A BRAVE NEW WORLD FOR M&A OF FINANCIAL INSTITUTIONS IN JAPAN: BIG BANG FINANCIAL Deregulation AND THE NEW ENVIRONMENT FOR CORPORATE COMBINATIONS OF FINANCIAL INSTITUTIONS

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1. INTRODUCTION

Japanese financial institutions have long been shackled by a web of legal restriction and labyrinthine regulation that has segmented financial institutions into limited fiefdoms, insularly limiting their ability to compete against one another. The catastrophic result of such daimyo-style regulation1 is evident in the general non-competitiveness of Japanese financial institutions, massive nonperforming loan problems, and the bankruptcies of several prominent financial institutions. In response to this financial malaise, Japan recently has begun loosening many of the legal shackles that have, inter alia, traditionally prohibited and restricted mergers and acquisitions of financial institutions in Japan’s tightly segmented financial industry. The poor performance of Japanese financial institutions has given them the incentive to utilize this freedom to combine in new ways to achieve business objectives in an environment less encumbered by restrictions on financial integration.

As financial institutions, both domestic and foreign,

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1 Daimyo were Japanese feudal fiefdoms headed by feudal lords, through which the Japanese Shogun indirectly controlled Japan. Members of the ruling warrior-class aristocracy (bakufu) enjoyed near monopolies on power and economic activity within their respective daimyo, but competed with other daimyo for official favors and territorial expansion.
increasingly begin to take advantage of the freedoms provided by a newly liberalized legal environment, they will test the boundaries of this new legal environment for corporate combinations of financial institutions. Section 2 of this article provides some brief background on the forces driving the need for change and the status of merger and acquisition activity in Japan generally. Section 3 explores how the financial business laws and regulations have all but eliminated mergers and acquisitions among financial institutions, and how a series of deregulatory measures has expanded the contours of financial activity by breaking down legal and regulatory barriers to corporate combination. In light of the recent elimination of the ban on financial holding companies, Section 4 explores how the Antimonopoly Law’s legal and regulatory standards impact mergers and acquisitions of financial institutions. Finally, Section 5 discusses the emergence of merger and acquisition-related activity in the financial sector and concludes that greater merger and acquisition activity should result as economic forces drive consolidation activity in a new legal environment.

2. THE FORCES驅使 THE NEED FOR GREATER JAPANESE MERGER AND ACQUISITION ACTIVITY AMONG FINANCIAL INSTITUTIONS

2.1. Economic Problems

Prompting the recent reforms is a financial system that has been broken by decades of inefficiencies—the product of systematic protection from internal and external competition. The Japanese financial system was exceptionally good at channeling capital away from consumption and toward investment, which helped to propel its rise to economic power. A byproduct of this same system, however, has been an excessively low cost of capital and a corresponding low return on the investment of that capital. Indeed, on an inflation-adjusted basis, Japanese bank interest rates and the earnings on yield have been lower than those in the United States for almost all the past two decades. Decades of high growth and a bubble economy built on land assets managed to mask the underlying inefficiencies

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throughout the 1980s. But with the burst of the Japanese economic bubble, Japan was painfully awakened as to the inefficiency of the financial institutions at the core of its economic system. As the Japanese economy spiraled into recession, it was hit with steep drops in land prices and stock prices. This was accompanied by a resultant massive amount of non-performing loans for financial institutions to shoulder (including the jusen mondai), the downgrading of the creditworthiness of Japanese banks with the imposition of a "Japan premium" on world capital markets, and a series of bankruptcies, most notably those of Yamaichi Securities—Japan's fourth largest brokerage—and Hokkaido Takushokku Bank—the first major bank to fail since World War II. Economic concerns were only compounded by the realization that the dismal rates of returns being squeezed out of the current financial system, combined with a rapidly aging population, meant massive underfunding of the pension system. At the same time, scandal after scandal has broken out detailing shady relations among powerful individuals from the Ministry of Finance, the Bank of Japan, banks, and brokerage firms. Clearly, this broken system needed fixing.

2.2. Pressures from the Foreign Environment

Along with this awakening as to the tattered state of the Japanese economy came the realization that Japan's sheltered financial fiefdoms looked increasingly dysfunctional in the world financial system. In terms of return on equity, return on assets, 

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3 Over the past ten years, the volume of shares of the Tokyo Stock Exchange has fallen by 53%. Since 1991, the number of foreign company listings has been halved. Between 1992 and 1995, Tokyo was the only major foreign exchange center that shrank, with some foreign exchange trading migrating to Hong Kong and Singapore. Singapore also now manages one-third of the trading in Japanese stock index futures. Fewer foreign companies and investors are borrowing or saving in yen, a trend that should be further exacerbated by the introduction of the Euro. See Bang, Pop or Splutter?, ECONOMIST, May 9, 1998, at 29.

4 See, e.g., Yozo Matsuda, Japan Premium as High as Rates in Developing Nations, DAILY YOMURI, Dec. 6, 1997, at 12.

5 In addition to these bankruptcies, a number of smaller institutions such as Sanyo Securities, Hanwa Bank, Tokuyo City Bank, and Kizu Credit Corporation have also gone bankrupt.

and other measures of business efficiency, Japanese financial institutions are extremely unprofitable.\footnote{See Kenneth S. Courtis, \textit{A Big Bang or a Wee Whimper?}, \textit{LOOK JAPAN}, Nov. 1997, at 13, 14; Katayama Osamu, \textit{Japan's Big Bang}, \textit{LOOK JAPAN}, Nov. 1997, at 3, 9.} In other markets where Japanese financial institutions can't lay claim to a protective regulatory regime, competitive pressure from more diversified, sophisticated western banks has helped roll back the efforts of many less flexible Japanese financial institutions abroad.\footnote{Leading western banks are able to propose new issues of stock, loans, and derivatives. Japanese banks, by contrast, cannot do much more than provide loans. Several Japanese banks, such as Nippon Credit Bank, have already pulled out of overseas operations, unable to compete with western banks regarded as offering superior asset-management and investment-banking capabilities. In response, Sanwa Bank and Dai-Ichi Kangyo are trying new types of wholesale and investment-banking operations through strategic alliances with banks in other Asian countries. See Masato Ishizawa, \textit{Banks Boost Asian Alliances}, \textit{NIKKEI WKLY.}, Feb. 16, 1998, at 1. Japanese banks have also been reducing their presence in Europe. \textit{See}, e.g., \textit{Big Japanese Banks Pulling Out of France, Merging European Branches}, \textit{NIKKEI SHIMBUN} available at <http://web.nikkei.co.jp/enews/SPECIAL/bigbang/bigbang61.html>.} While Japanese finance remains stagnant, financial institutions in the rest of the industrialized world continue to grow in size and scope. Financial institutions in Europe and the United States have been merging on a massive scale to take advantage of the blurring lines between financial products and the promised synergies of "one stop shopping." Meanwhile, most recent Japanese merger and acquisition activity has been limited largely to a few paltry acquisitions of insolvent banks.\footnote{This was the case, for example, in Daiwa Bank's acquisition of Cosmo Securities and Mitsubishi Bank's acquisition of Nippon Trust.} Europe, already the home of universal banking, has undergone a wave of consolidation including the acquisition by Dutch ING of Belgium's Banque Bruxelles Lambert, the merger of Sweden's Nordbanken with Merita of Finland, and the massive merger of Swiss Bank Corp. and Union Bank of Switzerland to form United Bank of Switzerland.\footnote{\textit{See}, e.g., \textit{The Craze That's Sweeping the Continent: Mergers}, \textit{BUS. WK.}, Dec. 29, 1997, at 48.} In the United States, the reach of the Glass-Steagall Act has continued to weaken as bank holding companies structure around a more flexible legal environment.\footnote{\textit{See}, e.g., \textit{Note, The New American Universal Bank}, 110 \textit{HARV. L. REV.} 1310, 1319-21 (1997).} In 1997, the financial sector accounted for one-third of the total

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merger and acquisition deals concluded in the United States. In the banking industry alone, more than 370 bank and thrift deals were announced in 1997 with a total price tag of $93 billion; such deals included the following: Merrill Lynch & Co.'s $5.3 billion acquisition of Mercury Asset Management, Morgan Stanley & Co.'s merger with Dean Witter, Discover & Co, and the Bankers Trust acquisition of Alex. Brown & Sons. Of all the mergers, perhaps the most alarming to Japanese financiers is the proposed merger of Citicorp and Travelers Group to form Citigroup, slated to become the world's largest financial institution with a market capitalization of $135 billion. Citibank already has over twenty branches in Japan and has proved itself to be a formidable competitor pushing against an oft-times slumbering status quo. To do this, it has utilized such "radical" innovations as twenty-four hour ATMs, multi-currency bank accounts, and the linking of its branches with the nation's postal savings network—much to the annoyance of Japanese commercial banks who had previously boycotted such a link. In the wake of the merger, Akio Utsumi, senior executive director at Mitsubishi Trust and Banking, noted the significance of the event by responding, "From now on, mergers between financial institutions in different areas will be accelerated." The recent tie-up of Japanese and foreign financial entities will only heighten concern among Japanese financial institutions.

2.3. Increased Receptiveness to M&A Activity in Japan

In general, however, merger and acquisition activity in Japan has traditionally come nowhere near fulfilling the important role that it has in other industrialized countries. To some extent,
Japanese merger and acquisition activity began to cause a stir in the 1980s with a number of Japanese acquisitions abroad, including some prominent American companies. Such merger and acquisition activity, however, took place beyond the borders of Japan. The converse, takeovers or mergers in Japan by foreign companies, remains extremely rare.\(^\text{(16)}\) Foreign hostile takeovers of Japanese firms are nonexistent, and foreign acquisition activity has largely been limited to buying out the Japanese partner of joint ventures between foreign and Japanese companies.\(^\text{(17)}\) In those very rare cases where a foreign company has successfully taken over a Japanese business, the acquisition has often been preceded by a long-term business relationship—as was the case with Merck's acquisition of Banyu, one of the better known cases of an acquisition of a Japanese company by a foreign entity.\(^\text{(18)}\)

The relative paucity of corporate combination activity in Japan is by no means limited to activity involving foreign entities. Although domestic activity is limited by international comparison, most acquisitions that do occur are friendly and involve acquisitions of very small corporations; they also often revolve around acquired companies in financial trouble (in which case the acquirer coming to the rescue normally comes from the same keiretsu), or involve the acquisition of financially sound but small family enterprises. The much rarer, larger-scale acquisitions are generally those that have been sanctioned by the government. Prominent examples of government-sanctioned mergers from Japan's first merger waves (or perhaps ripples) occurred during the mid-1960s and early 1970s and were defined by the merger of three heavy industries in the Mitsubishi group in 1964; the merger of Prince Motors and Nissan Motor Corporation in 1966; the Fuji Iron & Steel and Yawata Iron & Steel merger in 1970 to form Nippon Steel; and the merger of Dai-Ichi Bank and Nippon

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\(^\text{(16)}\) From 1955-1984, foreign companies acquired majority interests in only 32 Japanese firms. These were mostly petty acquisitions, including mostly minor sales outlets and no public companies. Since 1986, 24 American majority acquisitions have taken place, but 13 of them were joint venture buyouts or transfers of foreign subsidiaries. See W. CARL KESSLER, JAPANESE TAKEOVER: THE GLOBAL CONTEST FOR CORPORATE CONTROL 137 (1991) (citing Walter Ames & Michael Young, Foreign Acquisitions in Japan: Handling the Ultimate Barriers, J. AM. CHAMBER COM. JAPAN, Jan. 1986, at 10-29).

\(^\text{(17)}\) See id.

\(^\text{(18)}\) See id. at 141.
Kangyo Bank to form Dai-Ichi Kangyo Bank in 1971.\textsuperscript{19} The fact that one must span decades to find sizable mergers indicates the relative rarity of these large domestic merger transactions.

Commentators have advanced a number of reasons for the relative nonutilization of mergers and acquisitions in Japan: the low position of shareholders relative to other stakeholders in often heavily leveraged Japanese corporations (e.g., relative to employees and creditors such as a main bank), cross-shareholding of shares (mochiai) among keiretsu firms that collectively amount to majority stable shareholding, and the consequent lack of a market for corporate control on the stock exchanges.\textsuperscript{20} Other factors include problems with the Japanese tender offer system\textsuperscript{21} and restrictions imposed by the Foreign Exchange and Foreign Trade Control Law.\textsuperscript{22}

Compared with the United States, Japan continues to have substantially less merger and acquisition activity. However, the number of reported mergers and acquisitions has increased in recent years from 988 mergers and 1,450 acquisitions in fiscal year 1989 to 1,476 mergers and 2,271 acquisitions in fiscal year 1996.\textsuperscript{23} More recently, these numbers have included some higher profile mergers. For example, recent activity included the creation of Mitsui Chemicals through the merger of Mitsui Petrochemical Industries, the merger of Japan Paper Industry and Jujo Paperboard Industry, the merger of Japan Telecom and International Telecom Japan, the announcement that Chichibu Onoda Cement and Nihon Cement would merge, the formation


\textsuperscript{20} See id. at 99-102.

\textsuperscript{21} See Martin Saywell, \textit{The Ultimate Barrier Revisited: Mergers and Acquisitions in Japan, in JAPANESE COMMERCIAL LAW IN AN ERA OF INTERNATIONALIZATION} 41, 44-49 (Hiroshi Oda ed., 1994).

\textsuperscript{22} See id. at 50; H. Leigh French, \textit{INTERNATIONAL LAW OF TAKEOVERS AND Mergers: Asia, Australia, and Oceania} 16-17 (1986). The liberalization of foreign exchange under the newly revised Gaikoku Kawase Oyobi Boeki Kanri Ho [Foreign Exchange and Foreign Trade Control Law], Law No. 228 of 1949, makes this factor, to the extent it ever was one, no longer an issue.

of Tokyo Mitsubishi Bank, the merger of New Oji Paper and Honshu Paper, and the merger between Oni Paper and Kanzaki Paper.24

Merger and acquisition activity involving foreign firms has also picked up in number and more importantly, the joint-venture buyout trend has been decreasing while the number of majority control, or significant minority interest, in listed company deals has been increasing, evincing "a growing cultural acceptance of foreign control in Japan."25 Behind the trend, some believe that "[d]eregulation will inevitably produce financial sector failures, providing the opportunities to pick up cheap assets like distribution systems, client lists and personnel" and that "[t]he pressure to perform may lead financial institutions, particularly banks, to be more open to considering liquidating their positions by selling their equity holdings in struggling customers."26 Furthermore, according to the Nihon Keizai Shimbun's 1997 "Survey on Market Share for 100 Main Products," many companies are turning to mergers and acquisitions to increase their market share.27 As competitive pressures mount in a weak economy, the use of mergers and acquisitions as a means of boosting competitiveness is gaining greater acceptance.28

2.4. "Big Bang" Deregulation

In response to Japan's economic plight and its stagnant finance industry, Japan's policymakers have crafted the "Big Bang" financial reform package. Following the mantra of making Japan's markets "free, fair, and global" by 2001, the Big Bang image symbolizes the destruction of the existing constraints on

25 While the value of deals plunged 68% in 1997, the number of deals increased by 42%. See Michael Shatz, Direct Investment in Japan, 1997, AMER. CHAMBER COM. J., May 1998, at 49.
26 Id.
28 Various other forms of business alliances, such as joint production and development agreements linking companies without merging them, have also proliferated in recent years. For a discussion of some of these other financial arrangements, see infra Section 5.
the financial system in order to allow the financial system to reconstitute itself in a more efficient form. 29 In reality, a "long bang" (i.e., a crackle of firecrackers with delayed fuses going off over several years) more aptly describes the step-by-step reforms constituting Japan's Big Bang. 30 Nonetheless, the Big Bang is a watershed in Japanese finance. In essence, the Big Bang promotes change by making the financial system freer and more open to competition. New players may enter the competitive fray more easily, companies have greater freedom to compete on price, 31 and the legal walls break down that sheltered finance from competition. Particularly with respect to merger and acquisition activity, the Big Bang promotes consolidation among financial institutions by breaking down legal and regulatory walls that have historically prevented combination activity in the financial sector.

29 For more on Japan's Big Bang, see the Ministry of Finance's web site at <www.mof.go.jp/english/index.htm>.

30 With the UK's Big Bang of October 27, 1986, the enforcement of the Big Bang came into play all on the same day. The trading floor of the stock exchange was abolished; the system of market-making was introduced; membership of the stock exchange was opened to all interested parties; the brokerage commission was liberalized; and most of the securities brokers were eventually absorbed into British merchant banks, securities companies, and banking institutions of the United States and Continental Europe. See Sadakazu Osaki, Financial System Reform, in JAPANESE FINANCIAL MARKETS 253 (Shigenobu Hayakawa ed., 1996).

31 The Ministry of Finance has traditionally formally and informally regulated insurance premiums, deposit terms and rates, and brokerage commissions. In fact, more than 12 years after London eliminated its fixed share trading commission and more than 20 years after the United States eliminated set commissions, commissions in Japan will remain fixed on certain trades until their scheduled elimination some time in 1999. Non-price competition was also frowned upon by the regulators as demonstrated by the regulation of branching and advertising or by the practice of financial service institutions offering one and the same financial product or service at the same time. See Yukihiko Endo, Historical Development of the Japanese Financial System, in JAPANESE FINANCIAL MARKETS 8 (Shigenobu Hayakawa ed., 1996).
3. THE ROLE OF FINANCIAL BUSINESS LAWS AND REGULATION IN PREVENTING CORPORATE COMBINATION OF FINANCIAL INSTITUTIONS

3.1. The Role of the Tradition of Compartmentalizing Financial Activity in Preventing Mergers and Acquisitions

Merger and acquisition activity in the financial realm, in particular, has been almost nonexistent in Japan for the past five decades. In fact, the legal and regulatory regime extant for most of this period rendered such activity almost impossible. Ministry of Finance regulators tightly segmented financial activity to minimize "excessive" competition among financial institutions, and to channel capital to specific segments of the economy. While a degree of segmentation within the financial industry is not uncommon in modern financial regulatory regimes, Japan's financial regulators went particularly far in hyper-partitioning financial activity among specific financial institutions. This traditional prohibition on the integration of financial activity has been accomplished by minimizing overlapping areas of competition between financial institutions, and by discouraging merger and acquisition activity among financial institutions.


33 In the United States, for example, financial activity has been segmented into commercial banks, thrift banks of various kinds (mutual savings banks, savings and loans, and credit unions), brokerage firms, mutual funds and investment companies, life insurance companies, property-liability insurance companies, private pension funds, pension funds, underwriters, etc. Japan has gone further than this with the separation of short-term and long-term funding and the segregation of life insurers from all other types of insurance. The United States also long discouraged bank mergers through a complicated regime regulating branching, holding company activities, and mergers. For a general overview, see, for example, WILLIAM LOVETT, BANKING AND FINANCIAL INSTITUTIONS LAW 170-202 (1988). Deregulation over the past 20 years, however, has unleashed significant consolidation activity. See, e.g., Bevis Longstreth & Ivan E. Mattei, Organizational Freedom for Banks: The Case in Support, 97 COLUM. L. REV. 1895 (1997). Even the weakened Glass-Steagall Act has come under attack as being a burden on financial activities in the United States. See, e.g., Note, The New American Universal Bank, supra note 11, at 1319-21; Sarah Wagman, Note, Laws Separating Commercial Banking and Securities Activities as an Impediment to Free Trade in Financial Services, 15 MICH. J. INT'L L. 949 (1994).
3.1.1. Statutory Compartmentalization and Its Impact on Corporate Combination

A multitude of business-related finance laws delineate the broadest contours of financial institutions and financial transactions in Japan. The most significant of these laws are the Securities and Exchange Law\(^\text{34}\) and the Bank Law\(^\text{35}\) which fundamentally segregate the activity of banks and securities firms. In addition to the Bank Law, which provides for the powers and licensing of ordinary commercial banks (\textit{futsu ginko}), a number of other establishment laws govern specific types of depository organizations, including the Long-Term Credit Bank Law\(^\text{36}\), the Foreign Exchange Bank Law\(^\text{37}\), the Trust Business Law\(^\text{38}\), the Bank Trust Business Law\(^\text{39}\), the Workers' Banking Institution Law\(^\text{40}\), the Credit Associations Law\(^\text{41}\), and the Credit Cooperative Laws\(^\text{42}\). The Insurance Business Law has divided the insurance industry into two fiefdoms of casualty insurance companies and life and property insurance companies.\(^\text{43}\) Other laws describe

\(^{34}\) Shoken Torihiki Ho, Law No. 25 of 1948.

\(^{35}\) Ginko Ho, Law No. 59 of 1981 [hereinafter Bank Law]. Foreign bank branches are chartered and regulated as branches of ordinary banks under the Bank Law. \textit{See id.} art. 47(2).

\(^{36}\) Choki Shin’yo Ginko Ho, Law No. 187 of 1952.

\(^{37}\) Gaikoku Kawase Ginko Ho, Law No. 67 of 1954.

\(^{38}\) Shintakugyo Ho, Law No. 65 of 1922.

\(^{39}\) Futsu Ginko No Shintaku Gyomu No Ken’ei To Ni Kansuru Horitsu [Law Regarding Regular Banks’ Concurrent Engagement in Trust Business], Law No. 43 of 1943.

\(^{40}\) Rodo Kinko Ho, Law No. 227 of 1953.

\(^{41}\) Shin’yo Kinko Ho, Law No. 238 of 1951.


\(^{43}\) \textit{See Hokengyo Ho} [Insurance Business Law], Law No. 105 of 1996. The Insurance Business Law of 1995 was the first complete revision of the Insurance Business Law since its enactment in 1939. The new law abolished the Hoken Boshu no Tori Shimari ni Kansuru Horitsu [Law Concerning the Control of Insurance Soliciting], Law No. 171 of 1948, and Gaikoku Hoken Jigyo ni Kansuru Horitsu [Law Concerning Foreign Insurers], Law No. 184 of 1949. A number of other laws further delineate the scope of the insurance business in Japan. They are laws such as the Songai Hoken Ryoritsu Sanshutsu Dantai ni Kansuru Horitsu [Law Concerning Non-Life Insurance Rating Organizations], Law No. 193 of 1996; the Jidosha Songai Baisho Hoken Ho
different areas of financial activity and require Ministry of Finance approval for licenses to engage in activities within those fields. Such laws include the Securities Investment Trust Law, the Securities Advisory Business Law, the Asset Securitization Law, the Commodity Fund Law, and the Foreign Exchange


44 Shoken Toshi Shintaku Ho, Law No. 198 of 1951. Under this law, only licensed companies may originate and create securities investment trusts (mutual funds) or advise trustees on trust asset management. Only trust banks may administer these trusts as trustees in accordance with the instructions of the originators. The law also regulates relationships between originators (trusters) and other companies. See Masaki Yagyu, Securities Activities of Japanese Banks Under the 1993 Japanese Financial System Reform, 15 NW J. INT'L L. & BUS. 303, 309 (1994). For a more detailed exploration of investment trusts, see Yoshiki Shimada et al., Regulatory Frameworks for Pooled Investment Funds: A Comparison of Japan and the United States, 38 VA. J. INT'L L. 191 (1998).

45 Yukashoken ni Kansuru Toshikomongyo no Kisei To ni Kansuru Horitsu [Law Regarding Restrictions, etc., on Securities Investment Advisory Business], Law No. 74 of 1986. Under this law, only registered investment advisors may engage in the investment advisory business and prior additional approval is required to act as discretionary investment managers. The law further regulates relationships between investment advisors and other companies.

46 Tokutei Saiken to ni Kakaru Jigyo no Kisei ni Kansuru Horitsu [Law Regarding Restrictions on Business Relating to Specified Monetary Claims, etc.], Law No. 77 of 1992. This law restricts activities relating to securitization of lease and credit receivables of nonbanks to financial institutions and other licensed companies which are authorized to acquire, pool, and securitize such nonbank assets and/or distribute such asset-backed certificates. The law limits engagement in other businesses, and allows only trust banks to package and securitize such nonbank assets through trusts and to distribute beneficial interests in such trusts. See Yagyu, supra note 44, at 309. For developments in bank use of securitization, see, for example, Edward J. Park, Comment, Allowing Japanese Banks to Engage in Securitization: Potential Benefits, Regulatory Obstacles, and Theories or Reform, 17 U. PA. J. INT'L ECON. L. 723 (1996).

47 Shohin Toshi Ni Kakaru Jigyo No Kisei Ni Kansuru Horitsu [Law Regarding Restrictions on Business Relating to Commodity Investment], Law No. 66 of 1991. Under this law, only financial institutions and other licensed companies may originate and/or distribute interests in commodity investment funds. Only trust banks can administer as trustees the funds taking the form of trust and distribute certain kinds of beneficial interests in such trusts. Furthermore, only approved companies can provide discretionary management services on commodity investment. See Yagyu, supra note 44, at 309-10.
Statutory classification of financial activities into different categories of business, or different legal entities with the power to engage in specific categories of business, poses an initial difficulty for mergers and acquisitions among financial institutions for both entity-based and financial business-based reasons.

3.1.1.1. Entity-based Difficulties

The first difficulty arises when the merging institutions are different legal entities chartered under different statutes, a particular problem for mergers and acquisitions in the banking industry. The banking business has been “divided into many...
segments, including short-term banking, long-term banking, trust banking, retail banking, wholesale banking, small business banking, and international trade banking. The statutory regime compartmentalizes the activities of banks by allocating sectors of the banking business to different financial institutions and by providing for ordinary commercial banks (futsu ginko), as well as a range of other banking organizations. Long-term credit banks (choki shin’yo ginko) specialize in long-term loans primarily to large corporations rather than to consumers. Trust banks (shintaku ginko) also have been expected to engage in long-term lending, but must manage such funds through trusts. Foreign exchange banks (gaikoku kawase ginko) were created to engage principally in foreign exchange transactions, activities related to letters of credit, and other financing of international trade. Credit cooperatives (shin’yo kumiai) and credit associations (shin’yo kinko) were chartered to specialize in small business banking and retail banking. Other special institutions include.

50 Yagyu, supra note 44, at 303.
51 Long-term credit banks have traditionally collected long-term funds by issuing special debentures (kin’yusai) maturing in two to five years and discount debentures maturing in one year. There are some legal restrictions on their ability to take deposits and make short-term loans. The Industrial Bank of Japan, the Long-Term Credit Bank of Japan, and Nippon Bond Credit Bank are the only long-term credit banks in existence.
52 Trust Business Law, Law No. 65 of 1922, and Bank Trust Business Law, Law No. 43 of 1943, restrict trust activities, permitting only licensed nonbank trust companies and approved banks to engage in the trust business. Traditionally, there had been seven trust banks; the seven became six when Mitsubishi Bank acquired Nihon Trust in 1994.
53 The merger of the Bank of Tokyo (the only foreign exchange bank in existence at the time) with the Mitsubishi Bank (an ordinary commercial bank) functionally eliminated the category of foreign exchange bank.
54 Credit cooperatives are co-operative banking institutions devoted to mutual assistance among small businesses and workers founded under the Medium and Small Enterprise, Etc., Cooperative Association Law, Law No. 181 of 1949, and the Cooperative Associations Law, Law No. 189 of 1949. With the enactment of the Credit Associations Law, Law No. 238 of 1951, those credit unions which had taken on the characteristics of general banking institutions were allowed to embark on banking business as a credit association. The services provided by credit associations are essentially the same as those provided by ordinary banks, with the exception that credit associations are not allowed, in principle, to give loans to non-members or
the Shoko Chukin Bank, labor banks (rodo kinko), and a three-tiered agricultural banking system which includes agricultural cooperatives and fishery cooperatives organized under the Norin Chukin Bank (the Central Bank of Agriculture and Forestry). Specialized government and semi-private financial institutions have also played a major role in the financial sector.

operate outside their designated areas. Credit associations are members of the National Federation of Credit Associations, which facilitates intermediation among member associations. See Minoru Nakamura & Koji Yamada, Financial Institutions of Japan, in JAPANESE FINANCIAL MARKETS 128 (Shigenobu Hayakawa ed., 1996). Credit cooperatives have formed the National Federation of Credit Cooperatives to perform a similar role. See id. Along with ordinary banking activities, the credit cooperatives may take deposits and engage in foreign exchange, but they may only issue loans and discount bills for subscribers. See id.

55 See Shoko Kumiai Chuo Kinko Ho [Shoko Chukin Bank Law], Law No. 14 of 1936, art. 28(1)(xii). Partially financed by the government, the Shoko Chukin Bank is a special institution established to provide financial services for unions of small-sized and medium-sized enterprises. See Nakamura & Yamada, supra note 54, at 130.

56 Similar to credit cooperatives, labor banks are cooperative institutions whose primary activities consist of installment savings, lending, and deposit transactions for labor unions and their members. Id.

57 See Nogyo Kyodo Kumiai Ho [Agricultural Cooperative Law], Law No. 132 of 1948, art. 10(6)(vii). These cooperative institutions cater to the financial needs of the agricultural community and engage in a variety of nonbanking businesses, including marketing agricultural products and purchasing farm equipment. Agricultural cooperatives are also able to sell life insurance policies and property and casualty insurance over the counter, giving them traditionally a broader range of activities than other depository institutions.

58 See Suisangyo Kyodo Kumiai Ho [Fisheries Cooperatives Law], Law No. 242 of 1948. Fishery cooperatives focus on lending members' savings to members.

59 See Norin Chukin Bank Law, Law No. 42 of 1923, art. 13(1)(ix-ii). Agricultural cooperatives are required to deposit a percentage of funds in their respective prefectural Federation of Agricultural Cooperatives which in turn must deposit a percentage in the Norin Chukin Bank. The Norin Chukin Bank is essentially an agricultural central bank which raises funds not only through collecting from prefectural federations but also through issuing debentures. The Norin Chukin Bank either lends those funds to businesses engaged in agriculture, forestry, and fisheries or it invests surplus funds in security markets. See Nakamura & Yamada, supra note 54, at 128-29.

60 In addition to these private and semi-private institutions, the postal savings system channels funds into the Ministry of Finance's Trust Fund Bureau which funds government financial institutions such as the Japan Development Bank and the Export-Import Bank of Japan, as well as a number of government financial corporations. See The Fiscal Investment and Loan Program (FILP) Report '96 available at <http://www.mof.go.jp/zaito
Most of the statutes authorizing these institutions permit mergers with the authorization of the Ministry of Finance, but a merger between financial institutions of differing legal entities creates an issue as to what form the surviving legal entity should take. The 1968 Law Concerning Amalgamation and Conversion of Financial Institutions ("Financial Institution Amalgamation Law")\(^{61}\) reduced some of the ambiguity as to the permissibility of mergers and acquisitions among depository institutions organized under different laws. The law explicitly authorized mutual banks (sogo ginko, since converted to the legal form of ordinary commercial banks and de facto classified by the Ministry of Finance as second-tier regional banks),\(^{62}\) ordinary commercial banks, credit associations, and credit cooperatives to merge with one another.\(^{63}\) The surviving or resultant entity could take the form of either merging institution, except in the case of a merger between an ordinary commercial bank or mutual bank and a credit cooperative. In such case, the entity must take the form of an ordinary commercial bank.\(^{64}\) The law also allowed certain depository institutions to change their entity form to the entity forms of certain other depository institutions. Ordinary commercial banks could become mutual banks or credit associations,\(^{65}\) while mutual banks could become ordinary commercial banks.\(^{66}\) Credit associations could become ordinary commercial banks or credit cooperatives.\(^{67}\) Yet, the omission of explicit approval for mergers involving labor banks, foreign-exchange banks, and long-term credit banks has cast doubt on the legal ability of these institutions to merge with one another.

The 1992 Financial System Reform Law amended the

\(^{61}\) Kin'yu Kikan no Gappei oyobi Tenkan ni Kansuru Horitsu, Law No. 86 of 1948.


\(^{63}\) Financial Institution Amalgamation Law art. 3, amended by Financial System Reform Law.

\(^{64}\) See id. art. 3.

\(^{65}\) See id. art. 4.

\(^{66}\) See id.

\(^{67}\) See id.
Financial Institution Amalgamation Law in order to further reduce statutory compartmentalization in the banking industry. Specifically, the amending act designates two categories of depository institutions. "Banks" form the first category which consists of ordinary commercial banks, long-term credit banks, and foreign exchange banks. The second category, "cooperative-form financial institutions" (kyodo soshiki kin'yu kikan) includes credit cooperatives, labor banks, and credit associations. Regardless of category, any of these financial institutions are expressly authorized to merge with one another. The nature of the entity which survives or is created by the merger, however, will be determined by whether the merging institutions are within the same category or in different categories. With respect to mergers within the same category, the surviving or newly established entity may take the form of either of the parties to the merger. When there is a merger across categories, however, the surviving or newly created institution will almost always take the form of some kind of bank. The only exception to this is a merger between a bank and a credit association, in which case the resultant entity may be either a bank or a credit association.

In addition, the law encourages decompartmentalization by permitting financial institutions to change the form of their legal entity. Long-term credit banks or foreign exchange banks can become ordinary commercial banks, while ordinary commercial banks can become credit associations. In addition to being able to change entity form to that of commercial banks, "cooperative form financial institutions" may take the form of any other "cooperative form institution."

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69 Financial Institution Amalgamation Law art. 2(2), amended by Financial System Reform Law.

70 See id. art. 2(3).

71 See id. art. 3(1).

72 See id. art. 3(2).

73 See id. art. 3(2)(ii).

74 See id. art. 4 (1).

75 See id. art. 4(2).

76 See id. art. 4(3)-(5).
3.1.1.2. Business-Activity Based Difficulties

Other difficulties exist where the ability to engage in a particular business activity is drawn from an activity-based license rather than a legal entity-based one. In order for financial institutions engaging in different fields of financial business to combine, they need to fulfill simultaneously the licensing requirements mandated by regulations implementing the various financial laws impacting each of the activities in which the business is engaged. It may be impossible for the contemplated merger or acquisition to result in a single legal entity where licensing requirements conflict, or where simultaneous engagement in these activities is expressly prohibited.

The most important example of such a prohibition is the statutory wall separating the banking and securities industries. The Securities and Exchange Law of 1948 ("SEL"), modeled after the Securities Act of 1933 and the Securities Exchange Act of 1934 of the United States, was enacted, inter alia, to protect depositors against bank losses from investing in risky securities through the Article 65 separation of banking and security activities. The SEL restricts the "securities" business to licensed securities firms and imposes various regulations on these firms. With the exception of specific exempted transactions performed by certain approved financial institutions, financial institutions other than securities firms are generally prohibited from dealing in securities. The Bank Law bolsters this division by restricting the banking business to licensed banks and restricting the activities of licensed banks to the "core-banking business," "incidental banking business" (including "non-listed banking business"), and "other banking business." While the boundary

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77 Shoken Torihiki Ho, Law No. 25 of 1948 [hereinafter SEL].
78 See id. art. 28. Foreign security branches, however, are subject to a special legal regime, known as the Gaikoku Shoken Gyosha ni Kansuru Horitsu [Law Concerning Foreign Securities Dealers], Law No. 5 of 1971.
79 SEL arts. 28, 65-2, amended by Financial System Reform Law.
80 Bank Law art. 16-2(1), amended by Financial System Reform Law. Permissible activities may be roughly divided into typical bank business (the taking of deposits and installment savings; lending; discounting of bills and notes; and transfer of funds); ancillary business which may be performed by the bank or an affiliate (guarantees and bill acceptance; trading of securities, securities index futures, securities options and foreign market securities futures; securities lending; underwriting of government bonds, etc.); acquisition (ceding of monetary claims, arrangement for private placement, subscription agency
between banking and securities activities has eroded somewhat since it was first imposed, the SEL Article 65 division still serves as a powerful statutory roadblock nearly fifty years after its original inception. Because the securities business is essentially restricted to securities firms and because the banking business is limited to banking institutions and to activities related thereto, the SEL and the Bank Law at the very least prohibit the financial integration of banking and securities institutions into the same legal entity.

3.1.2. Regulatory Difficulties of Compartmentalization of Financial Institutions

Beyond the express statutory provisions that restrict mergers and acquisitions under the financial business laws, Ministry of Finance regulation powerfully augments this legal framework to compartmentalize these statutory divisions into further de facto divisions. Ministry of Finance approvals are necessary both for licensing new businesses and for the merger and acquisition of financial institutions. The Ministry of Finance's traditional regulatory philosophy of compartmentalization has been antithetical to the combination of financial institutions or the

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for local government, corporate and other bonds, etc.); securities business (retail sales and dealing of government bonds); and peripheral business which can only be undertaken by a bank's affiliate (leasing, venture capital, management consultation, investment advisory services, and others). See, e.g., FEDERATION OF BANKERS ASSOCIATIONS OF JAPAN, JAPANESE BANKS 1996 II(1). For a detailed treatment of the legal and regulatory boundaries of banks under the 1993 Financial Reform Law, see Yagyu, supra note 44.

81 The economic pressures that began to erode some of this separation are known as the two kokusai-ka. Depending on the kanji characters used, kokusai-ka can mean both internationalization and the growing use of government bonds in the Japanese financial market. Banking organizations have gradually won the right to engage in underwriting and dealing in government bonds, derivative activities (e.g., futures and options) related to domestic and foreign government bonds, and activities related to some money market instruments, such as commercial paper and certificates of deposit. Banks also began establishing locally incorporated subsidiaries in foreign countries through which they engage in the securities business. Securities companies, for their part, have begun to sell medium-term government securities funds, essentially money market instruments, which compete with bank deposits. See generally Jones, supra note 49 (discussing the erosion of the boundary between banking and securities activities).

82 Similar restrictions exist in the establishment laws for other types of depository entities. See, e.g., Long Term Credit Bank Law art. 6; Foreign Exchange Bank Law art. 6.
granting of the licensing approval necessary to enter multiple fields of financial activity. For example, trust banks legally are licensed ordinary commercial banks (*futsu ginko*). They possess the same corporate powers of ordinary banks and are statutorily augmented with trust power and permission to engage in the trust business concurrently with the regular banking business. The Ministry of Finance, however, has traditionally severed the trust business away from ordinary banking to function as a specialized form of long-term funding. At the same time, the Ministry of Finance has taken the position of not granting approval of trust business to other banking organizations, which strictly segregates this segment from other banking segments and other financial industries. Similarly, although there is no legal restriction on terms of deposits and loans for ordinary commercial banks, the Ministry of Finance has customarily limited the terms of deposits on a non-statutory basis in order to encourage commercial banks to focus on retail banking by taking short-term deposits and providing short-term credits. The activities of ordinary commercial banks have been even further divided on a non-statutory basis into city banks, regional banks, and second-tier

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83 “For historical reasons, prior to 1993, only three regular banks, Daiwa Bank Ltd., Okinawa Bank Ltd., and Ryukyu Bank, Ltd., were permitted to have limited trust power (excluding loan-trust).” Yagyu, *supra* note 44, at 304 n.3. Daiwa Bank has been able to engage in the trust business because it opposed the separation of the trust business from commercial banks in the late 1950s and was the only city bank to operate a trust business. See Kazunari Yokota, *Daiwa Bank Poised to Bolster Trust Business*, NIKKEI *WKLY.*, Mar. 2, 1998, at 10. Trust services traditionally have encompassed five areas: (i) ordinary banking service; (ii) long term loans to business corporations financed by funds collected from individuals by selling “loan trust accounts” (with a maturity of two to five years); (iii) asset management of corporate pension funds; (iv) investment advisory service; and (v) custodian business of securities investment trusts and tokin trust funds. See, e.g., Nakamura & Yamada, *supra* note 54, at 124.

84 See Yagyu, *supra* note 44, at 303.

85 The term “city bank” (*toshi ginko*) is used by the Ministry of Finance to describe large ordinary commercial banks operating on a nation-wide basis. The ten city banks locate most of their branches in the nation’s three economic centers (Tokyo, Nagoya, and Osaka) and provide short term credits to large corporations.

86 The term “regional bank” (*chiho ginko*) is used by the Ministry of Finance to describe relatively small ordinary commercial banks operating on a regional basis, each based in a particular prefectural capital (there are 47 prefectures). They provide loans to individuals and business corporations in their prefecture, underwrite municipal bonds issued by their local government,
regional banks (previously known as mutual banks) according to historical background, location, and customer base. The Ministry of Finance has been known to treat these institutions differently, even though they are legally all ordinary commercial banks (futsu ginko).88

As for the division between banking and securities, the Ministry of Finance has long sought to encourage compartmentalization of Japanese institutions abroad even though it lacked specific regulatory authority to regulate them until 1992.89 The Ministry of Finance projected in diluted form its concern for segregation of domestic financial institutions abroad by imposing regulations on foreign subsidiaries of Japanese financial institutions. Through the Three Bureau Administrative Guidance (so-called because it is jointly enforced by the Banking Bureau, the Securities Bureau, and the International Finance Bureau of the Ministry of Finance) of August 1975, the Ministry of Finance has given overseas subsidiaries of Japanese securities companies priority over

and handle the receipt and payment of local government funds. Usually, there is only one regional bank in each prefecture, but two or more exist where economic activity is diversified.

87 The Financial System Reform Law repealed the Sogo Ginko Ho [Mutual Loans and Savings Bank Law], Law No. 199 of 1951. Pursuant to the amendment of the Mutual Banking Law, mutual banks that had been catering exclusively to small and medium-sized enterprises were converted into ordinary banks called “second-tier regional banks.” Only these “sogo banks” were permitted to deal in mutual installment funds. They were otherwise permitted to engage in the same activities as ordinary banks, except that, with exceptions, they could only issue loans to, or receive mutual installment savings from, companies with three hundred or fewer employees or with capital of less than a stated amount. See Jones, supra note 49, at 394 n.48.

88 See Yagyu, supra note 44, at 307 n.11. The banking industry’s traditional specialization system has significantly changed during the last decade as the boundaries between realms of financial activity have blurred. The segmentation between the long and short-term fund intermediaries are vanishing due to innovations of financial technologies, such as interest rate swaps, gradual deregulation of deposit terms, and access to foreign money markets. For example, regular banks can issue long-term loans even at fixed interest rates by using interest rate swaps. All types of banking organizations have also been practically providing retail and small business banking services because large companies have been changing at least a part of their fund raising from bank loans to securities markets (e.g., debentures, commercial paper, etc.). See id. at 305.

89 The bureaus justified their policy by citing the spirit of Article 65 of the SEL which provides for the segregation of commercial banking and investment banking. See Osaki, supra note 30, at 253.
overseas securities subsidiaries of Japanese banks by acting as lead manager of a debt issue offered or placed by a Japanese firm on an overseas market when these two kinds of entities are in direct competition with each other.90

The Ministry of Finance’s regulation has been so pervasive that it has been characterized as a “convoy system” (goso sendan): The imagery is understood to denote a tightly organized group of financial institutions, each institution with its particular function, that moves at the speed of its slowest member in order to protect each institution and ensure that nobody sinks.91 The Ministry of Finance compartmentalized financial services into several groups according to the kinds of services that financial institutions provided, adopted a licensing system and required these institutions to engage exclusively in the areas of financial service specified in the license. The striking success of the Ministry of Finance’s compartmentalization is evident in the fact that the number of financial institutions in each segmented realm of finance has been almost constant throughout the postwar period.92 The only category in which there have been noteworthy fluctuations in the number of financial institutions is the securities industry up to the late 1960s. A telling testament to the strength of the Ministry of Finance’s licensing power is the fact that these fluctuations almost stopped entirely once licensing was adopted for the securities industry in 1968 in response to the securities market crisis of 1965.93

The convoy system is no longer what it once was. Its deterioration is illustrated by the decompartmentalization reforms discussed in Section 3 and by the recent bankruptcies of major Japanese financial institutions. Yet, there remains a strong mothering urge on the part of Ministry of Finance regulators.

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90 The 1992 Financial System Reform Law, which established that bank securities subsidiaries are allowed to compete in each other’s businesses with some restrictions, led to the planned phase-out by March 1998 of the decades-old Three Bureau Administrative Guidance. With the allowance of reciprocal entry into one another’s domestic markets, such regulation no longer made sense as it merely restricted banks from underwriting bond issues on overseas markets (which it could now do for domestic markets).

91 For a good description of the history of the goso sendan, see Yoshino Naoyuki, Kin’yu Biggu Ban no Haikei to Tenbo, 1119 JURISUTO, Sept. 15, 1997, at 3.

92 See app., tbl. 2.

93 See Endo, supra note 31, at 9, tbl. 1.2; apps., tbl. 2.
Perhaps the most interesting display of this tendency was the Ministry of Finance's action to force acceptance of public funds. The Ministry of Finance wanted the strongest banks to apply first but strong banks did not want the stigma of applying first; the very Japanese solution to this difficulty was for Japan's twenty-one largest banks to apply for identical sums of public cash in March 1998, despite differing needs for funding among these twenty-one banks.94

3.2. Less Encumbered But Not Free: The 1992 Financial System Reform Act

As the need for promoting greater integration became more evident, the use of a separate legal entity such as a subsidiary or holding company began to be debated as a means of promoting greater integration that would mesh with the statutory suprastructure of compartmentalization and the Ministry of Finance's regulatory penchant for segmentation. Until recently, however, holding companies were prohibited and holdings by financial institutions were limited to 5% without special approval from the Japanese Fair Trade Commission, and as a result of this legal environment, limited capital affiliations, augmented by linkages such as personnel exchanges, developed between some firms.95 Yet, even these limited capital affiliations were regulated if the company in which shares were held was deemed an affiliate. Under administrative rules, a bank affiliate was defined as "a company to which a bank has made and/or has maintained capital contributions and which has close relationships to such bank, by virtue of circumstances of its establishment, financial and personnel relationships, etc."96 Such regulation drew its legal authority from the Bank Law's prohibition against banks engaging in activities other than the banking business, defined as the core banking business, incidental banking business, and other banking business.97 It had been thought that even indirectly engaging in these activities through an affiliate was.

94 See Bang, Pop or Splutter?, supra note 3, at 31.
96 See Yagyu, supra note 44, at 365.
97 See Bank Law art. 1, amended by Financial System Reform Law.
impermissible.98

The Financial System Reform Law somewhat loosened a number of restrictions on the activities of financial institutions. In amending the existing statutes, including the laws governing most types of financial institutions, it took an important step toward de-compartmentalizing the Japanese financial world. The Law expanded the product areas in which different types of financial institutions were allowed to compete so that banks, for example, are now allowed to engage in, inter alia, greater securities-related activities.99 As for the securities industry, the Financial System Reform Law expanded slightly and clarified the definition of "security"100 while at the same time permitting banks to act as intermediaries for some of the instruments that were newly designated as securities.101

When the Japanese government authorized certain financial

98 Accordingly, certain activities are deemed completely unrelated to banking. These include real estate retail business, travel agency business, product sales, hotel business, warehouse business, marine courier business, and mining business. See Yagyu, supra note 44, citing Kin’yu kikan to sono kanrengaisha to no kankei ni tsuite (regarding Relationships Between Financial Institutions and their Affiliates), Okurasho Ginko Kyoku [Ministry of Finance Bank Bureau], No. 1968 (July 3, 1975), as amended.

99 For example, the Financial System Reform Law amends the Bank Law to permit all types of banks to participate in the private placement of securities in the secondary market. SEL art. 10(2)(vi), amended by Financial System Reform Law. Other types of financial institutions are also granted the same permission. E.g., Labor Bank Law art. 58(2)(xii), amended by Financial System Reform Law; Credit Association Law art. 53(3)(vi), amended by Financial System Reform Law; Law for Small Business Cooperatives art. 9-8(2)(xi), amended by Financial System Reform Law; Agricultural Cooperative Law art. 10(6)(vii), amended by Financial System Reform Law; Norin Chukin Bank Law art. 13(1)(ix-ii), Law No. 42 of 1923, amended by Financial System Reform Law; Shoko Kumiai Chuo Kinko Ho Shoko Chukin Bank Law art. 28(1)(xii), Law No. 14 of 1936, amended by Financial System Reform Law; Long-Term Credit Bank Law, Law No. 187 of 1952, art. 17. The financial system reform law also expands the definition of a bank's primary activities from "acceptance of term deposits" to "acceptance of term deposits, etc." Bank Law art. 10(1)(i), amended by Financial System Reform Law.

100 The SEL clarifies that private placements are "securities activities" for legal purposes, but that banks may, with the Ministry of Finance's permission, participate in private placements. SEL art. 2(8)(vi), amended by Financial System Reform Law. The definition of "security" is also expanded to a few specific instruments such as commercial paper and lists a number of instruments that may be designated as securities by administrative order some time in the future. Id. arts. 2(1), (2).

101 See id. arts. 65, 65(2).
institutions to create subsidiaries to enter new and diverse fields of financial activity, it took an important initial step toward the combination of financial institutions and the integration of formerly autonomous areas of financial activity. With approval from the Ministry of Finance, banks are now allowed to establish, acquire, and retain domestic securities and domestic trust banking subsidiaries provided that the parent bank owns at least 50% of the outstanding voting shares of the subsidiary. In addition, the SEL was revised to specifically state that the prohibition against a bank conducting securities activities does not bar a bank's acquisition of a securities firm. Securities companies, in turn, are permitted to establish trust and banking subsidiaries of their own. Other kinds of banking organizations which are failing, or have failed, can also be acquired, including deposit institutions such as long term credit banks and foreign exchange banks.

While the allowance of subsidiaries is a step toward the integration of different fields of finance, it is a limited one. The Financial System Reform Law, and the regulations implementing it, are riddled with “for the time being” exceptions, limiting the scope of activities of mutual entry subsidiaries. The law conditions the licensing of bank securities subsidiaries upon their refraining from engaging in securities brokering and from issuing, distributing, or brokering most forms of equity securities; this prohibition includes convertible bonds, warrant bonds, warrant securities, stocks, stock index futures, and stock index options. The regulations also establish a large number of firewalls, including restrictions on personnel exchanges between parent and

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102 See Bank Law art. 16-2(1), amended by Financial System Reform Law.
103 See SEL art. 65-3, amended by Financial System Reform Law.
104 See id. art. 43(2). The Financial System Reform Law also permits smaller institutions, which are generally too small to establish full subsidiaries, to engage in certain trust and securities-related activities by themselves. See, e.g., Agricultural Cooperative Law arts. 10(7), (8), amended by Financial System Reform Law.
105 See Yagyu, supra note 44, at 364 (citing Bank Law Administrative Ordinance art. 17-2(i)(ii)).
107 See Jones, supra note 49, at n.289 (discussing the limitations enforced on securities subsidiaries of banks).
subsidiary, dealings with common clients, transactions between parent and subsidiary, and the shared use of facilities. The Ministry of Finance was also effectively allocated power to expand or contract the law’s reach essentially at will. Prohibitions against transactions with subsidiaries or customers can be waived by the Ministry of Finance if necessary for the public interest. Alternatively, the Ministry of Finance has the power to designate transactions or activities between a parent bank and its subsidiary or the subsidiary’s customer as potentially hindering the parent bank’s sound and proper operations. The Ministry of Finance has discretion to designate by ordinance which types of securities companies, trust banks, or other banks can be acquired. The law also adds a provision requiring a bank to acquire authorization from the Ministry of Finance when it tries to establish a securities or trust subsidiary in a foreign country.

While regulations limit the scope of activities afforded to financial institutions, these institutions have moved quickly to take advantage of the new freedoms allotted to them. Pursuant to the Ministry of Finance timeline, long-term credit banks, trust banks, and central cooperatives are permitted to establish securities subsidiaries first. Accordingly, the Industrial Bank of Japan, the Long-term Credit Bank of Japan, and the Central Cooperative Bank for Agriculture and Forestry (Norinchukin Bank) opened securities subsidiaries in July 1993, and trust banks began establishing securities subsidiaries in late 1993. City banks were not able to set up securities subsidiaries until the

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108 Financial System Reform, supra note 106, at 107-08.
109 See SEL art.16-3, amended by Financial System Reform Law.
110 See id. arts. 10, 16(2)(3).
111 See Bank Law art. 16-2(3), amended by Financial System Reform Law.
112 See id. art. 16-4.
113 See Financial System Reform, supra note 106, at 109.
summer of 1994. Authorization for trust bank subsidiaries started later, in April 1994, with the authorization of federations of cooperative financial institutions and long-term credit banks. Securities firms and commercial banks were able to set up trust bank subsidiaries starting in October 1995. The impact has been to give everyone a foothold in each other's business. In some areas, financial institutions have already done a great deal with this small foothold. Bank securities companies, for example, have already won the lead management position in underwriting corporate straight bond issues and have boosted their share in the underwriting business from 6% in 1994 to 37.2% in 1996.

Although the acquisition and ownership of shares in a subsidiary engaged in merger and acquisition activity is permitted, the web of restrictions imposed on the activities of a subsidiary precludes acquisitions in practicality; the Ministry of Finance has, however, granted exceptions to this in rescue acquisition contexts such as those for Cosmo Securities and Nippon Trust Bank. Barring mergers or acquisitions of firms facing imminent bankruptcy, merger and acquisition activity is reserved for entry into new fields through the vehicle of a totally new subsidiary with a limited scope of business. One commentator has noted that, "instead of lowering walls between different segments, the Ministry of Finance has created whole new categories, albeit temporary, of mutant trust banks and emasculated securities companies, each subject to their own new rules."


116 See Courtis, supra note 7, at 17.

117 The Ministry of Finance has suggested that it would allow participation in the full range of securities activities for an acquired subsidiary, as opposed to newly established subsidiary, in order to enlist the aid of banks in bailing out Japan's many troubled smaller securities firms. See Bankers' Embrace, ECONOMIST, Nov. 28, 1992, at 88.

119 Jones, supra note 49, at 439.
3.3. Other Financial Subsidiaries

It is also noteworthy that the Financial System Reform Law did not reform the Insurance Business Law and did not explicitly state that banks could set up or purchase existing non-trust banks as subsidiaries; in 1996, a new Insurance Industry Law finally came into effect which permits life-insurers and non-life-insurers to enter each others' businesses through subsidiaries. The law merely began decompartmentalization within the insurance field, but did not provide for any integration with banking or securities. In June 1997, however, the three financial reform councils (banking, securities, and insurance) recommended further promoting mutual entry among banking, securities, and insurance. Toward this end, the Ministry of Finance scheduled to eliminate business restrictions on bank securities trust subsidiaries as well as security company trust subsidiaries in October 1999 and also allowed banks and securities companies to establish insurance subsidiaries by 2001.

As for bank control of other depository institutions, the law only explicitly authorizes banks to control trust banks or failed banks as subsidiaries. Accordingly, the Ministry of Finance stated its intention to submit a bill to revise the Bank Law and implement it as early as fall 1998; the proposed revision would explicitly allow all types of banks, including long-term credit banks and trust banks, to control other banks as subsidiaries. In light of the removal of the holding company ban, discussed infra Section 5, such regulation makes sense since one can create a number of banks under a single financial holding company. Such a revision would allow, for example, an urban bank to buy a regional bank to deal only in small loans, allowing the parent to concentrate on more risky businesses, like large-scale transactions, international banking, and money-market trading; in addition, the parent bank could also hold more than one regional bank as a

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120 Hokengyo Ho [Insurance Business Law], Law No. 105 of 1996.
122 See apps., tbl. 1.
123 The law in its current form, however, does not explicitly forbid bank ownership of another bank.
subsidiary, allowing it to possess a network of regional banks covering a specific geographic area.\textsuperscript{125}


While the gradual phasing in of mutual entry subsidiaries started the decompartmentalization of Japanese finance, the Big Bang's re-engineering of the legal environment for corporate combinations of financial institutions in 1997 and 1998 provides much greater liberalization of corporate combinations among financial institutions. The Japanese government enacted a revised Antimonopoly Law on June 2, 1997 and on December 17, 1997 removed the ban on non-financial holding companies; however, the government left the date of the lift for financial holding companies open to be established by another law because it desired to enact a finance-related businesses law to protect investors first.\textsuperscript{126}

Finally, on December 12, 1997, the 141st session of the Japanese Diet promulgated two laws eliminating the restrictions on financial holding companies based on the conclusions of the financial reform councils and they were as follows: (i) the Finance Related Law Concerning Maintenance of Finance Related Laws Accompanying the Removal of the Ban on the Establishment of Holding Companies\textsuperscript{127} and (ii) the Law Concerning the Special Case for Merger Procedures for Banks.\textsuperscript{128}

The Law for the Maintenance of Bank Holding Companies amended the Bank Law and the revised Article 52(2) of the Bank Law defines a bank holding company as a holding company which has been pre-authorized by the Ministry of Finance to take

\textsuperscript{125} See id.

\textsuperscript{126} With respect to the revision of the antimonopoly law, the ruling party's Antimonopoly Consultative Committee debated the issue that culminated in the "Three Party Agreement Concerning the Amendment of the Antimonopoly Law" (Dokusen Kaisei ni Kansuru San-To Goi). See Kawashima Makoto, Ginko Mochikabu Gaisha ni Kanren Ho ni Tsuite, 1129 JURISTO 64, 64 (1998).

\textsuperscript{127} Mochikabu Gaisha no Setsuritsu to no Kinshi no Kaijo to ni tomonau Kin'yu Kankei Horitsu no Seibi to ni Kansuru Horitsu, Law No. 120 of 1997 [hereinafter Financial Holding Company Law].

\textsuperscript{128} Ginko Mochikabu Gaisha no Sosetsu no tame no Ginko to ni kakaru Gappei Tetsuzuki no Tokurei to ni Kansuru Horitsu, Law No. 121 of 1997.
a bank as a subsidiary.\textsuperscript{129} Bank holding companies are charged with supervising subsidiary bank management and related business to maintain their soundness; this involves restricting the scope of bank activities, avoiding excessively risky activities, ensuring efficient performance of banks business, and the prevention of unscrupulous trading.\textsuperscript{130}

Just as regulations limit the relationships between banks and securities or trust bank subsidiaries, similar regulations, such as arm’s length transactions, restrict holding companies.\textsuperscript{131} For example, a managing director of a bank holding company cannot become a managing director of another company concurrently without specific authorization obtained from the Ministry of Finance.\textsuperscript{132}

The law places certain restrictions on the scope of a bank holding company’s business. Specifically, a holding company may hold as subsidiaries banks (including trust banks), long-term credit banks, foreign exchange banks, securities companies, and foreign subsidiaries engaging in banking or securities.\textsuperscript{133} In addition, with designation by Ministry of Finance ordinance, institutions “subordinate to, supplementary to, or related to banking or securities” may also become subsidiaries of a holding company.\textsuperscript{134} These include companies relating to bank accounting, companies that supervise real estate for bank use, credit card companies, leasing companies, investment advisory companies, and companies that cultivate new business fields with the approval of a ministerial ordinance (\textit{i.e.}, venture capital companies).\textsuperscript{135}

The law limits the bank holding company group’s collective acquisition of shares of companies in unapproved fields (\textit{i.e.}, those fields that are not subordinate to, supplemental to, or related to banking or securities). The bank holding company cannot acquire or hold in excess of 15% of the total number of outstanding shares, or the equivalent, of such a non-approved

\textsuperscript{129} Bank Law arts. 52(3), 52(4), \textit{amended by} Financial Holding Company Law.

\textsuperscript{130} See \textit{id.} art. 52(6).

\textsuperscript{131} See \textit{id.} art. 13-2.

\textsuperscript{132} See \textit{id.} art. 52(5).

\textsuperscript{133} See \textit{id.} art. 52(7).

\textsuperscript{134} See \textit{id.}

\textsuperscript{135} See Makoto, \textit{supra} note 126, at 66.
company (a so-called “general enterprise company”). To prevent the 15% rule from becoming a barrier to the establishment of bank holding companies, a bank holding company exceeding this limit will still be approved, conditioned upon disposal of the amount of shares exceeding the limit within a five year period from the day the bank holding company is formed. In no case, however, may the shares in a general enterprise company exceed 50% of the outstanding shares of the general enterprise company.

Beyond the Ministry of Finance’s ability to implement arm’s length rules and designate fields “subordinate to, supplemental to, or related to banking and securities,” it can regulate capital adequacy ratios for the holding group. The Ministry of Finance requires disclosure of regular annual and mid-year business reports on the assets and business of the bank holding company group and among others, and also has the power to require additional reports and materials and to conduct inspections. If the bank holding company violates an ordinance or commits an act harmful to the public welfare, the Minister of Finance has the power to dispose of the bank holding company. This means that if the bank holding company substantially violates its articles of association, violates an ordinance (horei), or commits an act harmful to the public welfare, the Minister of Finance can order the suspension of all or part of the activities of a subsidiary of the bank holding company.

The Deposit Insurance Law was revised to allow bank holding companies to apply to the deposit insurance fund (yokin hoken kiko). No special provisions of the Bank Holding Company Law apply to securities companies since the necessary regulation of proper trading acts related to securities trading intermediaries is thought to be accomplished within the existing regulatory framework.

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136 Bank Law art. 52(8), amended by Financial Holding Company Law.
137 See id. art. 52(8).
138 See id.
139 See id. art. 52(9).
140 See id. arts. 52(2), 52(12), 52(13).
141 See id. art. 52(15).
142 See id. art. 52(18).
143 See id. art. 52(12).
144 Yokin Hoken Ho [Deposit Insurance Law], Law No. 136 of 1957, arts. 2, 55-61.
framework for securities companies.\footnote{SEL arts. 55, 65(2), amended by Financial System Reform Law. See Makoto, supra note 126, at 69.}

Insurance companies, however, are treated somewhat differently. In order to protect insurance policy holders, holding companies making subsidiaries of insurance companies require special approval\footnote{See Insurance Business Law art. 271-3, as amended.} and face restrictions on their scope of business.\footnote{See id. art. 271-5.} Like bank holding companies, insurance companies must make holding company and subsidiary reports, submit to on-site investigations, and subject themselves to other measures similar to bank holding companies.\footnote{See id. art. 271(1)-(2).} Additionally, a special prohibition on subsidiary insurance companies explicitly prohibits these companies from executing contracts deemed excessively advantageous.\footnote{See id. art. 301.} The collective 15% restriction, however, does not apply to the shareholding of subsidiaries by insurance holding companies.

The Special Law for the Establishment of Bank Holding Companies amends the Japanese Commercial Code to provide for a triangular merger (sankaku gappei) of bank holding companies; however, this system poses difficulties because it requires approvals for the transfer of assets and obligations among a numerous and diverse group of claimholders.\footnote{See Makoto, supra note 126, at 69.} In a bank holding company triangular merger, an existing bank, or other financial entity, establishes a holding company-to-be. The contemplated holding company then establishes a new bank. The original bank and the new bank then merge, and the new bank subsidiary becomes the surviving entity. As a condition of the merger, the original bank shareholders approve the merger and get shares in the new bank subsidiary. The stockholders of the old subsidiary then give the shares to the new bank holding company in return for newly issued shares in the bank holding company.

While the basic legal infrastructure for creating holding companies has been established, unsettled tax issues\footnote{Tax problems with holding companies will be discussed briefly. See Hori Yutaka, Ginko Mochikabu Gaisha no Sosetsu no tame no Gappei Tetsuzuki Tokurei Ho ni yoru Gappei Hoshiki Kento, 1477 SHOJI HOMU, Dec. 15, 1997, at 27-32.} and the
nature and timeline of regulations implementing the laws will
determine the future viability of holding companies in Japan.
The Big Bang promises to further modify these boundaries by
extending the permissible range of activities of specific financial
institutions and their affiliates and by freeing financial institutions
to enter into other business areas through holding companies.

4. ANTITRUST LAW

The financial laws and their implementation by the Ministry
of Finance have typically served as a first and generally fatal
barrier to most corporate combination aspirations by financial
institutions. Even those aspirants that successfully navigate the
regulatory maze to secure Ministry of Finance blessing must still
overcome the final legal hurdle of Japanese antitrust law.

4.1. Overview of Japanese Antimonopoly Law

The basic form of Japanese antitrust law grew out of the
postwar efforts of the Allied Occupation to prevent the re-
emergence of the prewar zaibatsu. The zaibatsu were powerful
family-based groups that wielded massive control of the prewar
economy through conglomerations of financial institutions and
businesses linked through a web of holding companies and
interlocking directorates. Preventing the re-emergence of the
zaibatsu was a cornerstone of allied efforts to democratize Japan,
because the zaibatsu were regarded as collaborators with the
Japanese militarists and as engines behind the Japanese war
machine. Following the war, allied forces appointed the Supreme Commander of
Allied Powers ("SCAP"), which undertook a number of measures aimed at
breaking the power of the prewar financiers. These included suspension of
activities of all institutions unless permission was explicitly granted by SCAP,
the purging from office of senior executives, prohibitions on the sale and
transfer of securities of fifteen zaibatsu firms, the liquidation of zaibatsu
holding companies and many holding company subsidiaries, and prohibitions
on the use of zaibatsu names. See NORIO TAMAKI, JAPANESE BANKING: A

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153 Shiteki Dokusen no Kinshi oyobi Kosei Torihiki no Kakuho ni
Kansuru Horitsu [Law Concerning Prohibition of Private Monopolization and
Maintenance of Fair Trade], Law No. 54 of 1947, as amended [hereinafter
Antimonopoly Law]. An English translation is available at the homepage of

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Antimonopoly Law still constitutes the core of Japanese antitrust law. The original law even went so far as to ban, *inter alia*, mergers, unless special permission was obtained. In 1949 and 1953 major amendments to the merger control provisions substantially relaxed the restrictions on mergers. Only recently in 1997 and 1998, however, have amendments relaxed a total ban on holding companies and severe limitations on shareholding by financial institutions.

The ban on holding companies and the limitations on shareholding by financial institutions have particularly compounded the difficulties of structuring successful mergers among financial institutions. Different types of financial business, at the very least, had to be segregated into different legal entities, given the strict separation mandated by the financial laws and their regulatory implementation. As discussed in Section 3, for example, a bank could not merge directly into a securities company because of the Article 65 restriction of the SEL. At the very least, either a holding company or subsidiary would be needed to maintain the necessary legal separation. Holding companies would have made mergers more convenient by allowing the holding company to create a new subsidiary to merge with or to acquire a new entity in a different field of business. All financial holding companies, however, were expressly forbidden by Article 9 of the Antimonopoly Law until 1998, when the 1997 revision went into effect.

An alternative solution for meeting separation requirements mandated by the Antimonopoly Law is through the use of a separate legal entity. However, the Antimonopoly Law also forbids this by limiting the stockholding of financial institutions: Stock ownership by a financial institution has been limited to 5%
unless special permission is granted. In practice, with the exception of a couple of rescue mergers of distressed financial institutions such as the acquisition of Cosmo Securities by Daiwa Bank and the acquisition of Nippon Trust by Mitsubishi Bank, special permission has not been granted to facilitate mergers and acquisitions of firms engaged in traditionally segregated fields of financial business. As a consequence, the only theoretically possible means of structuring mergers that satisfies financial segregation requirements and antitrust law is limited to similar financial institutions merging into the same legal entity. In fact, in the postwar period, the only mergers of financial institutions of any consequence are a few instances of banks merging with other banks, and more recently, of banks acquiring bankrupt affiliates as subsidiaries.

Financial institutions that have structured successfully around Antimonopoly Law difficulties still have faced traditional antitrust-law analysis as to the competitive impact of the proposed merger or acquisition. In this regard, Japanese antitrust law has not proved, at least on its surface, a difficult hurdle for mergers and acquisitions in the past. Such a conclusion, however, must be carefully qualified. First, precisely because the financial company laws and their implementation by the Ministry of Finance have served as such a powerful barrier to almost any merger and acquisition activity by financial institutions, there has been extremely little development in this body of Japanese antitrust law. Second, the Antimonopoly Law and the restriction on stockholding by financial institutions have made the occurrence of any merger and acquisition activity among financial institutions extremely difficult, thus obviating the need for antitrust review. Third, the dearth of formal decisions or actions in this area does not address merger and acquisition activity that has been stopped informally or through self-restraint in anticipation of the expected reaction of the Japanese Fair Trade Commission ("JFTC") authorities.

158 See id. art. 11.
160 See infra Section 4.5.
161 Indeed, industry criticism of the JFTC suggests that self-restraint may deter some merger and acquisition activity. See infra Sections 4.2, 4.3.
Recent legal changes, however, make more stringent merger review a greater likelihood in the future. First, the Big Bang reform of the financial business laws expands the range of permissible merger and acquisition activities for financial institutions. This will be particularly significant once the remaining restrictions on financial business activities of mutual-entry subsidiaries are eliminated. Second, the Antimonopoly Law has been revised to revoke the outright ban on financial holding companies under certain conditions and to remove the shareholding limitation for the purpose of forming financial holding companies. The removal of these barriers should permit more combination activity to make it through these preliminary filters and will require that the JFTC undertake more evaluations. Accordingly, the JFTC at some point may heighten its profile as the final gatekeeper for competitive markets. The following section discusses the amended Antimonopoly Law, new JFTC guidelines to implement the law, and guidelines offered by past JFTC decisions in order to elucidate the likely role of the JFTC in determining the new apparent boundaries of corporate combination among financial institutions in Japan.

4.2. Overview of the Merger Review Process

The JFTC, an extra-ministerial body of the Prime Minister's Office, was established as the administrative body to implement the Antimonopoly Law. It acts as a completely independent organ that boasts both quasi-legislative and quasi-judicial powers. The JFTC's enforcement powers are subject only to

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163 See supra note 126 and accompanying text.

164 The JFTC consists of a chairman and four commissioners. The prime minister, with the consent of both Houses of the Diet, appoints the chairman and commissioners for five-year terms. See Antimonopoly Law arts. 29-30. Appointees must be aged thirty-five years or more and be experts in either law or economics. See id. art. 29.

165 For example, it can establish the procedure for handling cases as a quasi-legislative power, and can issue a decision after a hearing as a quasi-judicial power. See Structure and Role of the Fair Trade Commission (visited Oct. 8, 1998) <http://www.jftc.admix.go.jp/e-page/ftc.htm>. See also INTERNATIONAL AFFAIRS DIVISION, FAIR TRADE COMMISSION, HOW THE JAPAN FAIR TRADE COMMISSION ENSURES A ROBUST ECONOMY 6 (April 1998).
judicial review by the Tokyo High Court. The Mergers and Acquisitions Division of the Economic Affairs Bureau, one of its four divisions, regulates corporate combinations—shareholdings, interlocking directorates, and mergers.

Except for particular exceptions set to take effect January 1, 1999, the JTFC must be notified of all mergers or transfers of the substantial part of a business. Although the formal merger review process begins with the filing of a merger notification, as required of all proposed mergers and acquisitions by Articles 15(2) and 16 of the Antimonopoly Law, it is normal practice for the parties to the proposed merger to informally consult in advance with JFTC authorities if they are concerned about the possible application of any aspect of the Antimonopoly Law. The JFTC then examines the case to see if it possibly involves a violation of the Antimonopoly Law. If the JFTC indicates any problems at this consultation stage, the parties to the intended merger either abandon their merger plan or modify it in order to avoid an infringement of the Antimonopoly Law. While such a procedure protects the privacy of the parties contemplating merger, it creates a lack of transparency as to the standards being formulated by the JFTC to judge merger and acquisition activity.

The formal procedure mirrors the informal one. A merger notification is filed with, and examined by the JFTC. There is a thirty day waiting period after notification is given before the proposed merger or acquisition may take place. The JFTC may shorten or extend the required waiting period, but any extension must not exceed sixty days and requires the consent of the parties.

166 See Antimonopoly Law arts. 85-87.
167 The Economic Affairs Bureau (composed of four divisions and one department which includes three divisions), a Secretariat (composed of three divisions), and an Investigation Bureau (composed of four divisions and one department which includes two divisions) along with five Hearing Examiners (who hold hearing procedures commissioned by the JFTC) form the General Secretariat, which is in turn attached to the JFTC.
168 See Antimonopoly Law arts. 15-16. As of January 1, 1999, only mergers which involve one party whose total asset value exceeds 10 billion yen and another party whose total asset value exceeds one billion yen will need to be reported. Mergers between affiliated companies (such as a parent and subsidiary) where the shareholding of outstanding shares exceeds 50% will also be excepted. Almost identical provisions will apply to transfers of assets. See id.
169 See id.
170 See Antimonopoly Law art. 15(3).
If the JFTC finds that a planned merger or acquisition is likely to substantially restrict competition, the JFTC is empowered to prohibit it. This is just a formality, however, as any problems have almost always already been dealt with informally. Since its enactment, there have been only about twenty cases arising from violations of the provisions in Chapter IV (which deals with combination-related activity) of the Antimonopoly Law. Prior to 1991, the last formal case to be decided was in 1973. The 1991 case has been the only formal case since the JFTC published administrative procedure standards for examining mergers and shareholdings by companies.

4.3. Revision of the Article 9 Ban on Holding Companies

The Law for Partial Amendment of the Law Concerning Prohibitions of Private Monopolization and Maintenance of Fair Trade ("Antimonopoly Act") was promulgated on June 18, 1997 to pave the way for holding companies. Article 9, as amended, removed the general ban on holding companies and only prohibited holding companies which "constitute an excessive..."
concentration of economic power.” In response to pressures from the business world for a more objective standard, the definition of holding company was changed from a “company whose main business is to hold the shares of another company in order to control another company” to “a company whose holdings in a subsidiary exceed 50% [including indirectly] of the assets of the company.” JFTC Article 9 guidelines further define “the holding company group” as consisting of a holding company, its subsidiaries (companies in which greater than 50% of the stock is directly or indirectly owned by the holding company), and subsidiaries substantially controlled by the holding company. A subsidiary substantially controlled by a holding company is in turn defined as a company in which the holding company owns greater than 25% of its stock, including indirect ownership, and in which the holding company is a major stock holder of the subsidiary.

The holding group company is considered when determining whether a holding company constitutes an excessive concentration of economic power. Article 9(5) articulates the concern that:

If the holding company’s general scale of activities is substantially large and extends into numerous fields such that the holding company is able to extend substantial influence over the supply of funds to other enterprises, or if the holding company group occupies influential positions in a number of related fields of enterprise, the holding company will wield a large influence over the

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176 Revised Antimonopoly Law (amending Article 9(1)-(2) of the Antimonopoly Law).

177 Shiteki Dokusen no Kinshi oyobi Kosei Torihiki no Kakuho ni Kansuru Horitsu [Law Concerning Prohibition of Private Monopolization and Maintenance of Fair Trade], Law No. 54 of 1947, as amended [hereinafter Antimonopoly Law], art. 9(3), before amended by Revised Antimonopoly Law.


179 Kosei Torihiki Linkai, Jigyo Shihai ryoku ga Kado ni Shuchu suru koto to naru Mochikabu Gaisha no Kangae kata [Thoughts on Enterprise Power that Constitutes a Holding Company with Excess Market Concentration], December 8, 1997, at 1(ii) [hereinafter linkai].

180 See id. at 1(i)(b).
national economy and become a barrier to the promotion of fair and free trade.\textsuperscript{181}

Toward this end, Articles 9(6) and 9(7) require contemplated holding company groups whose combined total assets exceed 300 million yen to notify the JFTC before the establishment of a holding company and to submit business reports for all the concerned companies in the group at the end of each business year.\textsuperscript{182}

Article 9 guidelines illustrate the factors used to determine whether a holding company has an excessive concentration of economic power, thus barring its establishment as a holding company.\textsuperscript{183} The guidelines define three types of companies that constitute holding companies with excessive concentration of economic power, and provide four specific exemptions to the label.\textsuperscript{184} The exemptions are considered first, as they obviate any need to consider the three types if the conditions are fulfilled. First, an operational division reorganization is exempted when subsidiaries of a holding company are established solely through the process of splitting off respective operational divisions of a company.\textsuperscript{185} Second, a venture capital company exemption allows venture capital businesses to operate as holding companies.\textsuperscript{186} Third, a de minimis exception provides exemption from the excessive market concentration characterization when the total assets of a holding company group does not exceed 300 billion yen.\textsuperscript{187} The new financial business exemption is most relevant to financial institutions because it allows a financial company to enter financial business fields different from its own field through the establishment of a subsidiary.\textsuperscript{188} This exemption provides a means for the expansion of a financial group's activities, allowing financial institutions to take advantage of the liberalization created by the Big Bang financial reforms.

\textsuperscript{181} Revised Antimonopoly Law art. 9(5).
\textsuperscript{182} See id. arts. 9(6)-(7).
\textsuperscript{183} See id. art. 9.
\textsuperscript{184} See id.
\textsuperscript{185} See id. at 2(v)(a).
\textsuperscript{186} See id. at 2(v)(b).
\textsuperscript{187} See id. at 2(v)(d).
\textsuperscript{188} See id. at 2(v)(c).
With respect to mergers and acquisitions, this new financial business exception would not appear to exempt a financial institution from possible application of the "excess market concentration" doctrine where there is an overlap in the functions of the merging entities, i.e., where the business is not new. This might be the case for depository institutions or possibly even for the newly formed securities subsidiaries of Japanese banks. Accordingly, a holding company that involves the combination of two related businesses or does not fall into one of the other above exceptions may need to consider whether it falls within the following three types of holding companies that constitute an excessive concentration of economic power.

Type 1 is a mammoth diversified conglomerate prohibition. It is defined as a holding company whose group has total assets exceeding approximately fifteen trillion yen, and which owns at least five companies in separate principal fields of business (those among the three-digit classifications of the Japan Standard Industrial Classification in which shipment volume exceeds 600 billion yen) whose total assets exceed 300 billion yen each. The Type 1 category is not likely to apply to financial holding companies due to restrictions on shareholding by financial holding companies of general enterprise companies, and because Type 2 holding companies address financial holding companies specifically.

Type 2 is designed to keep financial institutions from mixing with regular businesses, a legacy of the prewar zaibatsu groups that linked powerful financial institutions with major businesses in order to dominate the economy. A Type 2 holding company is defined as one that owns a financial company with total assets exceeding 15 trillion yen, or that is composed of companies not engaged in financial business or in a line of closely-related business thereto whose total assets exceed 300 billion yen each. A business engaged in "financial business or closely related thereto" includes the credit guarantee business, the venture capital business, the leasing business, the investment advisory business, etc. Accordingly, this category is not meant to prohibit powerful financial conglomerates, but rather to prevent powerful

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189 See id. at 2(ii).
190 See id. at 2(iii).
191 Id. at supp. tbl. 3.
financial institutions from linking with regular business.

Type 3 is similar to a Type 1 in that it covers large conglomerates, but it lowers the thresholds where the subsidiaries enjoy substantial positions in fields of trade that are separate but closely related. A Type 3 company is one that owns at least five companies (or even three companies if the degree of influence which the companies possess, and the industries themselves, are vast in scale) in separate business fields (from the 3-digit classifications of the Japan Standard Industrial Classification, business fields in which shipment volume exceeds 600 billion yen), each of which possess a substantial position in the respective business field (commands a market share of not less than ten percent, or is among the top three companies in its respective field, the said fields of business being inter-related). Inter-relatedness refers to a situation in which there are trade relations among different fields of business, and goods or services from different fields of business are complementary to or substitutes for one another. Banking, securities, life insurance and non-life insurance are regarded as inter-related complements or substitutes under the guidelines.

If the merging entities cannot structure a holding company within the Article 9 guidelines, they can shed companies or assets that allow them to fit within these contours, forego the merger altogether, try to structure a merger without the use of a holding company (i.e., use subsidiaries), or challenge the JFTC guidelines.

4.4. Stockholding Limitations for Financial Institutions

In merging or acquiring another financial institution, a financial institution will have to overcome the Article 11 limitations on stockholding by financial institutions. As in the United States, the Japanese are suspicious of the banks' power to control business, a legacy of the prewar days of large zaibatsu. The Japanese approach, however, differs somewhat from the United States. Japanese financial institutions have been able to hold up to 5% of the outstanding stock in any particular company but bank holding companies have been prohibited from

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192 See id. at 2(iv).
193 See id. at supp. tbl. 4.
194 See Antimonopoly Law art. 11.
Even with these limitations, the power of banks in the Japanese economy has been particularly strong due to the under-development of the capital market for corporate fund-raising. Indeed, major banks have used their control of access to capital and this small percentage of shareholding to establish a web of cross-shareholding (mochiai) and to create bank-centered keiretsu groups that, in some ways, approximate weak versions of mammoth diversified conglomerates.\textsuperscript{196}

Of course, a strict enforcement of the Article 11 shareholding limitation for financial companies would severely limit the business activities of financial institutions, preclude the establishment of subsidiaries or holding companies for financial companies, and prevent mergers or acquisitions of financial institutions. Accordingly, even before amended, the Antimonopoly Law provided limited exceptions for specific purposes such as the acquisition or holding of stock as the result of the enforcement of a lien, pledge, or mortgage, or of payment in kind; the acquisition or holding of stock by a company engaging in securities dealing in the course of its business; and the acquisition of holding of stock in the form of trust property of a pecuniary or securities trust under certain conditions.\textsuperscript{197}

Additionally, the Antimonopoly Law granted the JFTC the discretion to approve exceptions to this limitation if authorization was obtained in advance.\textsuperscript{198}

The JFTC's prior views on authorization, as made public with its June 1994 Article 11 Guidelines,\textsuperscript{199} made it clear that approval would be granted for expanding operations internally, rather than by the merger or acquisition of existing companies. The JFTC stated that it would grant authorization in three cases: (1) for the establishment of a subsidiary that is engaged in business subordinate to the essential business of the applicant company; (2) for the establishment of a subsidiary in a business activity

\textsuperscript{195} See supra note 126 and accompanying text.
\textsuperscript{196} See generally TAMAKI, supra note 152 (explaining the keiretsu and zaibatsu groups); Gilson & Roe, supra note 95 (outlining the keiretsu structure).
\textsuperscript{197} See id. art. 11(1).
\textsuperscript{198} See id. art. 11.
\textsuperscript{199} JAPANESE FAIR TRADE COMMISSION, Administrative Procedure Standards for Authorization of Stockholding by Financial Companies, (issued on June 20, 1994, before it was amended on December 8, 1997).
different from the one performed by the financial company; and 
(3) new entry to Japan’s financial business by a foreign financial 
company. Furthermore, such authorization applied only to 
cases where the company issuing stock is newly established, the 
applicant company owns greater than 50% of the stock, and the 
new entry is made by said company into a business activity 
different from the one performed by the applicant company.

By contrast, the new Article 11 Guidelines facilitate 
corporate combination activity by expanding authorization 
without any conditions when the company issuing stock is a 
financial company (including foreign financial companies). Of 
course, this does not apply to combinations like ones prohibited 
by Article 9 (when the said applicant company groups own 
several companies, each of which possesses a substantial position 
in several fields of business such as banking, securities, non-life 
insurance, and life insurance). Nor does it apply to combinations 
prohibited by Article 10 (when the effect of such stockholding 
may substantially be to restrain competition in any particular 
field of trade).

For cases where the company issuing stock is not a financial 
company, authorization will be granted in only three cases. The 
first case is if the company in which stock is acquired is 
engaged in business subordinate to the essential business of the 
applicant company. Previously, the standard for showing 
subordination to the essential business of the applicant company 
was “at least 90 percent, in principle.” Under the revised 
guidelines, only a more liberal standard of “at least 50 percent in 
principle” applies. In the second exception, companies 
engaging in a line of business closely related to financial business 
are excepted. Authorization will be granted in cases of

200 See id.
201 See id.
202 See id.
203 General Secretariat, Fair Trade Commission, Draft Interpretations of 
Holding Companies Which Constitute an Excessive Concentration of Economic 
Power and Draft Amendment of Administrative Procedure Standards for the Author-
204 See id.
205 Id.
206 Id.
investment in a company that engages in the business activity (credit guarantee business, venture capital business, leasing business, etc.). This does not apply to combinations like ones prohibited by competition in any particular field of trade. Finally, and most importantly, the guidelines authorize stockholding for a holding company that owns only subsidiaries that engage in financial business or in a line of closely-related businesses. Approval will not, however, be granted where such combinations run afoul of Article 9, or if the effect of such stockholding may be substantially to restrain competition in any particular field of trade in accordance with Articles 10 and 16.209

4.5. Substantial Restraint of Competition under Articles 10 & 15

Most contemplated mergers of financial institutions will find little difficulty making it through these relatively black and white limitations as long as activities are restricted to finance-related fields. A proposed combination will, however, face some hazier tests under Japanese antitrust law. Article 10 prohibits companies from holding stock where the effect of such holding of stock may be "substantially to restrain competition in a particular field of trade." Similarly, Article 15(1)(i) prohibits mergers (including mergers of holding companies) whose effect is to substantially restrain competition in the market. There is no apparent distinction in the Article 10 standard "substantially to restrain competition in a particular field of trade" and the identical language under Article 15.

The forms currently required for reporting mergers provide some initial guidelines to the concerns of the JFTC in preventing "substantial restraint of competition" and one of two forms is generally filed for a merger. The simpler Form No. 9 requires

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207 See id.
208 See id.
209 See id.
210 Antimonopoly Law art. 10.
211 See id. art. 15(1)(i).
212 See id. arts. 10, 15.
213 The two forms conform to "Rules Concerning Approvals, Applications, Reports and Notifications under the provisions of Article 9-2 through 16 of the Act Concerning Prohibition of Private Monopoly and Maintenance of Fair Trade," Rule No. 1 of the Fair Trade Commission of 1953, as amended. The criteria for determining the circumstances under which
an outline of the merger, an outline of the continuing company or company incorporated post-merger, the relationship between reporting companies and affiliated companies, the market share of the post-merger company, and the merger objectives or reasons. Form No. 10 requires most of the same information as the simplified Form No. 9, but the postmerger company's market position for goods or services must be classified with respect to the five following parameters: (i) a market share over 25%; (ii) the largest market share, and holding 15% or more of the total market share; (iii) the largest market share, plus the difference between the market share of the top-ranked company and the second or third largest company must be more than a quarter of the market share of the top-ranked company; (iv) within the top three companies, and the total market share of the top three companies is 50% or more; and (v) the number of competitors of the post-merger company in whatever market the reporting company competes in (and in the case where the merging companies are in the same market, the post merger company's market) is seven or less. Form Nos. 11 and 12 for reporting acquisitions of assets to the JFTC are analogous to the merger forms.

The 25% screening criterion for market share has been of central importance in the JFTC's review of proposed mergers. Technically, the 25% figure is just a criterion for more stringent review. Mergers exceeding this amount may be approved and mergers less than this amount may be theoretically denied. Business leaders have criticized what they consider a strict 25%

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214 It seems likely that once the new reporting requirements' revisions come into effect in January 1999, Form No. 9 will be eliminated because the revisions exempt from the reporting requirement most types of mergers that come under Form No. 9.


216 See generally Form Nos. 11 & 12, reprinted in INTERNATIONAL Mergers: THE ANTITRUST PROCESS, supra note 172.


218 See id.
rule of the JFTC as an impediment forcing them to abandon mergers. In many cases, companies were required to cut back on production to meet the 25% rule. More recently, however, the JFTC has approved mergers and acquisitions exceeding this figure.

After a public relations push from Keidanren, the JFTC in April 1997 unconditionally approved the Mitsui Toatsu Chemicals and Mitsui Petrochemical Industries merger, which gave the combined companies a 56% share of the phenol market. In that decision, the JFTC took into consideration competition with foreign manufacturers. Also, in April 1998, the JFTC approved two mergers in the cement industry pushing the 25% threshold. The unification of the cement sectors of Mitsubishi Materials Corp. and Ube Industries Ltd. was approved with a 24.3% share. The merger of Chichibu Onoda Cement Corp. and Nihon Cement Co. which reached a 39.3% market share was also approved. Moreover, the top three companies will control more than 80% of the Japanese cement market. In support of its decision, the commission stated that a strong rival still holds 20% of the market, import competition is expected to increase, and the market clout of construction companies was likely to maintain pricing pressure. One commentator has classified cases where the 25% figure has been exceeded into five categories: (i) where powerful competition exists from either domestic or international competitors, (ii) where the merging company

219 See id.
220 See id.
221 See e.g., FTC Approves Big Cement Mergers, NIKKEI WKLY., Apr. 27, 1998, at 2.
222 For decision rationale, see Kosei Torihiki Ininkai (JFTC), Mitsui Seikyu Kagaku Kogyo oyobi Mitsui Toatsu Kagaku no Gappei ni tsuite [Regarding the merger of Mitsui Petrochemical Industries and Mitsui Toatsu Chemicals], (press release), Apr. 9, 1997.
223 See FTC Approves Big Cement Mergers, supra note 221, at 2.
224 See id.
225 See id.
226 See id.
227 For formal rationale of the JFTC decisions, see Kosei Torihiki Ininkai, Chichibu Onoda to Nihon Cemento no Gappei oyobi Ube Kogyo to Mitsubishi Materiarnn ni yoru cemento no Togo ni Tsuite [Regarding the merger between Chichibu Onoda Corp. and Nihon Cement Co., and the combination of the cement business of Ube Industries and Mitsubishi Materials Corp.], April 23, 1998.
disposes of assets, (iii) where the mergers are within a group of affiliated companies, (iv) where the mergers involve entities' customers that wield enough power to maintain pricing power, and (v) where the mergers involve bankrupt companies. Japanese financial institutions going beyond the 25% threshold would likely be able to claim several of these mitigating factors.

4.6. Precedents: M&A of Financial Institutions

Merger and acquisition precedent in the financial sector provides minimal guidance as to what extent the liberalized 25% rule applies to mergers involving financial institutions. This is so given the fact that there have been numerous famous cases of financial mergers such as the 1971 merger of Daiichi and Kangyo Bank, the 1974 merger of Kobe Bank and Taiyo Bank to create Taiyo Kobe bank, the 1985 acquisition of Heiwa Sogo Bank by Sumitomo Bank, the 1989 merger of Mitsui Bank and Taiyo Kobe Bank to form Mitsui Taiyo Kobe Bank (later renamed Sakura Bank), the 1991 merger of Kyowa Bank and Saitama Bank to create Kyowa Saitama Bank (now called Asahi Bank), and the 1996 merger of Mitsubishi Bank & Bank of Tokyo.

4.6.1. Mitsubishi Bank and Bank of Tokyo Merger

The JFTC published its rationale for approving the most recent of these mergers, the merger between the Mitsubishi Bank Co., Ltd., an ordinary commercial bank, and the Bank of Tokyo Co., Ltd., a foreign exchange bank, to form the Tokyo Mitsubishi Bank, an ordinary commercial bank. In determining the relevant "particular field of trade," the JFTC focused mainly on the nationwide impact that the merger would have on interbank relationships because both banks were city banks that conducted banking business through a large number of branches in a wide area through the reasonable use of capital. The JFTC distinguished city banks from long-term credit banks and trust

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228 KAWAKOSHI KENJI, DOKUSEN KINSHI HO: KYOSO SHAKAI NO FEANESU 93-95 (1995).
231 See id.
banks on the basis that the former were thought to have a different client base than the latter two, due to the following facts: (i) both long-term credit banks and trust banks have limits on deposits that they can accept and on the establishment of branches; (ii) long-term credit banks and trust banks have means of obtaining capital that city banks are not permitted to use, such as the issuance of debentures and loan funds; and (iii) long-term credit banks have restrictions on the establishment of storefronts. 232

The JFTC then partially distinguished regional banks and second-tier regional banks from city banks by ascertaining the relevant particular fields of trade threatened by the merger. 233 The JFTC noted that city banks, regional banks, and second-tier regional banks are all ordinary commercial banks and that their financing targets are becoming similar (as shown by the recent increase in the percentage of loans to small- and medium-sized industries from city banks). 234 But the JFTC noted that the operations and clients of regional banks and second-tier regional banks are mainly situated in the prefectures of their headquarters. 235 Furthermore, city banks tend to become the main banks of large corporations listed on a major exchange, whereas regional banks and second-tier regional banks mainly conduct their business with local industry. 236 Accordingly, the JFTC analyzed the impact of the merger on deposit and loan operations on a nation-wide level, but also studied the impact of increased concentration in various regions. 237

Having defined the relevant “particular fields of trade,” the JFTC found acceptable a postmerger market share, among domestic city banks, of 14.2% in terms of deposits and 14.7% in terms of lending, putting the Tokyo Mitsubishi Bank second among banks with nationwide operations. 238 It ranked first among city banks in loans to large corporations with 19.1%, while ranking fourth in total number of branches. 239

\[\text{See id.}\]
\[\text{See id.}\]
\[\text{See id.}\]
\[\text{See id.}\]
\[\text{See id.}\]
\[\text{See id. at 60.}\]
\[\text{See id.}\]
rationale that the proposed merger would not necessarily lead to substantial restriction of competition in the relevant market, the JFTC stressed that (i) the market share would not exceed 15% (in terms of both deposit and lending), and the difference in market share between the new bank and the bank ranking third would be only 2%; (ii) no extraordinary increase in market share in specific geographical areas was expected; (iii) the new bank’s share of the foreign exchange businesses in Japan would be less than 15% in terms of both inter-bank transactions and transactions with customers; (iv) the competition between banks would be expected to increase due to the decrease in the ratio of loans from banks procured by corporations and the deregulation and abolition of competition-restricting regulations such as interest rate regulations and operational regulations; and (v) although the share of loans to large-scale business would be 19.1%, the difference in market share with the second largest bank is merely 2.6% in an environment marked by increasing competition and low credit risk for stable large-scale businesses.240 Furthermore, the JFTC noted that corporations “in recent years have been utilizing their credit to issue low-interest commercial papers and corporate debentures, etc., to increase the procurement of funds to pay back loans from banks, thereby increasing the competition between these types of direct financing methods and bank loans.”241 Moreover, in the field of foreign exchange transactions, the extension of business hours of foreign exchange markets as well as the development of communication technology was expected to lead to increased interactions between the Tokyo market and overseas markets, heightening global competition in the business.242 Although any competition analysis is likely to be case-by-case, it appears likely that at least a 15% share in the relevant markets of financial institutions would be considered relatively safe, and that global and domestic competition would also play an important part in the analysis of other mergers involving financial institutions.243

240 See id. at 61.
241 Id.
242 See id.
243 See id.
4.6.2. Wakashio Bank

A wave of mergers among second-tier regional banks in the 1990s has also not met opposition from the JFTC; the fact that these banks are all relatively small, however, and that those merging are either bankrupt or near bankrupt institutions that present little danger of restraining competition generally does little to elucidate the boundaries of acceptable market share.\(^{244}\) One slight exception to this, however, is the March 1996 collapse of Taiheiyo Bank and the involvement of larger banks in its successor entity.\(^{245}\) This case involved a plan by Sakura Bank to establish the Wakashio Bank with a 100% investment to serve as a receiver for transfer of the operations of the Taiheiyo Bank after Taiheiyo Bank's failure.\(^{246}\) Previously, four city banks (Sakura Bank, Fuji Bank, Tokai Bank, and Sanwa Bank) had supported the rehabilitation of the Taiheiyo Bank, but the bursting of the economic bubble raised the value of the bad debts held by the Taiheiyo Bank to the point that it was no longer possible for the bank to continue operations.\(^{247}\) At the request of the financial authorities, the Taiheiyo Bank dissolved and reached an agreement for Sakura Bank to establish a subsidiary in the form of a new bank to serve as a receiver of the Taiheiyo Bank.\(^{248}\)

As a prelude to the preceding agreement, the Sakura Bank conducted a preliminary consultation with the JFTC regarding the joint investment by the four banks for the establishment of a

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\(^{244}\) These mergers include the following: the April 1992 takeover of Toho Sowa Bank by Iyo Bank, a regional bank; the April 1993 merger of Ugo Bank with Akita Akebono Bank, a regional bank, to form Hokuto Bank; the August 1995 collapse of Hyogo Bank and its succession by Midori Bank, financed by local companies and banks in January 1996; the March 1996 collapse of Taiheiyo Bank and its succession by Wakashio Bank, with the financing of Sakura Bank in September 1996; the collapse of Hanwa Bank under suspension order by the Ministry of Finance and the taking over of deposits by the newly established Kii Deposit Management Bank; the October 1997 merger announcement of Fukutoku Bank and Bank of Naniwa, effective October 1998; and the plan of Kyoto Kyoei Bank to transfer all operations to Kofuku Bank as of October 1998. See Kazunari Yokota, Mergers Reduce Ranks of Kansai Banks, NIKKEI WKLY., Oct. 20, 1997, at 13.


\(^{246}\) See id.

\(^{247}\) See id.

\(^{248}\) See id.
receiver. The JFTC indicated that if each of the market shares of deposit and lending operations of ordinary banks conducted by the Taiheiyo Bank and the four banks in Tokyo, which is their primary business market, are combined, these total over 30% and under 30% respectively. Under these circumstances, the adoption of a joint investment scheme would give rise to a collaborative relationship among the four banks, and the risk that competition would be substantially restricted in a particular field of trade. The four banks then agreed to have the Sakura Bank invest 100% of the capital needed to establish a new bank.

Because the new plan involved a bank holding over 5% of the stock of another company, authorization was required under Article 11(1) of the Antimonopoly Act. In this regard, the JFTC applied the “Administrative Procedure Standards for Authorization of Stockholding by Financial Companies” (June 20, 1994). These guidelines require consideration of the need for the applicant company to hold the stock, the risk of an increase in the economic power of the applicant company and the extent thereof, and the influence on the market with which the stock issuing company is affiliated. The JFTC found that the applicant company needed to hold the Wakashio stock in order to avoid events such as a run on the bank by depositors and to contribute to the stability and maintenance of the financial system. That the combination of the two institutions would push ownership in particular companies beyond 5% in some cases compounded the problem. The JFTC dealt with this issue by ensuring that by the time the stock issuing company would take over operations from the Taiheiyo Bank, Sakura Bank would dispose of its stock in any company that surpasses this 5% ownership margin when it is combined with the stock of the other company.

Relative to ordinary commercial banks in Tokyo, the market

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249 See id.
250 See id.
251 See id.
252 See Antimonopoly Law art. 11(1).
253 See Major Cases 1996, supra note 245.
254 See id.
255 See id.
256 See id.
257 See id.
shares of the Sakura Bank and the stock issuing company for deposits operations was 11.6% (ranking fourth) and for lending operations was 13.5% (ranking second). Even with the percentage increase in market shares of only 3.5% and 0.5%, respectively, there were no changes in the rankings, and the JFTC decided that the influence on the applicable markets was minimal.

From the Wakashio case, one can surmise that a 15% share in banking operations in a particular market again appears to be safe, while a 30% share raises the concern of JFTC regulators. Beyond this range, it is more speculative as to whether a tighter standard would apply to financial institutions than the general 25% benchmark applied to other industries. On the one hand, traditional suspicion against the overconcentration of financial power lingers from zaibatsu days and financial institution shareholding is still more tightly regulated than that of general enterprise companies. On the other hand, the JFTC may prefer to apply a relatively lenient standard to financial institutions given their general weakness and the present restructuring in the financial industry. Certainly, the JFTC has been more tolerant of large market shares for declining industries in other areas seeking to restructure. Indeed, even before the recent liberalization of antimonopoly law restrictions, the JFTC has been relatively lenient toward mergers involving defunct institutions that tested old limits of financial conglomeration; for example, Daiwa Bank was allowed to take control of a nearly insolvent Cosmo Securities in August 1993 and make it a subsidiary by bailing it out in the form of a private placement of new shares. This bailout was treated as an exceptional case authorized for the purpose of maintaining order in the financial markets. Cosmo Securities survived the crisis as a listed company, rather than as a wholly owned subsidiary of Daiwa Bank, and was allowed to

258 See id.
259 See id.
260 For example, even after recent amendments, Article 11 of the Antimonopoly Law still prohibits shareholding in excess of 5% for financial institutions (10% for insurance companies) unless an exception applies.
261 For example, see the cement and phenol mergers discussed supra Section 4.5.
262 See Osaki, supra note 30, at 252.
263 See id.
continue providing a full range of securities services as before.264 A similar rescue of Nippon Trust Bank Ltd. was undertaken by Mitsubishi Bank in November 1994.265

5. CONCLUSION

While it still is not clear to what extent financial institutions will take advantage of the new legal regime for mergers and acquisitions, merger and acquisition-related activity among Japanese financial institutions has increased. No major mergers have been consummated yet, but as financial restrictions have eased in the past twelve months, an astonishing number of mergers of small subsidiaries to create joint ventures and similar strategic tie-ups has occurred.

5.1. Foreign Tie-ups with Japanese Financial Institutions

Most of the recent merger and acquisition activity has taken place among Japanese financial institutions seeking tie-ups with foreign financial institutions in areas where they lack expertise. Foreigners, in turn, hope to boost their ability to access some of the $1.2 trillion in household savings in Japan.266 One of the earliest and most talked about deals was the September 1997 agreement between Swiss Bank Corporation ("SBC"), which in the Spring of 1998 merged with Union Bank of Switzerland and the Long-Term Credit Bank of Japan ("LTCB") to jointly establish a securities company in the first half of 1998.267 The LTCB-SBC alliance sought to start a full-scale private banking business, an undeveloped business area in Japan.268 The two companies plan to establish cross-ownership stakes and joint ventures in Japan for investment banking, asset management, and private banking.269 LTCB will operate as a holding company and will close some of its offices.270 More recently, in June of 1998,

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264 See id.
265 See id.
268 See id.
269 See id.
270 See id.

https://scholarship.law.upenn.edu/jil/vol19/iss4/2
Travelers Group agreed to take a 25% stake in Nikko Securities (Japan's third largest securities firm). Under the agreement, Nikko will combine its overseas operations with Salomon Smith Barney, a Travelers subsidiary. Nikko and Travelers will also form a joint venture in Japan to be 51% owned by Nikko, and which will encompass all of Nikko's business for corporate clients and all of Salomon Smith Barney's Tokyo operations, with the exception of proprietary account trading.

Several recent mergers and acquisitions have involved foreign financial institutions picking up the desirable pieces of weak or shattered Japanese financial institutions. For example, in November 1997, Merrill Lynch reached an agreement to establish a Japanese subsidiary to take over 2000 employees and 31 branches of Yamaichi Securities Company, formerly Japan's fourth largest investment bank. It plans to open a nationwide brokerage firm to sell mutual funds, convertible bonds, and foreign currency products to Japanese investors.

Another recent tie-up in which a strong U.S. financial institution picked up choice pieces of a weak Japanese financial institution more closely resembles a merger. GE Capital, the 13th largest insurer in the United States, announced a $1.2 billion joint venture with Toho Mutual Life Insurance, Japan's 12th largest insurer, to sell life and health coverage. As part of the deal, GE Capital boosted Toho Mutual's capital base through purchase of subordinated bonds totaling tens of billions of yen. The joint venture was capitalized at thirty-six billion yen and owned 90% by GE Capital and 10% by Toho Mutual Life, with Toho Mutual Life providing the company's president and many

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272 See id.
273 See id.
275 See id. By late summer, Merrill Lynch & Co. will offer domestic global investment trusts (mutual funds) plus convertible bonds and foreign currency investments. See id. Merrill Lynch Japan Securities will later merge with Merrill Lynch Japan Inc., which concentrates on institutional sales. See id.
277 See id.
managers. GE Capital and the joint venture bear no responsibility for existing policies, but the joint venture receives the rights to sell future insurance policies through Toho’s office network. Although Toho Mutual Life is restricted to existing insurance policies, it will accept 30-50% of total reinsurance policies from the joint venture for ten years. This structure allows GE capital to have its cake and also eat it by receiving the benefits of the Toho network along with limited downside liability risks.

5.2. Domestic Activity

Much of the recent activity in acquisitions among domestic institutions has focused on picking up the pieces from financial institutions that have faltered. Chuo Trust & Banking Company’s takeover of Hokkaido Takushoku Bank’s Honshu operations, announced February 17, 1998, is one example. The acquisition moved Chuo Trust from last in number of branches to twice as large a trust-banking network as its next biggest competitor.

There are also signs that the market is rewarding more aggressive behavior on the part of Japanese financial institutions. Following Chuo Trust’s acquisition of part of Hokkaido Takushoku, Moody’s Investor Service (a prominent U.S. credit rating institution) indicated that a rating upgrade could follow. As a result, its stock price started climbing and deposits and purchases of its trust products have soared in the ensuing months. North Pacific Bank earlier inked a similar agreement to absorb Hokkaido Takushoku’s business in its home region of Hokkaido. The rumor mill continues to churn with talk of

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278 See id. The companies will put another ¥36 billion as legal reserve, and the joint venture will accept ¥72 billion in subordinated loans making the joint venture Japan’s largest foreign-affiliated insurance company in terms of capital. See id.

279 See id.

280 See id.


282 See id.


284 See id.

additional nascent deals.  

The desire for keiretsu groups to form holding companies is also expected to boost some combination activity. Some keiretsu affiliates have already begun merging small affiliates. For example, the Dai-Ichi Kangyo group combined Asahi Investment Trust Management Company, Kankaku Capital Management Company, and Daichi Kangyo Investment Management to form Dai-Ichi Kangyo Asset Management. Although no financial holding companies have been formed to date, plans are being made at a number of financial institutions. Financial institutions from the same keiretsu groups are a natural form for such combinations given their histories of interlocking relationships, shareholdings, management meetings, and that they often share the same name. The Fuyo group companies, for example, have announced a plan to eliminate overlapping operations. Fuji Bank, Yasuda Trust & Banking Company, Yasuda Mutual Life Insurance Company, and Yasuda Fire & Marine Insurance Company will integrate brokerage operations, investment-advisory subsidiaries, and other affiliates within two to three years. As a first step, Yasuda Trust & Banking will transfer operations from its securities unit to a subsidiary of Fuji Bank, and its investment advisory affiliate will transfer operations to an

286 For example, life insurers from Germany and Switzerland are also seeking tie-ups as a means of penetrating the Japanese market. See Tatsuya Inoue, Insurer Opens Door for Foreign Ally, NIKKEI WKLY., Feb. 9, 1998, at 1, 13 [hereinafter Insurer Opens Door]. American International Group Inc. also planned to examine the operation of Aoba Life Insurance Ltd. with a view toward taking over the company. It would be the first purchase of a Japanese life insurer by a foreign firm. Aoba was established last October to take over the operations of failed Nissan Mutual Life Insurance Co. and is wholly owned by the Life Insurance Association of Japan. See U.S. Company to Study Buyout of Japan Insurer, NIKKEI WKLY., Apr. 20, 1998, at 17. Orix, Japan’s largest nonbank finance firm, entered negotiations to purchase Yamaichi Trust & Bank Ltd., a wholly owned subsidiary of failed Yamaichi Securities Co. Orix seeks to add a bank to its operations to provide its customers with a comprehensive range of financial services, having already added life insurance and brokerage operations to its primary leasing business. See Leasing Company BeginsNegotiating to Acquire Yamaichi Trust Bank, NIKKEI WKLY., Dec. 29, 1997 & Jan. 5, 1998, at 13.


289 See id.
arm of Yasuda Mutual Life Insurance at the end of March 1998. The use of a group holding company is expected to streamline the decision-making process, promote the development of new financial products, and enhance client cultivation by allowing closer ties to better serve common customers. Experts predict the Mitsui group companies of Sakura Bank, Mitsui Trust & Banking Company, Mitsui Marine & Fire Insurance Company, and Mitsui Mutual Life Insurance Company will pursue a similar plan. Sumitomo Bank has also hinted at the possibility of the formation of alliances and a holding company.

5.3. Further Obstacles

Some people in the Japanese financial community downplay the need for any merger activity. The Senior Managing Director of Daiwa Bank has said that it will not seek mergers but, rather, it will seek strategic alliances, such as the one it has with Asahi Bank, and will also seek strategic alliances with foreign financial institutions in weak fields but without capital alliances. Seiji Otsuka, banking industry analyst at Schroder Japan Ltd. has said, "Japanese banks will not engage in mega-mergers... In order for a merger to be effective, merging institutions should have their own specialties and strengths. But Japanese banks have not yet downsized their organizations by putting their resources in a specialized area. U.S. banks have already gone through that process." The key to winning the competition will be an alliance with foreigners. Other commentators warn of financial colonization (kin'yu shokuminka) and the "Wimbledon effect" to Japan's markets—whereby Tokyo becomes a world class market, but none of the winners are Japanese.

Furthermore, legal difficulties continue to compound merger and acquisition activity. For example, commentators have
blamed lax accounting standards for masking huge debts, thereby increasing the risk of a potential acquisition. The huge hidden debts of Yamaichi, for instance, hint that unpleasant surprises may await any acquirer of a Japanese financial institution. Deal structures that avoid outright mergers, such as that of the GE Capital-Toho deal and the Traveler’s Nikko deal, can minimize some of the downside risk. A larger issue for reorganization is tax-driven. For existing companies to create holding companies, they must pay an asset-transfer tax, registration, and license taxes. Banks, however, will be giving preferential tax treatment for fiscal 1998 to bank shareholders by possibly halving transfer taxes and securities transaction taxes levied when they exchange their bank shares with shares of the newly established bank holding companies. Such tax incentives are not available for holding companies’ brokerages, securities firms, or nonfinancial businesses. Moreover, that a holding company group is not yet permitted to file consolidated tax returns minimizes one of the advantages of forming a holding company. Further, the speed of decompartmentalization puts a ceiling on the pace of integration activity. For example, although the Fuyo group is considering establishing a holding company, Yasuda Life, as a mutual company, it cannot come under the control of the envisioned holding company. Fuyo is therefore considering another plan under which the four financial companies of the group would first establish a joint holding company to control integrated subsidiaries while awaiting further deregulation.

With much of the legal environment newly liberalized, however, the economic forces will prove too powerful for many institutions to ignore the merger and acquisition option. In

298 See Insurer Opens Door, supra note 286, at 1.
299 Interestingly, Nippon Telegraph and Telephone Corp. will be exempted from these taxes when it splits up its operations into a holding company in 1999. See Tax Changes Would Clear Way for Wider Use of Holding Companies, NIKKEI WKLY., Dec. 29, 1997 & Jan. 5, 1998, at 18.
300 See id.
301 See id.
302 See id.
304 See id.
particular, cash-rich foreign firms with cutting-edge risk and asset management technology, but limited success in penetrating Japan's financial markets, make natural partners for debt-laden Japanese firms dulled by lack of competition but enjoying insider access to a massive pool of savings. Kenneth Courtis, chief economist at Deutsche Bank, has argued that many institutions will have to disappear by merger or takeover.\textsuperscript{305} He notes that in 1980, a few years before the beginning of the Big Bang in the United Kingdom, few would have believed that by 1997 there would be but four major British financial institutions left: Lloyds, Hong Kong and Shanghai Bank, Barclays, and NatWest.\textsuperscript{306} Many other British financial institutions disappeared as they merged with Swiss, German, Dutch, and American firms. Deregulation in the United States has had a similarly profound impact on the financial landscape.

As major companies continue to merge to increase their global competitiveness in an increasingly international business environment, Japanese financial institutions can ill-afford to ignore the use of mergers and acquisitions in an environment where capital is a commodity that flows quickly and easily across borders. The recent deregulation of the financial world and the economic realities faced by Japan mean that a brave new world for mergers and acquisitions among financial institutions must arise in order for Japanese financial institutions to meet the challenges of the 21st Century.

\textsuperscript{305} See Courtis, supra note 7, at 15-17.

\textsuperscript{306} See id.
## APPENDIX

### Table 1. Big Bang Timeline and Projections

<table>
<thead>
<tr>
<th>Timeline</th>
<th>Financial Deregulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 1996</td>
<td>Life and Casualty Insurers can compete in each other's business through subsidiaries</td>
</tr>
<tr>
<td>June 1997</td>
<td>Stock options legalized</td>
</tr>
<tr>
<td>July 1997</td>
<td>Listed single stock options introduced</td>
</tr>
<tr>
<td>October 1997</td>
<td>Securities trust affiliates offer loan trusts</td>
</tr>
<tr>
<td></td>
<td>Banks securities affiliates can deal in convertible bond secondary market</td>
</tr>
<tr>
<td>December 1997</td>
<td>Banks can rent space to their investment trust affiliates which are allowed to sell their products at banks</td>
</tr>
<tr>
<td></td>
<td>Securities companies can offer securities general accounts</td>
</tr>
<tr>
<td>1997</td>
<td>Regional banks to offer trust products</td>
</tr>
<tr>
<td>January 1998</td>
<td>Non-financial holding companies legalized</td>
</tr>
<tr>
<td>April 1998</td>
<td>New Foreign Exchange Law introduced allowing companies and individuals to make foreign-exchange transactions without government authorization</td>
</tr>
<tr>
<td>April 1998</td>
<td>Freeing of stock transaction fees on large-lot transactions above 50 million yen</td>
</tr>
<tr>
<td>April 1998</td>
<td>Financial holding companies introduced</td>
</tr>
<tr>
<td>1998</td>
<td>Non-life insurance fees liberalized</td>
</tr>
<tr>
<td>Fiscal 1998</td>
<td>Securities companies go from licensing to registration</td>
</tr>
<tr>
<td></td>
<td>Banks allowed to sell investment trusts directly</td>
</tr>
<tr>
<td></td>
<td>Corporate investment trusts legalized</td>
</tr>
<tr>
<td></td>
<td>Securities companies allowed to expand asset-management services</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>October 1999</th>
<th>Securities companies trust affiliates allowed into pension trust market</th>
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<tbody>
<tr>
<td>During 1999</td>
<td>Bank securities subsidiaries allowed into the primary and secondary market for securities</td>
</tr>
<tr>
<td></td>
<td>Total liberalization of stock transaction fees</td>
</tr>
<tr>
<td>Fiscal 1999</td>
<td>Banks allowed to issue straight bonds</td>
</tr>
<tr>
<td>Second half of fiscal 1999</td>
<td>Barriers keeping banks, trust banks, and securities companies from entering one another’s markets removed</td>
</tr>
<tr>
<td>January 2000</td>
<td>Domestic non-life insurers allowed to enter securities, banking, and trust banking</td>
</tr>
<tr>
<td>End of 2001</td>
<td>Banks and securities companies allowed to enter the insurance sector</td>
</tr>
</tbody>
</table>

Note: The above information was gleaned from various newspapers and websites and is therefore subject to delays in regulatory implementation.
Table 2. Changes in the Number of Financial Institutions

<table>
<thead>
<tr>
<th>Year</th>
<th>AB</th>
<th>CB</th>
<th>RB</th>
<th>TB</th>
<th>LCB</th>
<th>LIC</th>
<th>P&amp;C</th>
<th>SC</th>
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<tr>
<td>1945</td>
<td>70</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>1</td>
<td>21</td>
<td>16</td>
</tr>
<tr>
<td>1950</td>
<td>70</td>
<td>13</td>
<td>50</td>
<td>6</td>
<td>6</td>
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<td>20</td>
<td>936</td>
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<td>1955</td>
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<td>7</td>
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<td>20</td>
<td>20</td>
<td>700</td>
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<tr>
<td>1960</td>
<td>87</td>
<td>13</td>
<td>64</td>
<td>7</td>
<td>3</td>
<td>20</td>
<td>20</td>
<td>552</td>
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<tr>
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<td>64</td>
<td>7</td>
<td>3</td>
<td>20</td>
<td>20</td>
<td>484</td>
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<tr>
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<td>86</td>
<td>15</td>
<td>61</td>
<td>7</td>
<td>3</td>
<td>20</td>
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<td>7</td>
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<td>1980</td>
<td>86</td>
<td>13</td>
<td>63</td>
<td>7</td>
<td>3</td>
<td>21</td>
<td>22</td>
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<td>1985</td>
<td>87</td>
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<td>64</td>
<td>7</td>
<td>3</td>
<td>23</td>
<td>23</td>
<td>221</td>
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<tr>
<td>1990</td>
<td>87</td>
<td>13</td>
<td>64</td>
<td>7</td>
<td>3</td>
<td>26</td>
<td>25</td>
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<td>1994</td>
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<td>7</td>
<td>3</td>
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<td>25</td>
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</tr>
</tbody>
</table>

Legend:
AB = All Banks
CB = Commercial Banks
RB = Regional Banks
TB = Trust Banks
LCB = Long-term Credit Banks
LIC = Life Insurance Companies
P&C = Property & Casualty Insurance Companies
SC = Securities Companies

Note: This Table includes data on domestic institutions only and excludes second-tier regional banks (former mutual banks). Recently, a few second-tier regional banks have either gone bankrupt or have begun merger or acquisition procedures with other second-tier regional banks.

See Endo, supra note 31, at 9, tbl. 1.2.