

LAW AND ECONOMICS YEARLY REVIEW

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MARKET
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DEVELOPMENT AND
GOVERNMENT'S
POLICIES ON
GLOBALIZATION

Editors

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**CURRENT BASIC LINES OF THE DISCIPLINE OF BANK CRISES
AND UNRESOLVED PROBLEMS: AN INITIAL COMPARISON
BETWEEN THE SOLUTIONS ACCEPTED IN THE EUROPEAN
UNION (WITH SPECIAL EMPHASIS ON ITALY) AND IN JAPAN,
BETWEEN THE ROLE OF BANKING AUTHORITIES AND THE
POWERS OF JUDICIAL AUTHORITY ***

Masaki Sakuramoto** - Alberto Urbani***

ABSTRACT: *In The European Union, the current guidelines for bank crises summarized in the EU directive No. 2014/59/UE seems to have been built around three basic lines: the consequences of the crisis shall be primarily borne by the failed bank's shareholders and by its creditors, and only secondly by the community; it is appropriate to widen the tools available to the authorities in the field to govern a bank crisis; from this point of view, in particular, it is necessary to reinforce the early intervention protections and the recovery measures, in order to prevent the worsening of the bank's financial difficulty. This article intends to carry out an initial comparison between the EU guidelines and the fundamental principles governing the bank crisis in Japan, focusing on the powers granted to the supervisory authorities in the European Union and to the judicial powers in the Asiatic country.*

SUMMARY: 1. From current affairs to critical analysis: the reasons for a revision. – 2. The clarification of some fundamental principles of the European Union guidelines in matter of bank crises: the priority criteria in risk sharing. – 3. (next) The plurality of tools available to public authorities. – 4. (next) The enhancement of the *early intervention* tools. 5. A look at the corresponding Japanese guidelines. – 6. «Act on Special Measures for the Reorganization Proceedings of Financial In-

*Although this paper is the result of a joint reflection of the Authors, Masaki Sakuramoto is primarily responsible for paragraphs from 6 to 8, whereas Alberto Urbani is primarily responsible for paragraphs from 1 to 4; paragraph 5 is co-authored.

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stitutions» and definition of terms used therein. – 7. Bankruptcy proceedings of banks. – 7.1. Bankruptcy capacity. – 7.2. Cause of bankruptcy. – 7.3. Non-existence of bankruptcy barrier. – 8. Conclusion.

1. In the latest years, as is well known, the Italian banking system had to face some bank crises of a certain size and, most of all, having significant impact for the areas where such banks were mostly established; some of these crises have luckily been contained while at their initial stage, other ones instead were unfortunately concluded with the bank leaving the market. Among the most serious instances we shall absolutely remember, in 2015, the affairs of the so-called “four banks” (Banca delle Marche, Banca Popolare dell’Etruria e del Lazio, Cassa di Risparmio di Ferrara, Cassa di Risparmio della Provincia di Chieti), placed under extraordinary administration at first and then under resolution, and later the two main Venetian ex mutual cooperative banks *default* (Banca Popolare di Vicenza and Veneto Banca), against which in 2017 a compulsory administrative banks liquidation was ordered; other cases of serious pathology, however, have been added concerning local small-sized banks, all having corporate form of credit union.

These crises events happened in reality at a very particular moment, not only due to the International economic crisis context that lasted, although through alternating stages, since 2008 and through which the whole global banking system had, to a greater or lesser extent, deal with, but also for having manifested right when the complex reform of the banks crises guidelines was coming into effect out of the implementation of the *Bank Recovery and Resolution Directive* (BRRD) No. 2014/59/UE. In Italy, this Directive has been completed with law decrees dated 16 November 2015, No. 180 and 16 November 2015, No. 181, the former forming an independent set of rules while the latter amending the provisions of the Consolidated text of the banking and credit laws (Law Decree dated 1 September 1993, No. 385). The Italian Credit Authorities, therefore, found themselves to be in the position, totally new for them and not just for them, not only to have to manage almost simultaneously the crises of many banks, some of which having signifi-

cant size, but mostly to have to do so in a set of rules that had deeply changed recently, for the first time experimenting tools until then unknown to the national legislation and most of all not easy to be coordinated with some general principles of the domestic legal framework¹.

A further objective element of difficulty derived from the fact that, as it is well known, with the emergence of the Banking Union the supervision on the single banking companies is no longer entrusted to the authorities of the Member State of origin of the body, since this was generally “centralized” at the European Central Bank and the same thing can be said, in parallel, for what concerns the Single Bank Resolution Mechanism in case of a credit institution crisis. The ECB itself, however, inevitably has yet to consolidate its own supervisory and governance practices for the disruption situations of banking operators, so the dialogue and exchanges between the various public authorities involved (including the European Commission itself, for the aspects relating to the protection of economic competition)² often turned out to be complex and, quite frankly, not so easy and proactive as the urgency and the sensitivity of the issues to be addressed would have required.

It shall also be taken into account that some basic principles and many of the new rules that concern the management of bank crises are the subjects of heated debates among the bank's public supervision authorities themselves, among academics and practitioners, and at political level too³. Just think about, for example, the new *bail in* policy, on which most people agree theoretically but that, when its concrete implementation is necessary, gives rise to much controversy and reasonable grounds of perplexity⁴: if in fact, in theory, it would seem

¹On this point, see the considerations of CAPRIGLIONE, *Crisi a confronto (1929 e 2009). Il caso italiano*, Padua, 2009.

²See, e.g., ROSSANO, *Gli aiuti di Stato alle banche e le ritrattazioni della Commissione: tra distorsioni della concorrenza e (in)stabilità finanziaria*, in *Riv. trim. dir. econ.*, 2016, II, p. 1 ss.

³On this point see also CAPRIGLIONE, *Regolazione europea post-crisi e prospettive di ricerca del diritto dell'economia: il difficile equilibrio tra economia e finanza*, in *Riv. trim. dir. proc. civ.*, 2016, p. 537 ss.

⁴See, e.g., AVGOULEAS and GOODHART, *Critical Reflections on Bank Bail-ins*, in *Journal of Financial Regulation*, 2015, 1, pp. 329; BOCCUZZI and DE LISA, *Does Bail-in Definitely Rule*

reasonable to choose to impose the effects of a bank crisis, as an undertaking, primarily to the shareholders, that is to those holding the share capital of the bank, however, in practice this choice can prove to be unfair and detrimental for all those small shareholders that do not have adequate know-how and skills to monitor and understand the real state of health of the bank and, most of all, the risks they will have to face.

As a consequence, a debate started not just in Italy but also at the European Union level, concerning the opportunity to re-examine some of the rules introduced in 2014 with BRRD: in the intentions, it shouldn't be to subvert all the systems of the provisions that have recently been introduced, but to implement targeted interventions that, even paying particular attention to the first experiences, may also be able to mitigate some consequences of the new rules that objectively appeared too harsh to the detriment of less aware investors⁵. The risk is, on the other hand, to compromise the trust of a wider audience less experienced with regards to either a single bank or the banking system as a whole. This is a risk that is just as serious and dangerous – therefore to avoid– because, by definition, it tends to manifest itself in a virulent manner when the pathology tends to prevail on the banking relationships physiology.

2. Especially when it is assumed to modify the rules in force due to their limits and criticalities, the comparison between the experiences of different coun-

out Bailout?, in *Journal of Financial Management, Markets and Institutions*, Issue 1, 2017, pp. 93-100; BABIS, *Bank Recovery and Resolution: What About Shareholder Rights?*, University of Cambridge Faculty of Law Research Paper No. 23/2012, available at SSRN: <https://ssrn.com/abstract=2144753>; TRÖGER, *Too Complex to Work: A Critical Assessment of the Bail-in Tool under the European Bank Recovery and Resolution Regime*, in *Journal of Financial Regulation*, Vol. 4, Issue 1, pp. 3572; GOODHART and AVGOULEAS, *A Critical Evaluation on Bail-ins as Bank Recapitalisation Mechanism*, Centre for Economic Policy Research, Discussion Paper 10065, 2014; PERSAUD, *Why Bail-in Securities Are Fool's Gold*, *Policy Brief*, Peterson Institute for International Economics, November 2014; HADJIEMMANUIL, *Limits on State-funded bailouts in the EU Bank Resolution regime*, in *European Economy*, 2/2016; HÜSER, HALAJ, KOK, PERALES and VAN DER KRAAIJ, *The systemic Implications of Bail-in: A Multi Layered Network Approach*, Working Paper Series 2010, European Central Bank, 2017.

⁵See EUROPEAN PARLIAMENTARY RESEARCH SERVICE, *Amending the bank resolution framework – BRRD and SRMR*, 2017.

tries and, consequently, of different legal systems is not just interesting, but many times can turn out to be fruitful.

Starting from these basic considerations and taking into account what mentioned before, we have deemed that, in the following pages, it would be interesting compare some guidelines relative to the regulations of the management of banking crises in the EU (and, of course, in Italy) as well as in Japan. The chance was offered by the presence at Venice, as *visiting professor* for one year at the University Ca' Foscari, of one of us, Masaki Sakuramoto, who, in his capacity of Bankruptcy Law Scholar, has had a chance to dialogue upon these topics with the other one, Alberto Urbani, that is Professor of Banking Law at the above-mentioned University. The following considerations represent the results of the first dialogue between two persons that are very different both for their own field of research. This is a dialogue that we hope to be able to better develop and deepen in the next future.

Now, starting from the European Union guidelines and in particular from the Italian one related to the management of bank crises, it seems to us that the layout of the rules launched in 2014 is essentially based on three basic ideas.

The first one, which we have fleetingly mentioned in the introduction, is that the negative effects of a bank crisis shall weight as far as possible on the credit institution shareholders and secondly, although within certain limits and with various precautions, on its creditors⁶. A public intervention to support a bank facing difficulties is therefore conceived as a somehow dystonic moment if compared to the general regulations, and so as an exceptional one⁷. As a consequence, we witness a coherent approach to one of the most consolidated methods of the European banking laws, that is the inherently entrepreneurial character of the banking activity. Since a bank is essentially an undertaking, it shall face all the risks

⁶On the general principles governing the treatment of creditors under the BRRD see BINDER, *The Position of Creditors Under the BRRD. Commemorative Volume in memory of Professor Dr. Leonidas Georgakopoulos*, Bank of Greece's Center for Culture, Research and Documentation, 2016, pp. 37-61, available at SSRN: <https://ssrn.com/abstract=2698086>.

⁷On this point, see more in details BRESCIA MORRA, *Nuove regole per la gestione delle crisi bancarie: risparmiatori vs contribuenti*, in *Analisi giur. dell'econ.*, 2016, p. 279 ss.

connected to any economic undertaking of the same kind, including the possibility of an adverse outcome of its entrepreneurial activity, up to the point that serious, difficult conditions may happen and, on occasion, have exceptional seriousness.

Now, who bears the business risk enshrined in the activity of any bank? If you take into account the fact that any credit institution not only represents the interests of the shareholders and mostly of the more or less wide class of customers, it will also favour, downhill, the development of a close network of economic relationships between the single customer and a plurality of other entities, it will be clear that the management of a bank crisis also underlies a very significant public interest: hence the need to not *a priori* exclude the opportunity of a public intervention not only to govern in terms of supervisory work the existing crisis, but also in order to transfer (at least partially) to the community the adverse economic consequences. Schematizing and so simplifying as close as possible the approach to this problem, we could place the issue in terms of an alternative: either choosing to shift the burden of the crisis on the direct interlocutors of the bank or, on the contrary, bailing it out on the whole community through the general taxation system; obviously intermediate solutions cannot be excluded, that is searching for a balance point between these two basic choices.

Consistent with the undertaking nature of the banking activity, effective from the BRRD the European Union expressed its strong preference towards the first solution. To get a confirmation, without analysing in detail the single provisions of the directive, it will be sufficient to read some *recitals*: in particular *Recital 67*, where it is written that «*An effective resolution regime should minimise the costs of the resolution of a failing institution borne by the taxpayers*», ensuring that «*systemic institutions can be resolved without jeopardising financial stability*» in general; or *Recital 8*, for which «*Resolution of an institution which maintains it as a going concern may (...) involve government financial stabilisation tools, including temporary public ownership*», but this, expressly, only «*as a last resort*»; or again *Recital 5*, where it requires that «*The regime should ensure that sharehold-*

ers bear losses first and that creditors bear losses after shareholders, provided that no creditor incurs greater losses than it would have incurred if the institution had been wound up under normal insolvency proceedings in accordance with the no creditor worse off principle as specified in this Directive». It is true that in the BRRD this latter clause has a central role, so much so that further on, in *Recital 46*, it is added that «*The winding up of a failing institution through normal insolvency proceedings should always be considered before resolution tools are applied*», but also, in turn, that

«*the resolution tools should be applied before any public sector injection of capital or equivalent extraordinary public financial support to an institution*» (*Recital 55*). In short, therefore, if the crisis of a bank would be deemed to be particularly serious by the sector authority, the directive 2014/59/UE prefigures an approach that favour such bank to leave the market (through its “liquidation,” very often in the form of compulsory administrative liquidation, like in Italy) and that just secondly will opt for one “resolution” tool, taking a possible public financial support just as the latter component of a global broader strategic plan, especially through the subscription of capital increase⁸. On the other hand, as it is well known, the compulsory liquidation of a bank can produce, at least with regards to the creditors, less penalizing effects compared to some resolution tools.

Therefore, according to the current way to govern bank crises in the European Union the entrepreneurial nature of the banking activity and the related competitive dynamics impose that the privileged way for resolving the irreversible crisis of a bank would be its removal from the market, through its liquidation, or to the maximum extent through severe resolution mechanisms, while the forms of collectivisation of the losses have to be considered absolutely exceptional.

In other terms, it is clear that the current guidelines are not focused on pre-

⁸On the relationship between these three stages of the authorities intervention in case of banking crisis, in the Italian scholarship see INZITARI, *BRRD, bail in, risoluzione della banca in dissesto, condivisione concorsuale delle perdite (d.lgs. 180/2015)*, in *Riv. dir. banc.*, 2016, n. 5, in *dirittobancario.it*; STANGHELLINI, *Risoluzione, bail in e liquidazione coatta: il processo decisionale*, in *Analisi giur. dell'econ.*, 2016, p. 567 ss.

serving the banking institution, but instead only to safeguard its *functions*: already the *Recital 1* of the Directive won't leave any degree of doubt about that.

3. A second option, very evident, from the European legislator, consists of making available to public authorities a broad range of tools to combat the crisis of a bank. This is made clear ever since in *Recital 5* of the Directive, at the point where it's pointed out that «*A regime is therefore needed to provide authorities with a credible set of tools to intervene sufficiently early and quickly in an unsound or failing institution so as to ensure the continuity of the institution's critical financial and economic functions, while minimising the impact of an institution's failure on the economy and financial system*»⁹.

We are in front of a highly significant suggestion, which demonstrates, at first, the effort to combine in this delicate matter a plurality of intentions (this way openly denying the conviction, quite prevalent among common people, that the current guidelines are focused on the fortunes of a intermediary experiencing difficulties leaving merely in the background any consideration on the implications of the crisis on the economy and on the financial system as a whole); at second, the effort to favour a coordinated deployment of response measures of various nature and degree of intensity, starting from the ones aiming at overcome a situation of difficulty at its early stage (*e.g.* resolution plans) in order to land at the other extreme of those usable in case of a very serious and full-blown crisis. In this context a long line of preventive and preparatory measures, of infra-group financial support, of early intervention and of resolution fit in (in particular, the transfer of business activities, the establishment of a bridge institution, *bail-in*).

It is clear that such a choice would consequently involve the Authorities, equipped by the legislator with «*the appropriate use of the margin of discretion*» in selecting one or another tool or, more often, in combining together more than

⁹See, *e.g.*, KLEFTOURI, *European Union Bank Resolution Framework: can the objective of financial stability ensure consistency in resolution authorities' decisions?*, in *ERA Forum*, 2017, vol. 18, pp. 263-279, 278 (noting that «it is necessary for the resolution authorities to have sufficient flexibility to be in a position to effect an orderly resolution as quickly as is necessary»).

one, as acknowledged by *Recital 89* of the Directive; rather, even, a bit before *Recital 85* clearly states that «*It is not necessary to prescribe the exact means through which the resolution authorities should intervene in the failing institution*».

Hence, however, two questions arise. First of all, we may wonder if and to which extent such a discretion would keep being consistent with the entrepreneurial nature of the banking activity according to the first basic idea of the European regulation that we have outlined above: also out of the drive from the many “external” requests to the bank in crisis we mentioned before, there is still a concrete risk that the public authorities be tempted to go back to forms of structural supervision that we thought to have definitely abandoned, at least starting from the Second directive of bank harmonisation of 1989. Secondly, sometimes we have the impression that the tools made available by the authorities are even more than they should, to the extent of having sometimes being replicated in several points without an effective need and with variants that are not so crucial¹⁰: just think of the powers to remove corporate representatives that also as a result of the so-called CRD IV (*Capital Requirement Directive*) No. 2013/36/UE are variously set either in the presence of an *in bonus* bank and in the event of the organisation is in crisis. *Entia non sunt multiplicanda sine necessitate*: are we sure that in this occasion the supranational legislator did properly take it into account?

4. The third and last guideline of the European discipline of banks crises, finally, constitutes basically a corollary of the previous one. Within a perspective that we can entirely consider shareable, in fact, the current provisions concerning the bank’s crisis dedicates to the first intervention measures – that is when the crisis is still showing to be in its early stage and without connotations of particular

¹⁰For a critical assessment, see, recently, CIRAIOLO, *Il finanziamento «esterno» delle risoluzioni bancarie tra tecniche normative e diritto vivente*, Padua, 2018, p. 112 ss.

seriousness – an attention rather unknown before¹¹. In this regard, the Preamble to the BRRD is clear and emblematic, especially when it points out, at *Recital 40*, that «*In order to preserve financial stability, it is important that competent authorities are able to remedy the deterioration of an institution's financial and economic situation before that institution reaches a point at which authorities have no other alternative than to resolve it. To that end, competent authorities should be granted early intervention powers, including the power to appoint a temporary administrator, either to replace or to temporarily work with the management body and senior management of an institution*». It is evident the assumption at the back that tools of this type could create a very important stronghold to avoid, or at least reduce, the chance that the bank's crises could become irreversible¹².

Concretely, besides recovery and resolution plans, they detect the tools referred at the III Title of the directive, that is the ones provided for by articles 27-30, which start from the request that the supervisory authorities could impose the administrative body of the bank in trouble to implement one or more of the measures specified in the recovery plan and that, following the request to call a meeting and/or remove one or more of the representatives deemed unfit to manage the bank, could lead to the administrative removal of such representatives and, if necessary, to their temporary replacement (but at times more simply to their temporary tutoring) with a temporary administrator.

From this point of view, the Italian banking system could luckily count on the long-standing years of application experience of extraordinary administration, an institution still provided for by the banking act dated 1936-38 and later replicated with few amendments in the Banking Consolidated Text dated 1993¹³. The

¹¹For all, see HUERTAS-NIETO, *A game changer: The EU banking recovery and resolution directive*, 2013, in *vox.eu.org*; SUPINO, *Soggettività bancaria, assetti patrimoniali, regole prudenziali*, Milan, 2017, p. 91.

¹²See SCHILLING, *Bank Resolution Regimes in Europe: Recovery and Resolution Planning, Early Intervention, Resolution Tools and Powers*, in *Eur. Bus. Law Rev.*, 2013, vol. 23, n. 6, p. 751 ss.; PELLEGRINI, *Piani di risanamento e misure di early intervention*, in *federalismi.it*, 2018, n. 2.

¹³On the previous guidelines, see BOCCUZZI, *Le procedure di amministrazione straordinaria e di liquidazione coatta amministrativa: i presupposti soggettivi e oggettivi*, in *La crisi dell'impresa*

Italian legislator had to implement the EU provisions concerning early intervention measures by introducing norms previously not provided for in the national legislation (articles 69-*octiesdecies*—69-*vicies-bis* t.u.b.), but – concerning the disqualification of the bank corporate bodies and their temporary replacement with others directly appointed by the supervisory authorities – he could take advantage of the discipline of the extraordinary administration, so that it has been able to limit itself to rather marginal corrective actions.

This does not, however, mean that, with the reform, the extraordinary administration had in fact not changed its connotation from the systematic standpoint. Before the 2015 reform, indeed, it was part of a Title expressly dedicated to the “*Management of the crises*” and was seen as a tool finalized to manage a bank crisis that was serious, but not to the extent to be deemed irreversible, so much so that the desired solution of the procedure (unfortunately not always achieved) was the return of the bank to the ordinary management. If we look at the requirements that can lead to its adoption and to the procedure effects, apparently things have not changed today. However, considering better the changes at the back, they are quite significant, in so far as the above-mentioned Title, which continues to regulate the extraordinary administration, has been completely amended and now is no longer referring to the “crisis” of the intermediary; on the contrary, the extraordinary administration has been incorporated in the list of the “restoration processes” (cfr. art. 69-*bis*, point *f*), t.u.b.), a fact that emphasises its innovative position¹⁴ that, in an ideal range in terms of seriousness of the crisis and therefore of the incisiveness of the intervention measures, see such procedure laid down a step higher than the preparatory and early intervention

bancaria. Profili economici e giuridici, a cura di Boccuzzi, Milan, 1998, partic. p. 147 ss. and especially, right before the reform, ID., *Towards a new framework for banking crisis management. The International debate and the Italian model*, in *Quaderni di ricerca giuridica* of Bank of Italy Legal Advice, n. 71, Roma, October 2011.

¹⁴See CAPRIGLIONE-SUPINO, *Comment* sub art. 70, in *Commentario al testo unico delle leggi in materia bancaria e creditizia*, ed. by Capriglione, 4th ed., Padua, 2018, p. 996 ss.

measures, but before the resolution tools¹⁵.

Only time will tell us if and to which extent this wide instrumentation of “prompt intervention” measures available to the authorities in the face of the emergence of a banking crisis will effectively be able to prevent further deterioration of the situation of the institution facing financial difficulties.

5. Let’s consider now the Japanese legislation, the figure that emerges from the main law that governs the banking crises in the Asiatic country (Law N. 95 of 21 June 1996) is substantially similar to the European Union one.

Even with regards to the three guidelines mentioned and summarized above, we can say that even in Japan the banking activity is codified as a business activity and consequently if the bank has become insolvent, a *lato sensu* bankruptcy proceedings is commenced. However, differently from Europe, the State intervention to support the banks in trouble is everything but residual.

It is instead possible to observe a full correspondence between the two legislations for what concerns the plurality of tools available to the authorities in the field to manage the collapse of a credit institution and also a more specific reference to the early intervention tools.

Having said this, it is, however, proper to immediately add that even if, like in Europe, in Japan the bank crises are managed under the aegis of the supervisory authorities, nevertheless the judicial authority performs a very important role in the Asiatic country. For this reason, after a short introduction to the Japan guidelines to the banking crises, we have deemed interesting to focus, albeit briefly, on the managing of the bank's crises not so much from the standpoint of the banking legislation, but rather of the bankruptcy laws.

The bankruptcy proceedings of banks in Japan are regulated by the *Act on Special Measures for the Reorganization Proceedings of Financial Institutions* (Act

¹⁵It wishes that consequently, even public authorities would adopt one or the other tool taking into account the different degree of intensity of the crisis CASTIELLO D’ANTONIO, *L’amministrazione straordinaria delle banche nel nuovo quadro normativo. Profili sistematici*, in *Analisi giur. dell’econ.*, 2016, p. 557 ss.

No. 95 of 1996) (hereinafter referred to as the “*Special Measures Act*”)¹⁶ and the *Bankruptcy Act* (Act No. 75 of 2004). When a bank becomes bankrupt, since the Special Measures Act is an act that prescribes the special provisions on the bankruptcy proceedings of banks, matters that are not prescribed in the Special Measures Act as special provisions are subject to the application of the Bankruptcy Act¹⁷.

In this paper, the overview and terms of the Special Measures Act will be explained in Chapter 6, and the conditions for commencing the bankruptcy proceedings of Japanese banks will be explained in Chapter 7 (7.1 Bankruptcy capacity, 7.2 Grounds for commencement of bankruptcy proceedings, 7.3 Non-existence of bankruptcy barrier)¹⁸.

Incidentally, because the Special Measures Act does not target banks having their head office in a foreign country, such banks are also excluded from this paper.

6. Before the burst of the bubble economy, even if a bank were to fail, the plan was to proceed with the insolvency proceedings by applying standard insolvency laws such as the Bankruptcy Act¹⁹. Nevertheless, after the burst of the bubble economy, many financial institutions, including banks, went insolvent, and the necessity of legislation and law revisions was felt keenly. The Special Measures Act was enacted as one of the series of relevant laws to deal with the foregoing situa-

¹⁶While the law number is indicated in the era name in Japan, the western calendar is used in this paper for the convenience of readers.

¹⁷See UCHIBORI and KAWABATA, *Overview of Reorganization Proceedings, etc. of Financial Institutions (Part 1)*, in *NBL*, 1997, n. 612, p. 25. N.B., all the documents cited in my part are written in Japanese.

¹⁸While the affairs performed by the Financial Administrator against financial institutions including banks and injunctions of the Prime Minister ordering the management of property (Deposit Insurance Act, Article 74 onward) or the measures against a financial crisis taken by the Prime Minister (Measures Under Item (ii), Measures Under Item (iii) (Deposit Insurance Act, Article 102, Paragraph 1, Item (2), Item (3)) may correspond to measures against banks subject to grounds for commencement of bankruptcy proceedings, they are not referenced herein because they are not judicial proceedings.

¹⁹See ITO, *Laws Concerning Insolvency Proceedings of Financial Institutions*, in *Course: System of Insolvency Laws (4th volume)*, eds. by TAKAGI and ITO, Tōkyō, 2006, p. 258.

tion²⁰.

Article 1 of the Special Measures Act prescribes as follows: «*The purpose of this Act is to enable smooth progress of reorganization proceedings, rehabilitation proceedings, and bankruptcy proceedings in financial institution or similar entity while ensuring that the rights of depositors and similar creditors are fulfilled, by, inter alia, providing for the necessary particulars concerning the reorganization proceedings of cooperative financial institutions and mutual companies so as to enable them to reorganize and remain in business while coordinating the interests of interested persons; by providing for the necessary particulars concerning Supervisory Agency petitions for reorganization proceedings, rehabilitation proceedings, and bankruptcy proceedings in financial institutions or similar entity; and by providing for the necessary particulars concerning actions within the scope of these processes that the Deposit Insurance Corporation of Japan and others undertake for and on behalf of depositors and similar creditors*» and aims to ensure the realization of rights of depositors, etc. and seek the smooth promotion of procedures in (corporate) reorganization proceedings, (civil) rehabilitation proceedings and bankruptcy proceedings of financial institutions and similar entities, including banks. This Act not only prescribes the special provisions of the Bankruptcy Act, it also prescribes the special provisions of the Civil Rehabilitation Act (Act No. 225 of 1999) and the Corporate Reorganization Act (Act No. 154 of 2002). Accordingly, this Act prescribes the special provisions of laws that regulate the basic matters of the insolvency law system regarding corporations that are at the core of the Japanese economy²¹.

The definition of terms is now explained. First, the term «*financial institution or similar entity*» means a foreign bank in relation to a foreign bank branch, bank holding company, long-term credit bank holding company, federation of

²⁰See YOSHIKAI, *Consideration of Legal Issues of Laws Related to Failed Financial Institutions (Part 1)*, in *Shōjihōmu*, 1999, n. 1531, pp. 4-5.

²¹Generally speaking, when the term «insolvency laws» is used in Japan, special liquidation is included in addition to these laws (Companies Act (Act No. 86 of 2005) articles 510 - 574, 879 - 902).

Shinkin Banks, federation of credit cooperatives, federation of labor banks, financial instruments business operator, designated parent company, insurance company, insurance holding company insurance company, or small amount and short term insurance provider (Special Measures Act, Article 490) (however, this is the definition of a financial institution or similar entity for which the supervisory agency may file a petition for commencement of bankruptcy proceedings²²). The term «*financial institution*» means a bank, cooperative financial institution, or the Shoko Chukin Bank Limited (Special Measures Act, Article 2, Paragraph 3), and the term «*cooperative financial institution*» means a credit cooperative, Shinkin Bank, or labor bank (Special Measures Act, Article 2, Paragraph 2).

The term «*bank*» refers to the bank defined in Article 2, Paragraph 1 of the Banking Act (Act No. 59 of 1981) and the long-term credit bank defined in Article 2 of the Long-Term Credit Bank Act (Act No. 187 of 1952). The term «*bank*» defined in Article 2, Paragraph 1 of the Banking Act means a person who engages in banking under the license from the Prime Minister, and the term «*banking*» means (1) acceptance of deposits or installment savings, as well as the lending of funds or the discounting of bills and notes, and (2) dealing in funds transfer transactions (Banking Act, Article 2, Paragraph 2). Furthermore, a bank must be a stock company (Banking Act, Article 4-2).

7.1 Here, I mention first persons who may file a petition for commencement of bankruptcy proceedings , and then the bankruptcy capacity is subsequently explained. First, a person who may file a petition for commencement of bankruptcy proceedings under the Bankruptcy Act is, generally speaking, a creditor or a debtor (Bankruptcy Act, Article 18), and, in addition, a director (*riji 理事*) of a general incorporated association or general incorporated foundation or a di-

²²The definition of «*financial institution or similar entity*» for which the supervisory agency may file a petition to commence reorganization proceedings is prescribed in Article 377 of the Special Measures Act, and, similarly, the definition of «*financial institution or similar entity*» for which the supervisory agency may file a petition to commence rehabilitation proceedings is prescribed in Article 446 of the Special Measures Act.

rector (*torishimariyaku* 取締役) of a stock company or mutual company may file a petition for commencement of bankruptcy proceedings under his/her status (Bankruptcy Act, Article 19). When this is applied to a bank, a depositor as an individual creditor (there is no criteria of the minimum claim amount for the petition to be approved) may file the petition, a bank as a stock company may independently file the petition (this is referred to as «*voluntary bankruptcy*» in this case), and a director of a bank may file the petition under his/her own individual qualification (this is referred to as «*semi-voluntary bankruptcy*» in this case). Furthermore, under the Special Measures Act, the Prime Minister as the supervisory agency (delegated to the Commissioner of the Financial Services Agency pursuant to Article 548 of the Special Measures Act) may file a petition for commencement of bankruptcy proceedings against a bank (Special Measures Act, Article 2, Paragraph 9, Item (1), Article 490, Paragraph 1). The reason for this is considered to be because it is difficult for individual depositors to comprehend the financial condition of banks, and, because it cannot be expected that a petition for commencement of bankruptcy proceedings will be filed in a timely manner, the authority to file the petition was granted to the supervisory agency which possesses information concerning the status of property and which is capable of determining, from a technical perspective, whether the filing of such a petition is necessary²³. When the supervisory agency is to file a petition for commencement of bankruptcy proceedings, it is prescribed that, if «*the maintenance of an orderly credit system may be materially affected if it files a petition to commence bankruptcy proceedings*», the supervisory agency must consult in advance with the Minister of Finance on measures necessary for the maintenance of an orderly credit system (Special Measures Act, Article 490, Paragraph 2, Article 377, Paragraph 2).

Next, with regard to the target of bankruptcy²⁴; that is, the bankruptcy ca-

²³See MIYAMA, *Financial Institutions and Bankruptcy*, in *Bankruptcy Act System (3rd volume)*, eds. by TAKESHITA and FUJITA, Tōkyō, 2015, p. 434.

²⁴Bankruptcy capacity is also acknowledged for inherited property and trust property. The petitioner in these cases is prescribed in Article 224, Paragraph 1 and Article 244-4, Paragraph 1 of the Bankruptcy Act.

capacity of whether a person is qualified to become bankrupt under the bankruptcy proceedings, in Japan which adopts the general bankruptcy principle (*ippanjin hasan shugi* 一般人破産主義), in addition to individuals (including foreign individuals), corporations (while all private corporations such as stock companies are affirmed, the national government and local governments are denied on grounds of being primary governing institutions, and there are disputes concerning special corporations and public partnerships) also have bankruptcy capacity, and, because a bank needs to be stock company as described above, there is no problem with respect to this point.

7.2. In the case of filing a petition for commencement of proceedings under the Bankruptcy Act, a bank must be «*unable to pay debts (Bankruptcy Act, Article 15, Paragraph 1)*» or «*insolvent (Bankruptcy Act, Article 16, Paragraph 1)*». This is derived from the fact that a bank is a stock company (corporation). Meanwhile, in the case of filing a petition for commencement of proceedings under the Special Measures Act, the requirement is prescribed as «*when a fact constituting grounds for the commencement of bankruptcy proceedings has occurred (Article 490, Paragraph 1)*», and it is said that this condition is the same as the condition for filing a petition for commencement of proceedings under the Bankruptcy Act²⁵. This is derived from the fact that a bank is a financial institution as referred to in the Special Measures Act. In other words, regardless of whether the supervisory agency files the petition or a deposit creditor, etc. files the petition, the bank must be unable to pay debts or insolvent to constitute grounds for commencement of bankruptcy proceedings, and with respect to this point there is no difference between the Special Measures Act and the Bankruptcy Act.

Incidentally, with regard to the timing of determining the following grounds for commencement of bankruptcy proceedings, grounds for commencement of

²⁵See UCHIBORI and KAWABATA, *Overview of Reorganization Proceedings, etc. Based on the Act on Special Measures for the Reorganization Proceedings of Financial Institutions (Part 1)*, in *Kinyūhōmujijyō*, 1997, n. 1478, p. 21.

bankruptcy proceedings need to exist at the time of trial of the bankruptcy case; that is, at the time of the first instance and the second instance. Accordingly, even if a cause of bankruptcy existed at the time that a petition for commencement of bankruptcy proceedings was filed, if such cause of bankruptcy no longer exists at the time of order of commencement, proceedings are not commenced, and, even if proceedings are commenced on grounds that a cause of bankruptcy existed at the time of the first instance, the order of commencement of bankruptcy proceedings will be rescinded if such grounds for commencement of bankruptcy proceedings no longer exist at the time of the second instance²⁶.

In the ensuing explanation, «*unable to pay debts*» and «*insolvent*» will be discussed as the cause of bankruptcy, and, while it does not constitute a cause of bankruptcy, «*suspension of payment*» will also be discussed as an inference thereof.

7.2.1. The concept of «*unable to pay debts*» is defined in Article 2, Paragraph 11 of the Bankruptcy Act, and is prescribed as follows: «*the condition in which a debtor, due to the lack of ability to pay, is generally and continuously unable to pay his/her debts as they become due*». In other words, (i) the debtor lacks the ability to pay, (ii) the debtor is unable to promptly pay his/her debts as they become due, (iii) the debtor is generally and continuously unable to pay his/her debts, and (iv) the debtor's state of "unable to pay debts" is an objective state.

Foremost, «*(i) the debtor lacks the ability to pay*» is comprehensively determined based on property, credit and labor, and refers to a case where debts cannot be paid based on any of the above. Accordingly, even if a debtor does not own any property, the debtor's solvency will be affirmed if he/she is able to borrow money from others based on his/her credit and repay the debts. Neverthe-

²⁶See, e.g., OGAWA, *Comment in pp. 66-67*, YOMORI *Comment in p. 69*, in *Commentaries on the Bankruptcy Act*, ed. by TAKESHITA, Tōkyō, 2007; SUGIYAMA, *Comment in p. 48*, in *Commentaries on New Basic Laws - Bankruptcy Act*, eds. by YAMAMOTO et al., Tōkyō, 2014; ITO, *Bankruptcy Act / Civil Rehabilitation Act (3rd ed.)*, Tōkyō, 2014, p.109; KOBAYASHI, *Comment in p.95*, in *Commentary on Bankruptcy Act (Part 1)*, ed. by National Insolvency Lawyers Network, Tōkyō, 2015.

less, even if a debtor owns property, if it is difficult to convert such property into cash, then the debtor's solvency will be denied.

Next, «(ii) the debtor is unable to promptly pay his/her debts as they become due» refers to a case where debts have matured, but the debtor is unable to pay the debts in which the performance thereof was demanded by the creditor. Even if it is certain that a debtor will not be able to pay debts that will mature in the future, so as long as the debtor is paying debts that are currently due, it is deemed that such debtor is not in a state of «unable to pay debts».

Furthermore, with regard to «(iii) the debtor is generally and continuously unable to pay his/her debts», the term «generally» refers to a state where all or most of the debts cannot be paid, and it is not deemed that a debtor is «unable to pay debts» in a state where he/she is unable to pay only a part of the debts. Next, the term «continuously» refers to a state in which a debtor is unable to pay debts is ongoing, and it is not deemed that a debtor is «unable to pay debts» even if he/she discontinues payment as a result of temporarily falling short of funds.

Finally, «(iv) the debtor's state of 'unable to pay debts' is an objective state» refers to a case where, even if a debtor underestimates his/her solvency and suspends payment, it is not deemed that a debtor is «unable to pay debts» if such debtor objectively has sufficient funds²⁷. If a bank is unable to pay debts, it means that there are grounds for commencement of bankruptcy proceedings, and the Prime Minister may file a petition for commencement of bankruptcy proceedings under the Special Measures Act, and a creditor (including a deposit creditor), the bank itself as the debtor, and a director of the bank as an individual may file a petition for commencement of bankruptcy proceedings under the Bankruptcy Act.

7.2.2 The concept of «insolvent» is prescribed in Article 16, Paragraph 1 of the Bankruptcy Act as «the condition in which a debtor is unable to pay its debts in

²⁷For explanation of requirements of (i), (ii), (iii) and (iv), refer to TAKESHITA (ed.), *op. cit.* (26), pp. 21-22; YAMAMOTO (eds.), *op. cit.* (26), pp. 46-47; ITO et al., *Article-by-Article of Bankruptcy Act (2nd ed.)*, Tōkyō, 2014, pp. 41-42; ITO, *op. cit.* (26), pp. 107-108.

full with its property». In other words, this refers to a state where the total amount of liabilities exceeds the total amount of assets²⁸. The concept of «*insolvent*» differs from the concept of «*unable to pay debts*» with respect to the following points; namely, undue debts are also calculated, and only the debtor's property is used as a reference, and the debtor's credit and labor are not given consideration²⁹.

Here, how to evaluate the debtor's assets upon determining whether or not such debtor is insolvent becomes problematic.

Theories can be generally classified as follows³⁰. (a) Theory that the debtor's assets should be evaluated based on the liquidation value as a result of disposing the debtor's business, (b) theory that the debtor's assets should be evaluated based on the going concern value on the assumption that the debtor's business is to be continued³¹, (c) theory that the debtor's assets should be evaluated based on a higher value upon comparing (a) and (b) above³², and (d) theory that the debtor's assets should be evaluated based on whether or not the debtor's business is ongoing; that is, based on the going concern value when the debtor's business is ongoing, and based on the liquidation value when the debtor's business has been discontinued³³.

When this is applied to determine whether a bank is insolvent, if the bank has already discontinued its business, etc., the property to become the creditor's security will be the liquidation value and, therefore, the bank's assets should be determined based on the liquidation value.

Meanwhile, if the bank is continuing its business, etc., because the creditor will receive payment solely from business profits when the going concern value

²⁸See YAMAMOTO (eds.), *op. cit.* (26), p. 49; ITO et al., *op. cit.* (27), p. 126; ITO, *op. cit.* (26), p. 113.

²⁹See TAKESHITA (ed.), *op. cit.* (26), p. 69; YAMAMOTO (eds.), *op. cit.* (26), p. 49; ITO et al., *op. cit.* (27), p. 126.

³⁰For details of the theory, refer to YAMAMOTO (eds.), *op. cit.* (26), p. 49; Network, *op. cit.* (26), pp. 99-100.

³¹See TAKESHITA (ed.), *op. cit.* (26), p. 69.

³²See YAMAMOTO (eds.), *op. cit.* (26), pp. 49-50; Network, *op. cit.* (26), pp. 99-100.

³³See ITO et al., *op. cit.* (27), p. 128; ITO, *op. cit.* (26), p. 115.

exceeds the liquidation value upon comparing the two, whether a bank is insolvent should be determined based on the going concern value.

Nevertheless, there may be a case where the bank is similarly continuing its business, etc., but the going concern value falls below the liquidation value.

For example, in cases where the bank is insolvent when determined based on the going concern value but not insolvent when determined based on the liquidation value, grounds for commencement of bankruptcy proceedings will be acknowledged when based on the going concern value, but an order of commencement of bankruptcy proceedings cannot be issued because the bank is not insolvent when based on the liquidation value.

In the foregoing case, which case would be more adequate for the bank?

Upon comparing a case where the bank is liquidated and a case where the bank continues its business, rather than intentionally liquidating the bank through bankruptcy proceedings, which would result in a state where the bank would be required to make distributions to creditors, preference should be given to continuing its business when giving comprehensive consideration to various factors including losses associated with liquidation and impact on society.

Accordingly, the theory that the debtor's assets should be evaluated based on higher value upon comparing the going concern value and the liquidation value would be valid³⁴.

7.2.3 The term «*suspension of payment*» refers to «*the debtor's act of externally indicating that, due to the lack of ability to pay, he/she is generally and continuously unable to pay his/her debts as they become due*»³⁵.

Nevertheless, the concept of «*suspension of payment*» is not a cause of bankruptcy, and has the following function: «*when a debtor has suspended payments, the debtor shall be presumed to be unable to pay debts*» under Article 15,

³⁴See YAMAMOTO (eds.), *op. cit.* (32); Network, *op. cit.* (32).

³⁵See TAKESHITA (ed.), *op. cit.* (26), p. 67; YAMAMOTO (eds.), *op. cit.* (26), p. 47; ITO, *op. cit.* (26), p. 109; Network, *op. cit.* (26), p. 96.

Paragraph 2 of the Bankruptcy Act.

As described above, if a bank is unable to pay debts, there will be grounds for commencement of bankruptcy proceedings, but because the concept of «*unable to pay debts*» is an objective fact and it is difficult to demonstrate the same directly, the Bankruptcy Act is attempting to infer the concept of «*unable to pay debts*» based on this «*suspension of payment*».

In other words, if a bank suspends the withdrawal of deposits, etc., it is inferred that the bank is unable to pay debts based on the foregoing fact unless the debtor (bank) disproves such suspension of payment or demonstrates that it is not in a state of «*unable to pay debts*», and grounds for commencement of bankruptcy proceedings are thereby acknowledged.

7.3 Where a petition for commencement of bankruptcy proceedings is filed and when it is found that there is a fact constituting the grounds for commencement of bankruptcy proceedings, an order of commencement of bankruptcy proceedings will be made, except in any of the following cases (Bankruptcy Act, Article 30, Paragraph 1, main paragraph).

The order of commencement made immediately becomes effective before the order becomes final and binding (Bankruptcy Act, Article 30, Paragraph 2). This is because, if the order of commencement does not become effective until it becomes final and binding, the bankrupt's property may become dissipated, and hinder subsequent procedures³⁶.

Bankruptcy barriers are (1) expenses for bankruptcy proceedings are not prepaid (Bankruptcy Act, Article 30, Paragraph 1, Item (1)), and (2) the petition for commencement of bankruptcy proceedings is filed for an unjustifiable purpose or it is not filed in good faith (Bankruptcy Act, Article 30, Paragraph 1, Item (2)).

Foremost, in the case of a petition filed by the supervisory agency with regard to Item (1), while it is difficult to anticipate that there will be no prepayment

³⁶See KOKUBO, *Comment in p.76*, in YAMAMOTO (eds.), *op. cit.* (26).

of expenses, there is the issue of whether expenses need to be prepaid to begin with.

With respect to this point, while the secondary function of the prepayment system of preventing the abusive filing of petitions does not apply to a petition filed by the supervisory agency, because numerous expenses are anticipated in the course of proceeding with the procedures, the prepayment of expenses has been acknowledged³⁷.

Next, in the case of a petition for commencement of bankruptcy proceedings filed for an unjustifiable purpose or not filed in good faith as referred to in Item (2), considered may be cases where a creditor files a petition for causing the debtor to preferentially make payment to himself/herself by threatening the debtor and saying that it will withdraw the petition once the debts are paid, or the debtor files a petition for escaping the creditor's pursuit³⁸, but it could be said that such cases would not apply to a petition filed by the supervisory agency.

There may be cases where a petition for commencement of bankruptcy proceedings and a petition for commencement of rehabilitation proceedings are both filed against a bank in a competing manner, or cases where bankruptcy proceedings have already been commenced but rehabilitation proceedings are also additionally commenced. In these cases, a stay order may be issued against the bankruptcy proceedings (Civil Rehabilitation Act, Article 26, Paragraph 1, Item (1)), or the bankruptcy proceedings may be automatically discontinued (Civil Rehabilitation Act, Article 39, Paragraph 1)³⁹.

Similar provisions are also prescribed in the Corporate Reorganization Act (Corporate Reorganization Act, Article 24, Paragraph 1, Item (1), Article 50, Paragraph 1)⁴⁰.

³⁷See UCHIBORI and KAWABATA *Overview of Reorganization Proceedings, etc. of Financial Institutions (Part 2)*, in *NBL*, 1997 n. 613, p. 20. While this description related to the petition to be filed by the supervisory agency in reorganization proceedings, it also applies to bankruptcy proceedings.

³⁸See ITO, *op. cit.* (26), p. 116.

³⁹See ITO, *op. cit.* (26), pp. 117-118.

⁴⁰See ITO, *op. cit.* (26), pp. 118-119.

The purpose of these provisions is, in cases where (civil) rehabilitation proceedings or (corporate) reorganization proceedings as reconstruction proceedings and bankruptcy proceedings as liquidation proceedings are in conflict, to give preference to the reconstruction proceedings, and position the liquidation proceedings as the final means in cases where the reconstruction proceedings were unsuccessful.

In other words, because the existence of civil rehabilitation proceedings and corporate reorganization proceedings which prevail over bankruptcy proceedings obstructs the commencement and continuation of bankruptcy proceedings, the non-existence of such reconstruction proceedings is also a bankruptcy barrier⁴¹.

8. Before the burst of the bubble economy, when a bank or any other financial institution failed, under the guidance of the Finance Ministry (at the time), the failed financial institution was relieved, pursuant to an agreement between the relieving financial institution and the failed financial institution, by the former succeeding the latter's business by way of absorption-type merger, transfer of operations, or transfer of business⁴².

After the burst of the bubble economy, numerous financial institutions, particularly banks, credit cooperatives, and Shinkin Banks, went bankrupt. According to the material of the Deposit Insurance Corporation⁴³, as of March 2017, financial assistance for failed financial institution reached 182 cases from Toho Sogo Bank to Incubator Bank of Japan, and among these 182 cases 20 were banks (ordinary bank). Among these failed banks, 12 banks transferred their operations to the relieving bank, 4 banks underwent merger (including specified merger), and 1 bank transferred a part of its business to the relieving bank. Furthermore, 1 bank

⁴¹See ITO, *op. cit.* (26), p. 117.

⁴²See MATSUSHITA, *Business Failure and Insolvency Proceedings of Banks and Cooperative Financial Institutions*, in *Jurist*, 1996, n. 1085, p. 27.

⁴³Deposit insurance corporation of Japan, *2016 Deposit Insurance Corporation Yearly Report*, Tōkyō, 2017, pp. 125-134, available at following address: <https://www.dic.go.jp/content/000025871.pdf>.

transferred its shares to the bank holding company, and 2 banks underwent the commencement of temporary government control by the Financial Reconstruction Commission.

Nevertheless, insolvency proceedings have not been commenced against any of these domestic failed banks pursuant to the Bankruptcy Act, the Civil Rehabilitation Act, or the Corporate Reorganization Act, let alone the Special Measures Act.

There is no choice but to say that domestic and overseas influence when a bank receives an order of commencement of bankruptcy proceedings, etc. is unknown, and whether there is any limit in the proceedings under the current legal system is also unknown. Accordingly, in order to determine what kind of unexpected problems may arise when a bank fails and what kind of measures would be optimal in such a case, we will need to wait for the accumulation of future cases.