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Amendment to the Money Lending Business Regulations – Effective from 1 April 2014

– Deregulation on intra-group loans (including cash management systems) and loans to JV companies –

The Money Lending Business regulations were amended (the "**Amendment**") on 24 March 2014, with the Amendment effective from 1 April 2014. The Amendment exempts loans made between certain group entities from the regulatory requirements (the "**Regulatory Requirements**") under the Money Lending Business Act of Japan (the "**MLBA**"). The Amendment will help to facilitate intra-group loans, and in particular is intended to facilitate the establishment of cash management systems in entity groups. In addition, the Amendment exempts loans made by a joint venture partner to its joint venture entity from the Regulatory Requirements.

Background of the Amendment

In Japan, a person or entity engaging in money lending business is required to be registered as a money lending business operator unless it holds a banking licence or other similar licence. A registered money lending business operator is subject to certain regulatory requirements under the MLBA, such as appointment of chief officers of such entity's money lending operations and delivery of certain documents at the time of lending.

Prior to the Amendment, the MLBA did not exempt an entity providing a loan to its affiliated entities (i.e. parent, subsidiary or sister entities) from the Regulatory Requirements. However, according to the written guidance published by the Financial Services Agency of Japan (the "**FSA**") (including no-action letters and responses to public comments), it was understood that lending between a parent entity and its subsidiary (in which the parent holds more than 50% of its voting rights) is not generally subject to the Regulatory Requirements. The Regulatory Requirements still applied, however, to lending between a parent entity and its subsidiary (in which the parent holds 50% or less of its voting rights) and lending between sister entities.

Recently, cash management systems for entity groups have become highly developed. For example, funds can be flexibly procured by physical cash pooling, where surplus funds can be automatically transferred from one entity's account to an account of its affiliate and then further automatically transferred to another affiliate's account that has insufficient funds. Proponents of the Amendment argued that if the Regulatory Requirements continued to apply to lending between certain group entities, those group entities would be prevented from establishing appropriate cash management systems.

In addition, as the Regulatory Requirements applied to loans made by a joint venture partner to its joint venture entity (with exceptions under limited circumstances), proponents of the Amendment also argued that without the Amendment, the financial concerns of joint venture entities would not be sufficiently addressed.

Against this background, the Amendment was promulgated on 24 March 2014 and is effective from 1 April 2014. The Amendment exempts from the Regulatory Requirements loans provided by (1) entities to certain affiliated entities and (2) a joint venture partner to its joint venture entity.

Outline of the Amendment

Under the post-effective Amendment, the Regulatory Requirements do not apply to the following lending operations (the "**Exemption**"):

1) Lending between entities (including certain partnerships) belonging to the same entity group, consisting of an entity (the "**Group Parent**") and any other entity whose determination of its financial and business policy is controlled by the Group Parent (the "**Group Member**") (i.e. lending between certain parent and subsidiary or sister entities); and

2) Lending provided to a joint venture entity by a joint venture partner holding 20% or more of the voting rights in respect of such joint venture entity, with consent to the loan being obtained from all of the joint venture partners.

With respect to 1) above, a Group Member must meet one of the two following requirements[1]:

(a) more than 50% of its voting rights are held by the Group Parent on its own account[2]; or

(b) 40% or more of its voting rights are held by the Group Parent on its own account and any of the following conditions applies:

i. the voting rights held by the Group Parent and persons who are expected (due to a close relationship arising from capital injection, human resources, funding, technology or transaction) or agree to exercise their voting rights in a manner consistent with the Group Parent together account for more than 50% of the voting rights of such Group Member;

ii. the Group Parent's officers, members executing its business or employees and/or persons who used to be officers, members executing its business or employees[3] of the Group Parent together account for more than 50% of the members of the board of directors or an equivalent body of such Group Member;

iii. there is an agreement pursuant to which the Group Parent controls the determination of such Group Member's important financial and business policies;

iv. the amount of loans[4] provided by the Group Parent (and persons having a certain close relationship with the Group Parent) accounts for more than 50% of the aggregate amount[5] of funds procured by such Group Member; or

v. there are any other circumstances from which it is inferred that the Group Parent controls such Group Member's determination of its financial and business policy.

It is important to note that the concept of a Group Member as described above is different from the concept of a "Subsidiary" as defined under the Companies Act of Japan (the "**Companies Act**"), in the following respects:

- A Subsidiary under the Companies Act can include (in certain situations) an entity whose voting rights are not held by its parent (an "**Item 3 Subsidiary**") (see Article 3, Paragraph 3, Item 3 of the Ordinance for Enforcement of the Companies Act). However, the Amendment does not include a provision for a company equivalent to an Item 3 Subsidiary. As a result, this means that in order to qualify as a Group Member, an entity must have at least 40% or 50% (as the case may be) of its voting rights held by the Group Parent on its own account as described in (a) and (b) above.

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[1] Except where (i) it is obvious from the financial or business relationship that the Group Parent is not controlling such other entity's determination of its financial or business policy or (ii) insolvency proceedings such as bankruptcy proceedings have been commenced in respect of such other entity or such other entity is under equivalent circumstances, and there is no effective controlling relationship.

[2] In connection with (a) and (b), the "Group Parent" can also include any other Group Members (i.e. entities whose determination of its financial and business policy is controlled by the Group Parent) who may hold voting rights of such an entity. For example, if an entity has 50% (or 40% in the context of (b)) of its voting rights held by (i) the Group Parent, (ii) another Group Member or (iii) a combination of the Group Parent and one or more Group Members, then such entity can constitute a Group Member.

[3] Limited to persons who can affect such Group Member's determination of its financial and business policy.

[4] Including amounts provided via guarantees or security in respect of the obligations of such Group Member.

[5] Limited to those reported as liabilities on such Group Member's balance sheet.

- Under the Companies Act, if certain conditions are met, there is a presumption that special purpose companies (*tokubetsu mokuteki kaisha*) are not Subsidiaries under the Companies Act. The amended MLBA does not provide for any equivalent exclusions. Consequently, special purpose companies (*tokubetsu mokuteki kaisha*) can qualify as Group Members, so long as they meet the requirements described in (a) or (b) above.

It should also be noted that the Regulatory Requirements apply not only to the provision of loans but also to the facilitation of loans made between other entities. The Exemption will also apply to the facilitation of loans, exempting from the regulations companies acting as intermediaries for its other group companies (defined by the above standards) that are lending amongst themselves. Please also see the next section entitled '*Helpful Clarification from the FSA*'.

In addition, the Exemption will apply to lending operations among not only companies but also partnerships or other similar entities or equivalent foreign entities. Accordingly, for example, if a foreign company provides a loan to its Japanese subsidiary that belongs to the same entity group (defined by the above standards), the Regulatory Requirements will not apply to such loan. However, it should be noted that, with respect to Exemption 1) above (i.e. loans from entities to certain affiliated entities), in order for a partnership to qualify as a Group Member, all of the members of such partnership must be legal persons (which can include foreign legal persons) in addition to the above-mentioned requirements.

Helpful Clarification from the FSA

The Amendment underwent a public consultation process from 27 January 2014 to 26 February 2014. The FSA published its responses to the comments submitted by the public on 18 March 2014, several of which are helpful to better understanding how the amended MLBA will work. Below are a few excerpts from the FSA's clarifications on the Amendment:

- If a borrower which is a Group Member receives a loan from another Group Member and thereafter either such borrower or such lender ceases to be a Group Member, (i) a loan that has already been made will not be affected, (ii) any additional loans provided to the borrower thereafter will be subject to the Regulatory Requirements and (iii) changes to the terms and conditions of an existing loan may not be subject to the Regulatory Requirements unless the changes fall within "novation" under Article 513 of the Civil Code of Japan or are otherwise regarded as the creation of a new loan. Practitioners have long argued that item (iii) above should be the correct interpretation of the MLBA in the context of changes that can occur to the terms and conditions of loans purchased from financial institutions, and the FSA's response seems to support this view.
- In general, acting as an intermediary for loans between other entities (not related) is subject to the Regulatory Requirements. As such, in theory, in the case where a parent negotiates with a lender with respect to a loan to be provided from such lender to the parent's subsidiary, both the lender and the subsidiary should be Group Members. However, the FSA has clarified that so long as the lender is a financial institution and the parent is acting solely for the benefit of its subsidiary, such parent may generally, without triggering the Regulatory Requirements, negotiate with such lender with respect to such loan.
- With respect to loans provided from a joint venture partner (holding 20% or more of voting rights of the joint venture) to its joint venture entity, the consent of the other joint venture partners to such loans may be embedded in the joint venture agreements in advance. The consent can be fairly broad/general and does not need to include the specific details of the terms and conditions of the relevant loan. This clarification should be helpful going forward to practitioners in drafting joint venture agreements.

In conclusion, the Amendment is expected to facilitate the provision of intra-group loans, including the establishment of cash management systems for group entities, as well as facilitate the provision of loans to joint venture entities. In doing so, the amended MLBA will assist in the provision of appropriate funding to entities in need of such funds.

Where Japanese legal concepts have been expressed in the English language, the concepts concerned may not be identical to the concepts described by the equivalent English terminology as they may be interpreted under the laws of other jurisdictions.

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