西村あさひ法律事務所

NISHIMURA & ASAHI

Financial Regulation Newsletter

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Group Companies and Joint Ventures Get More Freedom under New Japanese Money Lending Business Regulations

1. Introduction

The scope of "Money Lending Business" in Japan has recently been revised. The revision was made by subordinate legislation under the Money Lending Business Act, namely, the Order for Enforcement of the Money Lending Business Act and Ordinance for Enforcement of the Money Lending Business Act – both of which were promulgated on 24 March 2014 and came into effect on 1 April the same year, referred to below as the "New Amendments".

While the New Amendments are actually a revision of the financial regulatory regime, it is anticipated that they will have a greater impact on business companies comprising the same corporate group and entities engaged in joint business rather than on financial institutions. That said, the New Amendments will likely have a direct impact on bank account management services for business entities.

More specifically, under the New Amendments, activities such as (i) loans between companies belonging to the same corporate group and (ii) loans from joint investors to their joint venture companies engaged in joint venture business have, both within certain limits, been removed from the application of the money lending business regulatory regime. Even under the old regime, certain loans between same group companies had been interpreted as falling outside the Money Lending Business Act regulations (see discussion below). However, under the New Amendments, an even wider range of monetary loan activity has been excluded from application of the regulations.

2. Scope of "Money Lending Business" under old regime

2.1 Definition of "Money Lending Business"

"Money Lending Business" means, excluding the prescribed exceptions, "the business of loaning money or acting as an intermediary for the lending or borrowing of money" as a business (Article 2(1), Money Lending Business Act). Persons who seek to engage in Money Lending Business must be registered to do so (Article 3(1), Money Lending Business Act).

2.2 Interpretations by the FSA

In practice, there has always been a need for the money lending business regulatory regime not to apply to every type of intra-group company loan. The submission of so-called "no-action letters" (a procedure used to confirm the extent of application of a law prior to commencement of transactions) and "public comment" releases at the time amendments to laws and regulations including Money Lending Business Act were made were methods used in the past to obtain the views of the governmental agency which administers the Money Lending Business Act, the Financial Services Agency ("FSA"). The publically released views of the FSA to date in relation to whether monetary loans between intra-group companies were subject to the money lending business regulatory regime are as follows:

(a) Loans between parents and subsidiaries in which the parent held a majority of the voting shares in the subsidiary were not "Money Lending Business" and registration under the Money Lending Business Act was not required.

(b) Loans between "single person companies" (companies with only one shareholder) which share the same 100% parent company were not "Money Lending Business" and registration under the Money Lending Business Act was not required.

(c) Loans between subsidiaries of the same parent (which did not fall within category (b) above) were "Money Lending Business" and registration under the Money Lending Business Act was required.

(d) Loans between a parent and a subsidiary where the parent did not hold a majority of the voting shares in the subsidiary but, under the so-called substantial standard the two companies were in a parent-subsidiary relationship were "Money Lending Business" and registration under the Money Lending Business Act was required.

(e) Loans from an investing company which held

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50% of the voting rights in a joint venture company (excluding the case where, in effect, it could be seen as one entity making a loan to a joint venture company as its wholly owning parent) were “Money Lending Business” and registration under the Money Lending Business Act was required.

In relation to (a), (b) and the exception in parentheses in (e), the FSA’s view appeared to be that monetary loans between companies related by a certain level of shareholding did not fall within the FSA’s interpretation of “Money Lending Business.” Arguably, the FSA was taking into consideration the practical needs of the parties involved in the loan transaction in these instances. However, as the use of no-action letter procedures clearly shows, in practice there was also a need for the money lending business regulatory regime not to apply to situations (c), (d) and (e) as well.

As can be seen from the above, particularly from the viewpoint of making fund management more efficient, a legislative response relaxing the money lending business regulatory regime in relation to loans between companies of the same group was clearly needed.

3. Changes made by the New Amendments

Under the New Amendments, subject to certain conditions, where as a business activity:

(i) a loan is made between companies of the same corporate group; or

(ii) a loan is made from joint investor(s) to a joint venture company engaged in joint venture business,

the money lending business regulatory regime will not apply. A detailed explanation of the New Amendments follows.

3.1 Same group company loan examples & “Group Conditions”

The New Amendments treat any “company etc.” (meaning company, partnership (kumi`ai) or other similar business structure, including equivalent bodies in foreign jurisdictions – the same meaning to apply for the rest of this article) and its “subsidiary etc.” (meaning any “company etc.” which is equivalent to the definition of “subsidiary” under the Companies Act, such as a company etc. in which another company etc. holds a majority of the voting rights) as being of the same group of companies (the “Group Conditions”). Under the New Amendments, even if conducted as business, any loans between these “companies etc.” and “subsidiaries etc.” – that is, loans which satisfy the Group Conditions – will not be treated as “Money Lending Business” and therefore will not be subject to the money lending business regulatory regime.

Whether these Group Conditions are satisfied or not is determined based on the facts at the time of the loan is made. If the Group Conditions are satisfied when making the loan, then even if the Group Conditions cease to be satisfied thereafter, the money lending business regulatory regime will still remain inapplicable. Consequently, it is understood that if the Group Conditions cease to be satisfied after the loan is made, then, within certain limits, the term of the loan, interest rate and other loan conditions can be altered. Even if guarantees or collaterals are demanded by the lending company, this still should not trigger application of the money lending business regulatory regime. However, there are limits. For example, in relation to a loan for which repayment has become due, extending the term of the loan for the same period of time as the original term would likely be treated as making a new loan and, if the Group Conditions are not satisfied at that time, the money lending business regulations would likely be triggered.

As can be seen from such examples of intra-group company loans, so long as the loans are made between same group companies related to each other through majority shareholding or equivalent, loans can now be made between sister companies without trigging the money business lending regulatory regime.

3.2 Joint venture loan examples & “Joint Venture Contitions”

Under the New Amendments, if:

(i) two or more companies etc. (the joint investors) have entered into a contract under which they will jointly operate the business of another company etc. (the joint venture company) for the purpose of profit;

(ii) a joint investor holding 20% or more of the voting rights of all shareholders in the joint venture company makes a loan to the joint venture company; and

(iii) the loan is made in accordance with the consent of all the shareholders of the joint venture company (conditions (i) – (iii), the “Joint Venture Conditions”)

then even if conducted as business, the loan will not be considered to be Money Lending Business and, consequently, it will not be subject to the money lending business regulatory regime.

In relation to condition (iii), the consent of all the joint shareholders, as the case may be, means exactly that. That is, the consent of both of all joint

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shareholders who will not be making the loan and all joint shareholders who will be making the loan, is required. However, there is debate as to what form this consent should be in practice. On this point, the FSA has publically stated that condition (iii) would be satisfied if, "consent has been obtained from all shareholders each time a loan is made or, if the loan is made in accordance with the shared consent of all shareholders as specifically expressed in the terms of a contract between all shareholders" and, "it would basically be sufficient if the contract specifically states that they agree to the loan itself. It is not necessary to include all terms and conditions of the loan."

As these examples of loans from joint investors to joint venture companies reveal, the scope for such loans is much wider than that permitted under previous FSA interpretations. As long as the Joint Venture Conditions are met, joint investors are now able to loan capital to joint venture companies without being subject to the money lending business regulatory regime.

4. Impact on CMS operations

"CMS" is an abbreviation of "Cash Management System" and in the context of company financial management is the general term used to denote the service providing primary management and transfer of funds through an IT system of computers and transmission hardware for companies in the same corporate group. CMS functions include netting, payment agency services and similar matters but another function CMS can perform is cash pooling.

Cash pooling is an activity by which fund is transferred between same group companies as means of efficient capital sourcing. Considering such transfer of funds, there is a debate as to whether it should be governed by the money lending business regulatory regime. Under the regime that existed prior to the New Amendments, based on the FSA's interpretations set out above, the practical options were to (i) transfer funds only between parent-subsidiaries in a direct majority voting right relationship or sister companies who shared the same 100% parent company, or (ii) establish a scheme where one company within the corporate group was registered as the Money Lender under the Money Lending Business Act and transfer intra-group funds through that registered entity.

However, in practice, there has long been a need to transfer funds between companies within the same group even if they were not in a direct parent-subsidiary relationship. More recently, with the globalization of corporate groups, an increasing number of Japanese companies have been included in cash pooling reviews performed under foreign law and foreign corporate groups who have entered the Japanese market seek to include their Japanese companies within their cash pooling activities. The need for corporate groups, not just parent-subsidiary companies, to be able to more easily transfer funds within their group has become even stronger.

As set out in the examples above, under the New Amendments, so long as fund transfers are conducted within a corporate group between companies related through holdings of more than 50% voting rights, it is now possible for fund transfers to be conducted by companies other than those in direct parent-subsidiary relationships and without any money lending business registration. Based on these examples, it would seem likely that the regulatory approach to CMS designs that include cash pooling functions will become more flexible. Corporate groups which had decided not to use CMS or had implemented versions of CMS which did not match all of their operational needs based on the old money lending business regulatory regime in Japan might now use the New Amendments as an opportunity to implement CMS or to consider redesigning their current CMS.

Furthermore, the New Amendments are not aimed just at CMS or cash pooling. They target all loan activity between companies of the same corporate group. The removal of certain loan activity from the money lending business regulatory regime by the New Amendments is expected to not only improve CMS but also lead to more flexible and convenient intra-group financial processing.

5. Impact on joint venture operations

In addition to joint investors making capital investments in their joint ventures, the need for joint venturers to provide finance in the form of loans to their joint venture also arises from many other considerations: capital policies, tax implications as well as flexibility and ease in obtaining and supplying funds.

Under the New Amendments, provided that all joint investors agree, a joint investor with 20% or more of the voting rights in the joint venture company may make a loan to the joint venture company without registering as a Money Lending Business. Excluding exceptional situations where the agreement of all joint investors cannot be obtained or the joint investor seeking to make the loan holds less than 20% of the voting rights in the joint venture company, these conditions do not appear difficult to satisfy. Consequently, it is anticipated that in practice, loans by joint investors to their joint venture companies will become possible in a wide variety of circumstances – and registration under the money business lending regulatory regime to make such loans will not be necessary.

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6. Conclusion

The New Amendments recognize that (i) loans between group companies in limited circumstances and (ii) loans from joint investors to joint venture companies in the joint venture field do not harm the preservation profits of those in need of capital. With the aim of improving the ability to obtain and receive finance, the New Amendments remove these activities from the application of the money lending business regulatory regime. It is expected that the New Amendments will also make loaning and control of funds in areas such as intra-group finance using CMS and joint ventures more convenient – the impact of the New Amendments on daily operations of these entities has the potential to be enormous. There is also an especially strong expectation that they will lead the way towards an environment which enables foreign corporate groups with Japanese subsidiaries to efficiently manage their funds. It is hoped that companies comprising corporate groups will fully realize the power of the New Amendments and apply them to their benefit in their group financing and joint venture pursuits.

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