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## Amendment to Act on Special Measures for Strengthening Financial Functions

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## Amendment to Act on Special Measures for Strengthening Financial Functions

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### 1. Background for Enactment

On October 24, 2008, the Cabinet approved a bill to amend the “Act on Special Measures for Strengthening Financial Functions” (Act No. 128 of 2004, the “ASFF”), and the government submitted it to the Diet on the same day. This bill was partially amended and approved by the House of Representatives, and was sent to the House of Councilors on November 6, 2008 (The bill is under deliberation of the House of Councilors as of November 20, 2008. The amended ASFF by the bill and the pre-amended ASFF shall be hereinafter referred to as the “Amended ASFF” and “Pre-Amended ASFF”, respectively).

The ASFF will allow the Deposit Insurance Corporation of Japan (“DICJ”) (in practice, the Resolution and Collection Corporation (“RCC”), which is retained by DICJ) to accept applications for subscriptions of shares, etc. and other matters (i.e. injection of public funds) from financial institutions in case that the financial institutions fail to fulfill the capital adequacy requirements (but are not bankrupt or insolvent), thereby bolstering their capital basis. Alternatively, the DICJ can be so used to fulfill the capital adequacy requirements for a financial institution, of which capital ratio exceeds the capital adequacy requirements, want to undertaking a fundamental restructuring of its organization through merger or assignment of businesses. The ASFF was basically enacted as temporary legislation to support measures to strengthen local financial institutions. Under the Pre-Amended ASFF, the period for application for the injection of public funds expired at the end of March, 2008.

However, in the first half of 2008, there was an increase in chain-reaction bankruptcies among real estate and construction companies as well as an increase in bankruptcies among small-and medium-sized enterprises (“SMEs”). These bankruptcies resulted in an increase in credit cost. Moreover, the sub-prime loans triggered a financial crisis, including bankruptcy of Lehman Brothers Holdings Inc. (“Lehman Brothers”) in particular, caused disruptions in the financial markets. Under these circumstances, many local financial institutions have been severely affected by write-off of outstanding securities issued by Lehman Brothers and nose-diving of market prices of other securities they hold. If their equity capital is weakened, there is a risk that these local financial institutions will become reluctant to provide funds to SMEs.

As a measure to cope with the financial crisis, the Deposit Insurance Act (Act No.34 of 1971) provides constant measures for bolstering the equity capital of financial institutions (the same Act, Article 102, Paragraph 1, each Item). However, such measures can be adopted only when the Prime minister “recognizes the fear that there is an extremely serious threat to the continued financial stability of Japan or a part of Japan where financial institutions are conducting operations”, and therefore, it is impossible to inject public funds into local financial institutions in a prompt manner.

The Amended ASFF was enacted for the purpose of dealing with such business climate changes and strengthening the financial institutions.

### 2. Application for Government’s Capital Participation

#### (1) Extension of Application Deadline (Amended ASFF, Article 3)

Pursuant to the Pre-Amended ASFF, financial institutions may apply to the government for subscription of shares or other measures for bolstering their capital basis (i.e. injection of public funds into financial institutions which are facing equity capital shortages) until the end of March 2008. The

bill proposed that this application period shall be extended to the end of March 2012.

(2) Simplification of the matters to be included in the management enhancement plan ("Management Enhancement Plan") (Amended ASFF, Article 4, Paragraph 1)

If financial institutions intend to apply for the government's capital injection pursuant to the ASFF, they need to submit a Management Enhancement Plan (Article 4).

According to the Pre-Amended ASFF, the following matters shall be included in a management enhancement plan:

- (i) numerical targets of profitability and efficiency;
- (ii) measures to achieve those targets;
- (iii) establishment of a responsible management system including revision of the previous management system; (\* The part of the bill amended by the House of Representative is underlined.)
- (iv) clarification of the responsibility of management and shareholders in the Management Enhancement Plan if the government injects capital into financial institutions which fail to meet capital adequacy requirements (e.g. financial institutions whose capital adequacy ratio is below four (4) %);
- (v) (If there is no fundamental organizational restructuring), clarification of management responsibility in case of failure to achieve the targets by the management at the end of the Management Enhancement Plan (this clarification can be implemented over a maximum period of three (3) years); and
- (vi) measures which contribute to the revitalization of the local economy, such as the smooth provision of credit.

On the other hand, the Amended ASFF will not always require to pursue responsibilities of management and shareholders ((iv) and (v) above). This amendment intends to lower the legal hurdles for applicants which are suffered from a shortage of equity capital. It has been made for the purpose of promoting the smooth functioning of financial services to SMEs.

Furthermore, by changing the wording of "measures which contribute to the revitalization of the local economy, such as the smooth provision of credit" (vi) to the wording of "measures which contribute to the revitalization of the local economy, such as the smooth provision of credit to SMEs", the Amended ASFF clarifies that its objective is to promote the smooth provision of financial services to SMEs.

### **3. Easing of Criteria for Government's Capital Injection (Amended ASFF, Article 5, Paragraph 1 and Article 17, Paragraph 1)**

Pursuant to the Pre-Amended ASFF, if the following criteria, etc. are satisfied, the government will determine how much capital it will inject upon receipt of a Management Enhancement Plan submitted by the applicant.

- (i) if the improvement of profitability and efficiency is expected to meet the target set forth in the Management Enhancement Plan;
- (ii) if the Management Enhancement Plan is correctly implemented;
- (iii) if the smooth functioning of financial services is expected to benefit local areas;
- (iv) if the collection of public funds is not deemed to be difficult;
- (v) if the assets are properly evaluated;
- (vi) if such financial institution is not bankrupt or insolvent; and
- (vii) (in case where there is no fundamental organizational restructuring), if any measures for

business restructuring are adopted.

On the other hand, the Amended ASFF will not always require measures for business restructuring if no fundamental organizational restructuring is planned. Furthermore, by changing the wording of “if the smooth functioning of financial services will be expected in local areas;” (vi) to the wording of “if the smooth functioning of financial services to SMEs will be expected in local areas”, the Amended ASFF clarifies that its objective is to promote the smooth provision of finance services to SMEs.

#### **4. Creation of Capital Injection System for the Central Organization of Cooperative Structured Financial Institution**

##### **(1) Background**

Taking into account the financial functions of central organizations (“Central CSFI”) of cooperative structured financial institutions (“CSFI”), which operate across the country (which includes the Shinkin Central Bank, the Shinkumi Federation Bank, the Rokinren Bank, the Norinchukin Bank, the National Federation of Agricultural Co-operative Associations, the National Federation of Fisheries Co-operative Associations, and the National Federation of Fishery Processor’s Co-operative Associations), the Pre-Amended ASFF allows the government to make capital injections into a Central CSFI if it submits a Management Enhancement Plan as described in 2 (2) above and satisfies the criteria described in 3 above (capital participation in the central organization as a non-consolidated entity).

Furthermore, among Central CSFIs which operates across the country, the Shinkin Central Bank, the Shinkumi Federation Bank and the Rokinren Bank may request the government to purchase trust beneficiary rights, etc. (including without limitation, the preferred equity investment) issued by each CSFI under umbrella of a Central CSFI and held by the Central CSFI as a measure of the recapitalization support to its members (including, without limitation, the undertaking of preferred equity investment) even under the Pre-Amended ASFF, if each individual CSFI submits a Management Enhancement Plan and satisfies the criteria equivalent to 3 above (capital participation in individual CSFI through the central organization) (ASFF Article 25 through 34).

As described above, the Pre-Amended ASFF permits the injection of public funds into Central CSFI or into each individual CSFI through its Central CSFI. However, in the latter case, the individual CSFI is required to submit a Management Enhancement Plan as well as to satisfy the criteria for examination. Furthermore, there was no system with respect to the injection of capital in individual agricultural- and forestry-related CSFI through the Norinchukin Bank.

On the other hand, the Amended ASFF allows the government to inject capital in Central CSFIs (the Norinchukin Bank, in addition to the Shinkin Central Bank, the Shinkumi Federation Bank and the Rokinren Bank) by undertaking their preferred equity investment in advance for the purpose of facilitating the continued functioning of financial services provided by CSFIs in general (Amended ASFF Article 34-2 through 34-9).

The capital injected by the government may be used for capital support to each CSFI, as well as reinforcing the financial soundness of its Central CSFI

##### **(2) Application for the Government’s Capital Injection**

Central CSFI which applies for capital participation shall submit the enhancement plan for its CSFI’s financial functions (“CSFI Enhancement Plan”) to the government (DICJ) (Amended ASFF, Article 34-3).

The following matters shall be included in such an Enhancement Plan:

- (i) measures to improve the profitability and efficiency of the businesses of the central organization of the CSFI, and the CSFI itself;
- (ii) guidelines for instructing the management of the CSFI which will receive financial support;
- (iii) structure for effective utilization of public funds;
- (iv) measures which contribute to the revitalization of the local economy such as the smooth provision of credit.

The responsibility of management needs to be clarified in CFSI Enhancement Plan if it is necessary. (\* The part of the bill amended by the House of Representatives is underlined.)

### (3) Criteria for Government's Capital Injection

If the following criteria are satisfied, the government will decide to undertake the preferred equity investment, etc. upon receipt of the CFSI Enhancement Plan submitted.

- (i) if the CFSI Enhancement Plan is deemed as appropriate to facilitate the functioning of financial services which CSFIs, in general, provide;
- (ii) if the CFSI Enhancement Plan is expected to be smoothly implemented without fail;
- (iii) if the collection of public funds is not deemed to be difficult;
- (iv) if the assets are properly evaluated; and
- (v) if such a financial institution is not bankrupt or insolvent.

### (4) Publication of the Name of CSFI Which Have Received Financial Support

If Central CSFI which has received the government's capital injection provides financial support to its member CSFI, it shall publish the name of that CSFI. (\* The part of the bill amended by the House of Representatives is underlined.)

### (5) Government's Supervisory Measures

Central CSFI which has received the government's capital injection through the preferred equity investment shall report the implementation status, etc. of the matters described in the CFSI Enhancement Plan every six months to the minister in charge until such preferred equity investment is disposed of in full (Amended ASFF, Article 34-8).

Furthermore, the minister in charge may give a supervisory order as deemed necessary to the Central CSFI in which the government has made the preferred equity investment (Amended ASFF Article 34-9).

## 5. Enforcement Date

The Amended ASFF shall become effective on a day as specified in the Cabinet Order but not exceeding two (2) months from the date of promulgation (Supplementary Provision, Article 1).

**Contact Information:**

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