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**ROUNDTABLE ON COMPETITION, CONCENTRATION AND STABILITY IN THE BANKING  
SECTOR**

**-- Note by the delegation of Japan --**

*This note is submitted by the delegation of Japan to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 16 - 17 February 2010*

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## ROUNDTABLE ON COMPETITION, CONCENTRATION AND STABILITY IN THE BANKING SECTOR

-- Note by Japan --

### 1. Introduction

1. Since the late 1990s, financial institutions accelerated a process of reorganisation, as a result of factors such as (i) financial infrastructure development through progress in the financial system reform, etc., (ii) the necessity of dealing with the non-performing loan problem, (iii) the legalisation of reorganisation schemes, including holding companies, to realise business strategies. Against these contexts, the major banks leading Japan at the time converged into 3 mega bank groups by the middle of 2000s.

2. In this paper, we would like to summarise the progress of regulatory reforms in the financial sector in Japan and the process of reorganisations of financial institutions, after which we will introduce the views of competition law and policy followed by cases regarding reorganisations in the banking sector since the late 1990s.

### 2. Financial System Reform and the Competition Environment of the Banking Sector

#### 2.1 Reorganisations of Major Banks

3. In the progress of financial system reform, major banks, based on their own management judgments, intended to strengthen (i) competitiveness and (ii) management vitality, including improvement of capital adequacy ratios through mergers and alliances. Consequently, the major banks leading Japan converged into 3 mega bank groups (Mizuho Group, Sumitomo Mitsui Group and Mitsubishi UFJ Group).

- *Mizuho Group* (the Dai-Ichi Kangyo Bank, Ltd., the Fuji Bank, Ltd. and the Industrial Bank of Japan, Ltd.)
  - Establishment of Mizuho Holdings, Inc. (a holding company) (September 2000)
  - Reorganisation to Mizuho Bank Ltd. and Mizuho Corporate Bank Ltd. (April 2002)
- *Sumitomo Mitsui Group* (the Sakura Bank Ltd. and the Sumitomo Bank Ltd.)
  - Merger of the Sakura Bank Ltd. and the Sumitomo Bank Ltd. (Sumitomo Mitsui Banking Corporation) (April 2001)
  - Establishment of Sumitomo Mitsui Financial Group, Inc. (a holding company) (December 2002)
- *Mitsubishi UFJ Group* (the Bank of Tokyo-Mitsubishi Ltd., the Sanwa Bank Ltd., the Tokai Bank Ltd., etc.)

*[Mitsubishi Tokyo Group]* (The Bank of Tokyo-Mitsubishi Ltd., etc.)

- Establishment of Mitsubishi Tokyo Financial Group, Inc. (a holding company) (April 2001)

*[UFJ Group]* (The Sanwa Bank Ltd., the Tokai Bank Ltd., etc.)

- Establishment of UFJ Holdings, Inc. (a holding company) (April 2001)
- Merger of the Sanwa Bank Ltd. and the Tokai Bank Ltd. (UFJ Bank Limited) (January 2002)

*[Mitsubishi UFJ Group]* (Mitsubishi Tokyo Group, UFJ Group)

- Integration of Mitsubishi Tokyo Financial Group, Inc. and UFJ Holdings, Inc. (Mitsubishi UFJ Financial Group) (October 2005)
- Merger of the Bank of Tokyo-Mitsubishi Ltd. and UFJ Bank Limited (the Bank of Tokyo-Mitsubishi UFJ, Ltd.) (January 2006)

## **2.2 Competition Environment of the Banking Sector**

### **2.2.1 Background**

4. After the late 1990s, as entries into the banking business gained momentum through Internet-based banks and from other industries, and the move intended to form a new type of banking business was boosted. As a result, Japan saw the emergence of (i) 5 Internet-based banks including Sony Bank Inc. and the Japan Net Bank, Limited, as well as (ii) banks based mainly on collaboration with retail commerce facilities including supermarket, such as Seven Bank, Ltd. and Aeon Bank, Ltd, during the time when reorganisation of major banks made progress.

5. Additionally, in not only the banking sector but overall financial sectors in Japan, since the late 1990s, regulatory reforms, which enhance the competitive financial environment, have been progressing continuously. Hence, banks have been embarking on securities business acting on their own or through their subsidiaries and competing with securities companies in addition to the traditional banking business, such as loan-deposit business and exchange business (e.g. sales of investment trusts, undertaking of stocks and corporate bonds, etc.)

### **2.2.2 Recent Developments**

6. During the recent financial crisis, since the Japanese financial system itself has been relatively sound compared with those in the United States and Europe, there have been no cases of major mergers and reorganisations triggered by the crisis in the banking sector, among the 3 mega bank groups.

7. As regards recent regulatory reform which influences the competition environment of the banking sector, it can be pointed out that businesses other than banks have been permitted to operate money transfer business for a small amount, which was allowed for only banks, under a registration system as the result of the enactment of the Payment Services Act in 2009.

## **3 Reorganisation in the Banking Sector and Competition Policy**

### **3.1 Views of Merger Investigation toward Business Combinations of Financial Institutions**

8. Chapter IV of the Antimonopoly Act (AMA) prohibits business combinations that may substantially restrain competition in any particular field of trade. And, as guidelines on the interpretation of those provisions, the Japan Fair Trade Commission (JFTC) compiled and published “Guidelines for the Interpretation on the Stipulation that ‘The Effect May Be Substantially to Restrain Competition in a Particular Field of Trade’ Concerning M&A” in 1998 and, as its revision, “Guidelines to the Application of

the Antimonopoly Act concerning Review of Business Combinations”<sup>1</sup> in 2004. The views explained in these Guidelines are applied to business combinations in the banking sector, as well as other sectors, concerning the judgment of whether a business combination may substantially restrain competition in a particular field of trade or not. In other words, there are no special guidelines or enforcement standards of the AMA that specialise in the business combinations of financial institutions, including banks.

### 3.2 *Main Cases of Business Combinations of Major Financial Institutions since the late 1990s*

9. The following 5 cases can be named as the main cases in which the JFTC has carried out merger investigations on the reorganisation of major financial institutions since the late 1990s.

- *Mizuho Financial Group Case* (the establishment of a joint holding company by the Dai-Ichi Kangyo Bank, Ltd., the Fuji Bank, Ltd. and the Industrial Bank of Japan, Ltd.) (2000)
- *UFJ Holdings Case* (the establishment of a joint holding company by the Sanwa Bank, Ltd., the Tokai Bank Ltd. and the Toyo Trust Bank Ltd.) (2001)
- *Sumitomo Mitsui Banking Corporation Case* (the merger between the Sumitomo Bank Ltd. and the Sakura Bank Ltd.) (2001)
- *Mitsubishi Tokyo Financial Group Case* (the establishment of a joint holding company by the Bank of Tokyo-Mitsubishi Ltd., Mitsubishi Trust and Banking Corporation and Nihon Trust and Banking Corporation) (2001)
- *Mitsubishi UFJ Financial Group Case* (the business combination between Mitsubishi Tokyo Financial Group, Inc. and UFJ Holdings, Inc.) (2005).

10. Among those cases of business combinations of financial institutions that the JFTC has made public in the past, there are no examples of the JFTC pointing out that such combinations may substantially restrain competition. However, in some cases, the JFTC indicated problem(s) from the viewpoint of competition policy based on the result of surveys on the impact of the combinations on the industry.

#### 3.2.1 *Mizuho Financial Group Case*

##### Summary of the case

11. In this case, the Dai-Ichi Kangyo Bank, Ltd., the Fuji Bank, Ltd. and the Industrial Bank of Japan, Ltd. attempted to fully integrate their businesses as the “Mizuho Financial Group” by jointly establishing a holding company. The three banks were to be placed under the holding company, while the three securities subsidiaries of the banks (Dai-Ichi Kangyo Securities, Fuji Securities and Kogin Securities) and the two trust bank subsidiaries (Dai-Ichi Kangyo Fuji Trust Bank and Kogin Trust Bank) were to be merged.

##### Analysis under the AMA

12. As regards the impact on competition in the financial market, the JFTC made a careful examination by defining the particular field of trade as each of the deposits, loans, foreign exchange, securities and trust banking businesses. Although the Mizuho Financial Group would be the leader in such

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<sup>1</sup> These guidelines were also amended partially in 2007. <http://www.jftc.go.jp/e-page/legislation/ama/RevisedMergerGuidelines.pdf>

fields as deposits and loans, the JFTC judged that it would not substantially restrict competition in any business area taking into account various factors, including competitive pressure from neighbouring markets, the existence of strong competitors and entries from other industries. For example, as regards the deposits business, it was taken into account that under low interest rates, individual deposits flowed to alternative financial products including investment trusts, thus, competition pressure existed from neighbouring markets of financial products which alternate deposits and are provided by securities companies, investment trust companies and insurance companies. And, as regards the loan business, it was taken into account that accompanied with the diversification of financing methods, major firms carried forward direct finance including corporate bonds, commercial paper and account receivable financing, thus, competition pressure from neighbouring markets of those financial products would operate.

### Impact on the Industry

13. As regards the impact on the industry, the JFTC conducted questionnaire and interview surveys with firms financed by the three banks, as the three banks would be financing about 70% of the listed companies. From the result of the surveys, the JFTC judged that the integration might lead to interference in the management of firms the group would have an increased share in financing and ownership of (for example, by requesting such firms to conduct (or increase) transactions other than borrowing, such as deposits), as well as to the formation of exclusive and closed trading relationships through the selection of trading partners based on whether they belong to the corporate group or not.

14. Accordingly, the JFTC indicated to the three banks that the necessary measures should be taken to prevent such concerns from being realised.

15. The three banks responded as follows to the JFTC:

16. As regards the concern about the new group interfering with management on the strength of its increased share in loans and stockholdings, the three banks are currently doing their utmost to ensure full compliance with the AMA by thoroughly informing their directors, officers and employees of its importance. Such efforts will be continued after the integration. In the holding company to be created, a regime will be built to monitor the compliance of the group as a whole so as to prevent such acts as pointed out by the JFTC.

17. As regards the concern about closed relationships within the corporate group, the Mizuho Financial Group will be operating its businesses as an impartial and open financial group. The group does not intend to initiate the formation of any specific or exclusive corporate group. By the spring of 2002, when the member banks will be integrated and restructured, they will review the operation of corporate groups that formed with banks as cores and consider the possibility of their dissolution.

18. As regards the business integration plans, the JFTC concluded that the proposed establishment of a holding company, under which the three banks were placed, and the merger of the three banks' subsidiaries, including 3 securities companies and 2 trust banks, would not be likely to violate the provisions of the AMA. When the further organisational restructuring of the three banks was to take place in spring 2002, the JFTC intended to examine the case as necessary. As to the proposals made by the three banks in response to the indications by the JFTC concerning the impact of the consolidation on various industrial sectors, the JFTC will carefully monitor how the proposals are being carried out and will strictly deal with whatever activities may constitute violations of the AMA.

### 3.2.2 *Sumitomo Mitsui Banking Corporation Case (2001)*

#### Summary of the case

19. In this case, the Sumitomo Bank Ltd. and the Sakura Bank Ltd. attempted to merge to deal with tougher competition accompanying the progress of reorganisations in the banking sector and so on. (The Sumitomo Bank Ltd. was the merging company and after the merger it was renamed the Sumitomo Mitsui Banking Corporation or 'SMBC.')

The JFTC investigated this case based on the request of a prior consultation by concerned parties and, from the result of the investigation, the JFTC judged it would not be likely to violate any provisions of the AMA.

#### Analysis under the AMA

20. For this case, as regards the impact on competition in the financial market, the JFTC defined a particular field of trade as each of the deposits, loans, foreign exchange and securities businesses, then, the JFTC judged it would not substantially restrain competition in any business area. For example, as regards deposits and loans, although the new company would take second position in the market share and the degree of concentration of the leading banks would increase because other major banks also planned to integrate, various factors including competitive pressure from neighbouring markets, the existence of strong competitors and entries from other industries were taken into account. As regards bond underwritings, although the new company would be the leader in the market share, the prediction on the extension of the securities market and active competition in said market and the existence of strong competitors including major securities companies were taken into account.

#### Impact on the Industry

21. Accompanying this merger, the new bank would be financing about 60% of the listed companies, so the JFTC conducted questionnaire and interview surveys on firms financed by the new bank (the listed companies and small and medium-sized companies). As the result of the surveys, it was determined that about 25% of the companies had no alternative method for the procurement of equipment funds and operating funds, thus, they could not change the structure of financing. Furthermore, it was determined that about 30-40% of the companies actually received or expected to receive a request on the transactions other than borrowing, such as deposits, and to use a specific securities company as the main underwriter of corporate bonds.

22. From the result of the surveys, the JFTC indicated the following problems under the AMA and competition policy to the new bank:

- In the process of the surveys of this case, the firms where the new bank would have an increased share in financing and ownership, expressed concern that the new bank would intervene in the management of said firms, for example, by requests to conduct (or increase) transactions other than borrowing, such as deposits.
- If the new bank carries out such conducts as those described above against the background of an increased share in financing and ownership, and indicates a disadvantage to those firms that do not obey such 'requests' and so on, those conducts will be likely to compose unfair trade practices (violations of Article 19 of the AMA). In this regard, the new bank must take necessary measures to prevent the conducts that cause a disadvantage to the trading firms against the background of its influence in the future operation's activities.

23. To the above indications, the concerned companies responded their utmost to ensure full compliance with the AMA by thoroughly informing their directors, officers and employees of the measures including (i) the establishment of internal rules including a Compliance Manual, (ii) education and training, (iii) circulation of the Compliance Manual Handbook among their directors, officers and employees for the purpose of avoiding violations of the AMA.

### 3.2.3 *Mitsubishi UFJ Financial Group Case (2005)*

#### Summary of the case

24. In this case, Mitsubishi Tokyo Financial Group and UFJ Holdings planned a business integration including the merger between them.

#### Analysis under the AMA

25. In this case, regarding the market definition, the JFTC found that the products and services sold by the group companies of the two banks could be classified into 30 categories. This classification was made based on the criteria of whether products or services offered users similar functions or utilities. Also, the JFTC recognised that the goods and services were generally sold in each national market, but the deposit and loan markets consisted of their national and prefectural markets. In conclusion, forty-seven markets were defined in total, the JFTC carried out an in-depth investigation (Phase II investigation) on 23 categories including deposits (7 markets, including the whole country, Tokyo Metropolitan, Aichi Prefecture and Osaka Prefecture), loans (7 markets, including the whole country, Tokyo Metropolitan, Aichi Prefecture and Osaka Prefecture) and the trust business (7 markets). For example, as regards deposits and loans, although the new group would be the leader with 25%-40% in market share, the JFTC judged that this integration would not be likely to substantially restrict competition from both unilateral behaviour and co-operative behaviour viewpoints by taking into account various factors including competitive pressure from neighbouring markets, influential competitors and entries from other industries. Also, the JFTC judged that this integration would not be likely to substantially restrain competition in any areas other than the above.

### 3.3 *Reorganisation of Financial Institutions and Problems under Competition Policy*

26. As the above (3.2), although there is no example among the cases of reorganisations of major financial institutions in which the JFTC judged it would be likely to substantially restrict competition, in the questionnaire surveys the JFTC conducted with the industry, there are cases of firms where the new bank would have an increased share in financing and ownership, expressing concern that the new bank would intervene in the management of said firms, for example, to request to conduct (or increase) transactions other than borrowing, such as deposits.

27. If a bank carries out the sales activities of financial products by unjustly using its influence through loan businesses, it would deprive the firms' free and independent judgment, at the same time, the competitors in the sales of financial products would fall to a disadvantaged position, thus, fair and free competition in the market of these sales would be likely to be impeded. When any entrepreneur, individually or by combination or conspiracy with other entrepreneurs, or by any other manner, excludes or controls the business activities of other entrepreneurs, thereby causing, contrary to the public interest, a substantial restraint of competition in any particular field of trade, such a conduct would be prohibited as a Private Monopolisation under the AMA (Article 3). Also, even when a conduct does not fall under Private Monopolisation, such a conduct could be questioned as a violation of the AMA including an Unfair Trade Practice prescribed in Article 2 (9) of the AMA.

28. In December 2004, accompanying the relaxation of controls over the classification of business categories and the expansion of scope of business for financial institutions, to prevent violations by clarifying the conducts that will be questioned by the AMA, the JFTC compiled ‘the Guidelines for Unfair Trade Practices Associated with the Relaxation of Controls over the Classification of Business Categories and the Expansion of Scope of Business for Financial Institutions.’

29. In actuality, there is one case in which a major financial institution forced borrower companies to purchase other financial products by using its trade position in loans (the following case of abuse of dominant bargaining position by Sumitomo Mitsui Banking Corporation).

30. Also, the JFTC published the “Survey Report on the Trade Practices between Financial Institutions and Firms” (June 2006), clarified the actual conditions of unfair trade practices in the trades between financial institutions and borrowers and showed the views under competition policy regarding them. At the same time, the JFTC reiterated its position that it would continue to observe the outcome of the trades between financial institutions and firms and, if it faces a case in which fair and free competition is impeded, it will deal with such a case strictly based on the AMA.

#### **4. Case of Abuse of Dominant Bargaining Position by Sumitomo Mitsui Banking Corporation (2005)**

31. As of March 2005, the net asset of Sumitomo Mitsui Banking Corporation (SMBC) reached about JPY 91 trillion and SMBC was the banking sector leader in Japan in net assets.

32. Among companies, in particular small and medium-sized companies, which obtained a loan from the SMBC, there were several that found it difficult to procure funds by obtaining loans from financial institutions other than the SMBC or by other means at that time. Since business operations would have been adversely affected if they could not obtain a loan from the SMBC, borrower companies were forced to accept not only loan terms but also various requests from the SMBC in hopes of continuing their loan transactions. Thus, the bargaining position of these companies was inferior to that of the SMBC.

33. The SMBC demanded those companies with which it had a financial relationship and which were in an inferior bargaining position to the SMBC to purchase a derivative financial commodity (an interest swap). The SMBC did so by proposing that the said companies purchase the commodity during the process of moving forward with financial procedures and by directly expressing and/or suggesting that the companies’ purchase of the commodity was a condition for receiving a loan and that their requests for a loan would be handled in an unfavourable manner if the companies did not purchase the commodity. These acts left the borrower companies with no choice but to purchase the commodity. On December 2, 2005, the JFTC issued a recommendation for the elimination of such misconduct for violation of Article 19 of the AMA (corresponding to Paragraph 14 (1) of the Designation of Unfair Trade Practices, “Abuse of Dominant Bargaining Position”). (The decision was issued on December 26, 2005.)