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Japan’s Abenomics - Deregulating the Money Lending Act, More Reforms to Come

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During Prime Minister Shinzo Abe’s first 16 months in office, he has released two of the “three arrows” of his program to revitalize Japan’s economy — *massive monetary easing* and *targeted fiscal stimulus*. These reforms are credited with having quickened economic growth and ended over a decade of deflation. The Japanese government is now assessing how and when to release the third and most important arrow — *reform*. Among other measures, such as reducing the corporate tax rate and deregulating special economic zones, the government may deregulate the Money Lending Act of Japan (the “Act”). The government recently amended the government ordinances of the Act (the “Amendments”) . The Amendments, which came into effect on April 1, 2014, have significantly impacted the practice of intra-group cash management and joint venture financing, as outlined in this alert.

I. Intra-group Cash Management Exemption

Under the Act, any person or entity who repeatedly lends or intermediates lending must register with relevant authorities and comply with certain ongoing requirements. Prior to the Amendments, there were only a few exemptions from the registration requirements, and it was understood that even company intra-group lending was subject to those requirements.

Although there was no clear exemption provision, it was understood that, through the use of no action letters, intra-group cash management can be exempt from registration requirements if such lending is made between a parent company and its subsidiaries, or between the companies wholly owned by the same parent company. Therefore, an international corporation with a Japanese subsidiary had to either register to conduct a money-lending business or lend only through its ultimate parent company to manage cash from its Japanese subsidiary.

The Amendments state that entities conducting intra-group lending will be exempt from registration requirements. What constitutes a group is broadly defined and includes not only entities controlling or controlled by a majority of voting rights, but also includes those that control or are controlled by at least 40% of voting rights with significant influence on the entity. See chart below for an illustration. The result is that intra-group cash management involving Japanese entities has become very flexible; those who have applied for registration for intra-group cash management purposes no longer need to maintain such registrations, and this may reduce operational burdens and costs substantially.

II. Joint Venture Financing Exemption

The Amendments provide a further exemption for shareholder loans made by certain shareholders in a joint venture. A loan from a shareholder entity that holds at least 20% of the entity's voting rights is now exempt from the application of the Act if (i) the shareholder entity jointly controls the entity with other shareholder entities pursuant to a joint venture agreement and (ii) all shareholder entities approve loans from such shareholder entity or such loans are contemplated under the joint venture agreement.

As a result, the Amendments facilitate financing joint ventures. For example, a Japanese entity that is a minority partner in a joint venture can make loans to the joint venture without registration if it owns 20% or more in the joint venture. See chart below for an illustration.

III. Further Amendments Expected

As described above, the Amendments will facilitate intra-group cash management and joint venture financing. Furthermore, the Abe government is considering submitting further changes to the Act, including a proposal to lift the interest-rate ceiling from the current 20% to 29.2% per annum, and eliminating the total volume control to certain authorized non-banking institutions.

Although "Abenomics" is benefiting large companies and banks, SMEs still struggle to get financing due to their lower credit ratings and the reluctance of banks to lend. As such, SMEs are expecting non-banking institutions to play an active role as financiers.

O'Melveny will continue to monitor developments and provide further updates as significant developments unfold.

For more information about the Act, please contact the authors of this alert Yoji Maeda or Hiroki Sugita in our Tokyo office.
