducts "Dependent Business" including payment-related system

operations is required to ensure that revenues from the parent bank group are not less than 50% of its total revenues (in addition, it should receive revenues from a bank that belongs to the same group).

On this point, amid growing needs to review a cost structure through streamlining payment operations and to make a strategic IT investment, there is a request from financial groups to make it easy to outsource payment-related operations within a group or insource them from other groups²⁴.

It is considered the purpose of "Regulation on revenue dependence" regarding "Dependent Business" is to allow such business by limiting the scope of such business to the range where the integrity with banking business is ensured as it is necessary for executing banking business, while it is not appropriate to allow "Dependent Business" to be carried out without restriction within a bank group since it is, in nature, other business compared with banking business from a perspective of securing the soundness of banking business.

In this regard, there are some "Dependent Businesses" including IT system development where an initial cost is high but additional costs will be decreased by scale economies. Some point out that amid growing urge for strategic IT investments, if the regulation on revenue dependence is applicable to every category of dependent business in the same way, costs will become excessive and as a result, strategic IT investments could be harmed.

²⁴ In this connection, in cases where a company that carries out dependent business undertakes businesses from multiple bank groups including the parent bank group, there is another rule that total revenues from these groups should be not less than 90% of its total revenues (in addition to that, it should receive a revenue from a bank that belongs to each group). Despite that, there is a review that it may result in harmful effects. For instance, in cases where a dependent business company that receives a revenue of 70 (not less than 50%) from the parent bank group and a revenue of 30 from other business companies is additionally entrusted 50 from another bank group, the revenue from the parent bank group (70) will be approximately 47% (less than 50%) of the total revenues (150), and the combined revenues from the parent bank group and another bank group (120) will be 80% (less than 90%) of the total revenues (150), which cannot fulfill either rule, violating the regulation on revenue dependence.

In light of these points, it is considered appropriate²⁵ to make regulations more flexible²⁶ by lowering the revenue dependence ratio that is, at present, uniformly set at not less than 50% for some “Dependent Businesses,” including bank system management and ATM maintenance that strongly require cooperation and collaboration among multiple financial groups in promoting business efficiency within a group or strategic IT investments in line with the progress of computerization.

(3) Issues associated with participants in banking business from different industries

Since the early 2000s in Japan, different industries such as business firms have entered into banking business in full scale where the different industry group achieves synergetic effects between its own business and a bank in the group through their store network and standardization of customer base to construct a new type of business model with the use of a bank.

It is also pointed out that it is important to study how regulations on these different business groups should be with a view to equal footing²⁷ with those on conventional financial groups centered on a bank.

In this regard, it is considered appropriate to further study from the following perspectives.

- While there may be a growing number of entries into banking business from different industries and increasing share of banking business within different industry business groups, is the current regulatory power for different industry groups sufficient? For instance, since the parent company of a bank in a different industry group is only regulated as a major shareholder of a bank, if there is any problem with activities of a financial group that entered into banking business from a different industry, is it possible to fully supervise the group?
- With a view to the advancement of innovation in the future, should it be deliberate to excessively restrain an entry into banking business from different industries?

²⁵ It is considered appropriate to review the provision of the current Banking Act that “Dependent Business” should be carried out “mainly” for business that a bank conducts.

²⁶ It was pointed out that it is necessary to give consideration to whether there is room to review the provision of the current Banking Act that IT related business is positioned as dependent business.

²⁷ Under the current Banking Act, a bank holding company is defined as “the value of shares of its subsidiaries accounts for more than fifty-hundredth of its total assets,” and business scope regulations are applied to the entire group under the bank holding company.

On the other hand, a parent company (business operator) of a bank in a different industry group, including a logistics business group, is not applicable to the definition of a bank holding company and is only subject to regulations as a major shareholder of a bank (company that holds not less than 20% voting rights of a bank), not to subject to business scope regulations.

In the US, a bank holding company is defined as “company that holds not less than 25% voting rights of a bank or company that controls a bank by appointing a majority of directors, etc. (12 USC 1841(a))

CONCLUSION

The above-mentioned are the findings from the deliberations at Working Group. In light of the approach presented in this report, it is hoped that concerned parties will proceed with the development of appropriate institutional measures.

This report is provided in the hope that it will help enhance business management of Japanese financial groups, and the consolidation of common and duplicate operations within a group and the facilitation of financial groups' investments into finance-related IT companies will lead to synergetic and cost-reduction effects and incorporation of innovation in business operations of a whole financial group, and ultimately to the improvement of services provided by financial groups and conveniences of users of such services.

It is hoped that regulatory authorities and financial groups will take appropriate measures with fully understanding the points in this report.

In addition, in response to changes in environments around financial groups, it is expected that legal framework on financial groups will be continuously studied.