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Financial Reconstruction Commission
Financial Services Agency
August 3, 2000

# Basic Principles concerning New Types of Banks including Entries into Banking Business by Non-Financial Entities

1. There has recently been a move toward entries into banking business by non-financial entities including non-financial companies, and establishments of new types of banks differing from traditional banking operations which include banks primarily designed to provide settlement services through ATMs placed in convenience stores and banks providing services solely over the Internet. These developments are expected to contribute to revitalizing Japan's financial industry and to improving the quality of customer services through the innovation of financial technologies and the promotion of greater competition.

2. On the other hand, these new types of banks would pose such various issues as follows, which were not assumed in conventional banking operations:

(1) ensuring the independence of a subsidiary bank from its non-financial parent entities;

(2) shielding the subsidiary bank from the risks of its parent entities' operations;

(3) protecting the privacy of customer information when the subsidiary bank is involved in comprehensive business operations with its non-financial parent entities;

(4) ensuring appropriate risk management and profitability when the asset structure of the bank is heavily concentrated on government bonds and other securities;

(5) protecting customers in the case of banks operating solely through ATMs and over the Internet with no face-to-face contact with

customers.

These are issues which have arisen with the emergence of new types of banks differing from conventional types in terms of their capital, operational, and branch structures. These issues need to be addressed from the perspective of ensuring sound and appropriate management of banking business as required under the provisions of the Banking Law.

3. Pursuant to the above basic principles, the Financial Reconstruction Commission and the Financial Services Agency have formulated the Operational Guideline regarding measures for licensing and supervising new types of banks under the current laws and regulations as attached, after having issued them for public comments earlier.

As those which carry out settlement and financial intermediary functions, new entrants into banking business will be required to have in place adequate financial foundations, appropriate human resources and internal control systems in the same way as conventional banks. In line with this Guideline, including the above-mentioned requirements, due assessment will be made in licensing and on-going supervision.

4. This Guideline only provides the basic principles in coping with major issues which are recognized at the present time. The rapid pace of innovation in financial technologies will continue to bring forth new types of banks in the future, and additional consideration may become necessary to cope with such developments.

5. In closing, it should be noted that current laws and regulations do not empower the supervisory authority to gain advance knowledge of changes in principal shareholders of banks and to exclude shareholders who are not fit and proper to ensure sound bank management. In light of the requirements of the Basel Core Principles and current legislation in major developed countries, deliberations at the Financial System Council will be begun promptly as to empowering the supervisory authority to gain advance knowledge of and to exclude principal shareholders who are not fit and proper to ensure sound bank management.

Furthermore, as a flip side of the issue of new entrants into banking business, the issue of deregulation will be studied, such as the relaxation of the ban on banks' engagement in non-banking businesses and restrictions on shareholding, in line with the "Three-Year Plan for the Promotion of Deregulation (Second Revision)" approved by the Cabinet at the end of March 2000 at the Financial System Council, with the consensus of the parties concerned.

Note:
The "Core Principles for Effective Banking Supervision" (September 1997) of the Basel Committee on Banking Supervision mentions the following minimum standards for banking supervision by national supervisory authorities.

Principle 3:
The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organization's ownership structure, directors and senior management....(The rest is omitted)

Principle 4:
Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interest in existing banks to other parties.