Newsletter

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So far in 2022, Atsumi & Sakai has held seminars on some 25 themes for Japanese financial institutions. Following the seminars, we are publishing a series practice notes discussing some of the topics covered that may be useful for overseas readers. In this edition, we outline a lecture that explores the trends in syndicated loans in Japan and related regulations under Japanese law.

Trends in Syndicated Loans and Related Regulations in Japan

1. Trends in syndicated loans

The value of syndicated loans in Japan has been increasing in much the same way as in other countries. For borrowers, syndicated loans are large and flexible funding vehicles, and for lenders it is a business with a controlled credit risk, and which generates a high loan margin income. For financial institutions in Japan, where the Bank of Japan's long-term low interest rate and easy monetary policy creates an unprofitable environment, overseas business centered on the U.S. syndicated loan markets, which generates a large fee pool, is an important source of income and it was recently reported that the number of syndicated loans managed by Japanese financial institutions to U.S. corporations in 2021 was approximately three times that of 10 years earlier.

On the other hand, transactions in foreign currency markets in Japan are rare, and it remains difficult for Japanese banks to procure stable USD and other foreign currencies. In order to strengthen the profitability of Japanese banks, it is desirable for them to attract foreign financial institutions to participate in syndicated loans originated in Japan denominated in foreign currencies. To that end, it was reported at the end of last year that Japan's Financial Services Agency had started to consider allowing foreign banks without a Japanese banking license, etc. to participate in syndicated loans originated in Japan.

2. Approvals and licenses required for foreign banks to participate in Japanese syndicated loans

Currently, for a foreign bank to participate in syndicated loans with a Japanese borrower on a primary basis it must:

(i) Obtain a license under Article 47, Paragraph 1 of the Banking Act; or

(ii) Register as a money lending business pursuant to the Money Lending Business Act; or

(iii) Entrust the business to a Japanese bank that engages in foreign bank agency services (the foreign bank being a "principal foreign bank") pursuant to Article 52-2-4 of the Banking Act,

(i) and (ii) requiring a local office.

A foreign bank can participate in a syndicated loan to a Japanese corporation based on (i) – (iii) as follows:

In the case of (i), only the local offices of foreign banks with an Article 47 license are deemed to be Japanese banks and can participate in syndicated loans for Japanese borrowers, and it is a breach of the Banking Act for the foreign bank to participate in syndicated loans to Japanese borrowers from a foreign office.

In the case of (ii), since the registration as a money lending business should be made on the premise that the entity conducting the money lending business has its own business office in Japan, it is a breach of the Money Lending Business Act for a foreign financial institution with a local office registered as a moneylender to participate in syndicated loans to Japanese borrowers from a foreign office.

In the case of (iii), it is possible for the foreign bank registered under the Banking Act as a principal foreign bank to participate in a syndicated loan from a foreign office on the condition that a Japanese bank performs foreign bank agency services as an intermediary in the syndicated loan transaction. It should be noted that if the principal foreign bank as a participant in the syndicated loan transaction is involved in the conduct of the intermediary, it may, depending on the degree of such involvement, violate the Banking Act.

3. Caps on fees and interest rates

In Japan, the Act Regulating the Receipt of Contributions, Receipt of Deposits and Interest Rates ("Contributions, etc. Act") and the Interest Rate Restriction Law impose limits on the fees and interest that can be received or charged by financial institutions, the current interest rate cap being 15%-20% of the borrowed amount. These regulations apply domestically to both consumer and corporate loans and regardless of currency, so care needs to be taken with loans denominated in foreign currencies as the interest rates on foreign currencies are generally significantly higher than those for Japanese yen and there is a higher risk of breaching the interest rate cap in a foreign currency loan. The cap covers both stated interest and certain fees and charges that would be regarded as "deemed interest".

(1) Arrangement Fees

The Contributions, etc. Act provides that "No person acting as an intermediary in the lending or borrowing of money shall enter into a contract for a fee in excess of 5% of the amount of the loan to the intermediary or receive a fee in excess of this.".

While it is a matter of debate whether a person is a "person acting as an intermediary for the lending of money" where it assists in the arrangements for a loan but the loan is ultimately not agreed, in practice, it is considered safer to receive arrangement fees only after the loan agreement is concluded.

The next issue is whether the arrangement fee can be received after the loan agreement has been concluded but before a loan is advanced. In Japan, the traditional view had been that a loan contract becomes valid only after the agreement to lend has been entered into and funds are advanced under it, so the arrangement fee would only be payable after a loan has been advanced. However, a recent amendment to the law has clarified that written loan agreements are valid without the funds being advanced, and the current view of the issue is that once the loan agreement is concluded, it is deemed that the intermediary actions that should have been taken must have been completed and a financial institution as an arranger of a syndicated loan can receive the arrangement fee before any loan is actually made.

When multiple arrangers are involved, the question arises whether each arranger can receive up to 5% or the total paid to all arrangers is capped at 5%. It is customary to take a conservative view and apply the cap to the aggregate arrangement fees for all arrangers.

Where a loan agreement is amended to increase the amount that can be borrowed, the 5% cap on the arrangement fees would apply to the additional loan amount.

(2) Deemed Interest - Arrangement Fees & Agent Fees

There is debate as to whether arrangement fees and agent fees constitute interest for the purpose of the Interest Rate Restriction Act, a common view being that they are not as they are simply a consideration for business performed independently of the loan itself and not for the use of the principal, but the question needs to be considered based on the facts of each case.

(3) Deemed Interest - Commitment Fees & Facility Fees

The Act on Specified Commitment Line Contracts exempts commitment fees and facility fees received by financial institutions from the application of the Interest Rate Restriction Act when the borrower is a listed company subject to that Act. Therefore, if the borrower is not subject to the Act (such as a small and medium-sized enterprise ("SME")), commitment fees and facility fees received by the lender will be deemed as interest under the Interest Rate Restriction Act. If a commitment fee or facility fee is charged without the loan being extended, the effective interest rate would become infinite, which would violate the Interest Rate Restriction Act and the Contributions, etc. Act. In such cases, measures to mitigate the risk should be taken which include (a) requiring the borrower to borrow a specified amount or (b) adjusting the amount of the commitment fees and interest payable so as to lower the effective interest rate below the capped rate.

(4) Deemed interest - Other Fees

Other fees that may be regarded as deemed interest include upfront fees, etc. such project structuring fees or administration fees, and monitoring fees for bilateral covenant financing.

A common criterion for distinguishing what is or is not deemed interest is "whether the business that involves actual social and economic conditions is conducted so that the fees received can be evaluated as compensation for a business that is independent of the loan". However, this is not considered an objective standard, and whilst the terms of the loan, etc. agreement are relevant each situation has to be examined based on its facts so it is difficult to exclude the possibility of such fees being treated as deemed interest despite the terms of the loan documentation.

4. Security/Guarantees

One of the factors behind the rise of syndicated loans in Japan since the early 2000s was that the fundamental characteristics of syndicated loans, which monitor business conditions by setting covenants, were consistent with Japan's challenge at that time to break away from the traditional approach of providing credit enhancement through security and guarantees.

However, when providing syndicated loans for SMEs, it is essential to consider providing credit enhancement through security and guarantees and a considerable proportion of syndicated loans to SMEs are still backed by security or guarantees.

When taking security or a guarantee, it is necessary to keep in mind that depending on the scope of the secured claims, there may be a question of whether revolving or ordinary collateral or guarantees should be taken. Typically, revolving collateral and/or revolving guarantees are used where secured claims are likely to arise and be extinguished repeatedly, such as in the case of commitment lines, and for a specific secured claim, such as a term loan, ordinary collateral and ordinary guarantees are used.

In Japan, guarantees provided by individual owners/managers of the borrower have traditionally been viewed as contributing to the smooth procurement of corporate funds, though they can be seen to impede management flexibility and have a negative impact on business succession. For revolving guarantees by individuals, rules have recently been introduced through legislation and guidelines which may void revolving personal guarantees and/or require certain formalities to be complied with. Therefore, financial institutions must take more care than before when accepting revolving guarantees from individuals.

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We are the only independent Japanese law firm which is located in New York, London and Frankfurt which together with our Tokyo head office enables us to provide real-time advice on Japanese law to our clients globally.

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