



# FSA Newsletter January 2008



Minister Watanabe received the report by the first Subcommittee of the Sectional Committee on Financial System of the Financial System Council. (December 18)

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## Photograph Gallery

In this corner, we post photographs of the Minister, the Senior Vice Minister, the Parliamentary Secretary and FSA officials at work in meetings, conferences and other events.



Senior Vice Minister Yamamoto exchanged views with debt counselors at the "Country-wide Consultation Week for Multiple Debtors Campaign" at the Tokyo Metropolitan Government's consumer affairs center. (December 4)



Senior Vice Minister Yamamoto made an address at the "Meeting for Exchange of Views for Smooth Financing of Small-and Medium-sized Enterprises". (December 10)

## Statements, Speeches & Material

In this corner, we post statements and speeches made by the Minister, the Senior Vice Minister, the Parliamentary Secretary and FSA officials, as well as presentation material they used.

### Speeches

December 6, 2007

"The Global Financial Market Turmoil and its Policy Implications" Speech by Takafumi Sato, Commissioner of the Financial Services Agency at the EU Financial Counsellors Meeting, Tokyo

[Featured]

## **Publication of the “Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets”**

On December 21, 2007, the Financial Services Agency (FSA) published the “Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets” (hereinafter referred to as the “Plan”).

In “Economic and Fiscal Reform 2007” (cabinet decision on June 19, 2007) , the FSA was instructed to put together a plan for strengthening the competitiveness of Japan's financial and capital markets by the end of 2007 and it was decided that the plan would be promoted by the entire government. In response to this decision, the FSA has conducted an extensive study on the measures necessary for strengthening the competitiveness of Japan's markets.

The Plan incorporates specific measures to strengthen competitiveness in the following four policy areas:

1. Creating reliable and vibrant markets;
2. Putting in place a business environment that vitalizes the financial services industry and promotes competition;
3. Improving the regulatory environment (“better regulation”); and
4. Improving the broader environment surrounding the markets.

The key points of the Plan regarding the above four policy areas are as follows:

### **(1) Creating reliable and vibrant markets**

In order to create a “marketplace” for financial transactions, the Plan incorporates measures to put in place a market infrastructure that enhances diversity in financial services and raises user benefits – for example, by enabling diversified financial instruments to be traded on exchanges – while ensuring market fairness and transparency by, for example, making the administrative monetary penalty system more effective against market misconduct under the Financial Instruments and Exchange Act.

### **(2) Putting in place a business environment that vitalizes the financial services industry and promotes competition**

In order to foster a favorable environment for market players engaged in financial transactions, the Plan incorporates measures to put in place a system for controlling conflicts of interest and put in place an institutional framework that can meet the needs of the times by, for example, revamping the firewall regulations among banking, securities and insurance businesses.

### **(3) Improving the regulatory environment (“better regulation”)**

It has been seriously recognized that the regulatory environment is a crucial determinant of the strength and competitiveness of the financial and capital markets. Therefore, the Plan incorporates measures to enhance the effectiveness, efficiency and transparency of financial regulation by improving the FSA's supervisory method, so as to draw out more vitality of the markets.

#### **(4) Improving the broader environment surrounding the markets**

The plan incorporates measures not only to improve the financial and market systems, but also to upgrade the environment surrounding the markets by, for example, the development of an environment favorable to the nurturing and pooling of human resources with expertise in finance.

The FSA is determined to implement the measures incorporated in the Plan in a timely manner, with a view to constructing attractive and high-quality financial and capital markets, to which capital, information and human resources flow in from within and outside Japan.

\*For detailed information, please access [“FSA publishes the Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets”](#) on the FSA's Web site.

### **Basic concepts of the Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets**

#### **The need to strengthen competitiveness**

- In order to achieve sustainable growth of Japan's economy as the population ages, it is essential that its financial and capital markets:
  - provide good investment opportunities to financial assets held by the household sector, and
  - supply domestic and foreign firms with adequate amount of capital for growth.
- Given the intensifying global competition among markets, strengthening the competitiveness of Japan's markets and raising their attractiveness is urgently needed so that they can fulfill their role in meeting the demands of domestic and foreign users.
- As an industry that can generate high value added, a vibrant financial services industry is also expected to contribute to the growth of Japan's broader economy.

#### **Four pillars of the Plan**

##### ***1. Bolstering the confidence and vigor of the markets***

→ Putting in place a market infrastructure that enhances diversity in financial services and raises customer benefits, while ensuring market fairness and transparency

##### ***II. Business environment that vitalises the financial services industry and promotes competition***

→ Putting in place a competitive environment that meets the needs of the times and enables provision of diverse and high-quality services

##### ***III. Improving the regulatory environment (better regulation)***

→ Enhancing effectiveness, efficiency and transparency of supervisory response

##### ***IV. Improving the broader environment surrounding the markets***

→ Nurturing internationally competitive experts; Improving the urban infrastructure

# Outline of the Plan

## I . Bolstering the confidence and vigor of the markets

<Promoting provision of diverse opportunities for investment and funding>

### 1. Diversification of products tradable at exchanges

-Diversification of exchange-traded funds (ETF)

【Bill to be introduced to Diet promptly ; secondary regulation to be amended in 1st half of 2008】

Making it possible to invest in a wide range of products, including financial and commodity derivatives

-Alliance between financial and commodities exchanges

【To be implemented promptly after consideration given in 2008】

Enabling exchanges groups to offer a full line of products from equities, bonds, financial derivative to commodity derivatives

### 2. Fostering vibrant transactions among professionals

【Bill to be introduced to Diet promptly】

### 3. Taxation scheme for stocks and investment trusts that facilitates the shift from savings to investment

<Ensuring market fairness & transparency>

Making civil money penalties more effective against market misconduct

Strengthening of market surveillance at Securities and Exchange Surveillance Commission and other relevant bodies

## II . Business environment that vitalizes the financial services industry and promotes competition

Revamp of the firewall regulation among banking, securities, and insurance businesses

【Bill to be introduced to Diet promptly】

- Lifting the ban on interlocking officers and employees
- Relaxing the restrictions on the sharing of undisclosed corporate customer information between banking and securities businesses

Broadening the scope of businesses permitted to banking and insurance groups

【Bill to be introduced to Diet promptly】

- Commodities dealing, Islamic finance, emission trading, equity holding for the purpose of corporate restructuring, etc

Encouraging financial firms to manage conflicts of interest effectively

【Bill to be introduced to Diet promptly】

Encouraging foreign fund managers to participate in Japanese markets by removing taxation risk in carrying out business through independent agents in Japan (PE risk)

## III . Improving the regulatory environment (better regulation)

-Intensive dialogue and sharing of principles with the industry

-Enhanced transparency and predictability of regulation and supervision

-Strengthened co-operation with foreign authorities

-Close monitoring of market developments and effective supervisory response

-Improving the quality of FSA staff

## IV . Improving the broader environment surrounding the markets

Developing and accumulating internationally competitive human resources specializing in finance, law, and accounting

-Advanced and practical financial education

-Improving the modalities of CPA examination [by 2010]

-Nurturing financial experts  
[consideration of institutional design will start in 2008]

Enhancing urban functions as an international financial center

**Publication of the “Report by the First Subcommittee of the Sectional Committee on Financial System of the Financial System Council: Towards Strengthening the Competitiveness of Japan's Financial and Capital Markets”**

On December 18, 2007, the First Subcommittee of the Sectional Committee on Financial System of the Financial System Council (chaired by Kazuhito Ikee, Professor, Faculty of Economics, Keio University) issued the “Report by the First Subcommittee of the Sectional Committee on Financial System of the Financial System Council: Towards Strengthening the Competitiveness of Japan's Financial and Capital Markets.”

From October 2007, this subcommittee held nine sessions of deliberations on the following issues, based on the “Interim Summary of Issues (Phase1)” (published on June 13, 2007) compiled by the Study Group on the Internationalization of Japanese Financial and Capital Markets of the Financial System Council, with a view to strengthening the Japanese markets:

- \*Diversification of financial instruments traded on exchanges
- \*Making transactions among professionals more vibrant
- \*Revamp of the firewall regulations between banking and securities businesses
- \*Making the administrative monetary penalty system more effective against market misconduct

Regarding the review of the administrative monetary penalty system, the “Working Group on Legislative Issues” was established under the First Subcommittee for the purpose of conducting deliberations from the viewpoint of experts.

“Report by the First Subcommittee of the Sectional Committee on Financial System of the Financial System Council: Towards Strengthening the Competitiveness of Japan's Financial and Capital Markets” was compiled as a result of discussions by the First Subcommittee. The FSA is determined to put in place frameworks and systems promptly, with due consideration of the contents of the First Subcommittee’s report.

<Outline of the Report>

**○Diversification of financial instruments tradable on exchanges**

- \*Diversification of exchange-traded funds (ETFs)

From the standpoint of enhancing customer benefits, a framework needs to be put in place that enables Japan’s exchanges and exchange groups to offer a wider variety of instruments ranging from stocks, bonds and financial derivatives to commodity derivatives.

- \*Alliances between financial instruments exchanges and commodity exchanges

In order to enhance the business infrastructure of Japan’s exchanges and reinforce their international competitiveness, it is essential to put in place an institutional framework that makes alliances possible

between financial instruments exchanges and commodity exchanges, including capital tie-ups, under the overall framework that financial instruments and financial transactions are regulated under the Financial Instruments and Exchange Act while transactions of commodity derivatives are regulated under the Commodity Exchange Act.

### **○Making transactions among professionals more vibrant**

In order to make Japan's financial and capital markets more vibrant and strengthen their international competitiveness, it is essential to establish a marketplace with a high degree of freedom intended for professional investors. To this end, it will be appropriate to establish the following frameworks and systems:

- \*putting in place measures necessary for making transactions among professional investors more vibrant under existing frameworks, such as the regulations on the system for exempting offers of newly issued securities limited to qualified institutional investors (so-called "private offerings to professionals") and the PTS (proprietary trading system).
- \*developing a new framework for an exchange market, the participants of which will be expanded to include specified investors.

### **○Revamp of the firewall regulations between banking and securities businesses**

Regarding the existing firewall regulations between the banking and securities businesses, it will be appropriate to introduce a new regulatory framework that contains the following measures, in order to ensure the effectiveness of prevention against conflicts of interest or abuse of dominant positions by banks and the like, improve customer convenience and accommodate the demand from financial groups for integrated internal control:

- \*Obligation for securities companies and banks and the like to put in place a system for controlling conflicts of interest
- \*Prohibiting securities companies from soliciting customers by abusing dominant positions held by banks
- \*Abolition of the ban on concurrent posts
- \*Relaxation of restrictions on the sharing of undisclosed customer information as follows:
  - (i)Sharing of personal information: The existing "opt-in" arrangement (where the customer's prior consent is necessary for information sharing) shall remain unchanged.
  - (ii)Sharing of corporate information: The existing "opt-in" arrangement shall be replaced by an "opt-out" one (where information sharing shall be restricted only when the customer does not allow it).
  - (iii)Sharing of information for the purpose of internal control: Approval from the authorities shall be unnecessary.

### **○Making the administrative monetary penalty system more effective against market misconduct**

With respect to the administrative monetary penalty system under the Financial Instruments and Exchange Act, it is appropriate to make necessary reviews regarding the amount of penalty charges, the scope of application, the statute of limitation, etc. From the standpoint of ensuring more effective deterrence against securities violations, based on the report compiled by the Working Group on Legislative Issues,



\*Increase the amount of penalty charges for the following violations:

- (i) Insider trading
- (ii) Market manipulation
- (iii) Dissemination of unfounded rumors and use of fraudulent means
- (iv) False disclosure in offering documents and ongoing disclosure documents

\*Add the following violations to the scope of application of administrative monetary penalties:

- (i) Illegal market stabilization (market manipulation that does not involve market fluctuation)
- (ii) Omission of filing offering documents and ongoing disclosure documents
- (iii) False disclosure in tender offer bid disclosure documents and large shareholding disclosure documents, and omission of filing such documents

\*Introduce a system to increase the amount of penalty charges (e.g., in the case of repeated offenses) and reduce the amount of penalty charges (e.g., in the case of offenders that voluntarily report their violations).

\*Extend the statute of limitation (e.g., from the current three years to five years).

**Publication of the "Report by the Second Subcommittee of the Sectional Committee on Financial System of the Financial System Council: What to Do with Restrictions on the Scope of Businesses of Banking and Insurance Groups"**

The Second Subcommittee of the Sectional Committee on Financial System of the Financial System Council (chaired by Shinsaku Iwahara, Professor, University of Tokyo Graduate Schools for Law and Politics) held three sessions of deliberations from November 2007 regarding what to do with the restrictions on the scope of businesses of banking and insurance groups, in light of the growing needs for new financial businesses due to the increasing sophistication and diversification of financial services.

Based on the results of the deliberations, the "Report by the Second Subcommittee of the Sectional Committee on Financial System of the Financial System Council: What to Do with Restrictions on the Scope of Businesses of Banking and Insurance Groups" was issued on December 18, 2007.

Based on the proposals presented by this report, the FSA will take measures promptly to put in place necessary frameworks and systems.

<Outline of the Report>

This report, which is comprised of three parts – "1. What to Do with Restrictions on the Scope of Businesses of Banking and Insurance Groups," "2. Prevention of Harmful Effects Due to Conflicts of Interest" and "3. Deregulation Regarding Insurance" – puts forth a wide variety of proposals as follows, with a view to securing the international competitiveness of Japanese banking and insurance groups:



## **1. What to Do with Restrictions on the Scope of Businesses of Banking and Insurance Groups**

In order to secure the international competitiveness of Japanese banking and insurance groups while making sure to keep the soundness of the banks and insurance firms, the following measures should be taken to establish the frameworks and systems necessary for an expansion of the scope of such groups' businesses:

- \*Introduction of a framework for allowing sibling companies of banks belonging to banking groups that meet certain requirements, such as financial soundness and adequate risk management, to begin new businesses.
- \*To allow banks' sibling companies to engage in spot commodity transactions under the above-mentioned new framework.
- \*To allow banking and/or insurance groups to perform settlement by delivery for derivative transactions, on condition that they take measures to hedge the risk of holding commodities.
- \*To allow subsidiaries and sibling companies of banks and insurance firms to engage in Islamic finance, on condition that the finance may be deemed to be identical in effect to loans.
- \*To consider allowing banks and insurance firms to conduct emissions trading directly, with due consideration of future developments regarding emissions trading.
- \*To allow subsidiaries and sibling companies of banks and insurance firms to conduct secondhand sales and purchases of the same types of equipment and goods handled in their leasing operations, on condition that they engage mainly in finance leasing (i.e. leasing that may be deemed to be identical in effect to loans provided for capital expenditures).
- \*To consider broadening the scope of exemption to the restrictions on banking groups' holdings of voting rights for purposes such as fostering venture businesses and facilitating corporate restructuring, from the viewpoint of further promoting relationship-based banking.
- \*To allow banks and insurance firms to engage in the investment advisory and agency businesses.
- \*To allow banks to act as agents and intermediaries for foreign banks while giving consideration to the need to prevent inappropriate transactions, such as those related to money laundering and tax fraud.

## **2. Prevention of Harmful Effects Due to Conflicts of Interest**

In light of the planned expansion of the scope of businesses of banking and insurance groups, it is necessary to obligate such groups to establish internal control systems to prevent conflicts of interest, with a view to ensuring effective prevention of harmful effects due to conflicts of interests and abuse of superior positions by banks and insurance companies.

## **3. Deregulation Regarding Insurance**

It is necessary to review and revise the restrictions on the ratios of insurance companies' investments by asset type (the limit is currently set at 30% each for investments in domestic stocks and investments in foreign-currency assets and at 20% for real estate investments), with a possible abolition in mind, while giving consideration to the need to secure the soundness of the companies.

**Publication of “Interim Summary of Points of Discussion on Payment and Settlement”  
by the Study Group on Payment and Settlement of the Financial Research and  
Training Center of the Financial Services Agency**

On December 18, 2007, the Study Group on Payment and Settlements (Chairman: Prof. Shinsaku Iwahara, University of Tokyo Graduate Schools for Law and Politics), established by the FSA’s Financial Research and Training Center (FRTC; Director: Prof. Naoyuki Yoshino, Keio University), published “Interim Report on Issues Regarding Payment and Settlement”, after twelve meetings since July 2007.

The report discusses a broad range of issues concerning new payment services such as electronic money payment system such as the Zengin System, and securities settlement system, in light of ongoing environmental changes in payment and settlement, with a view to enhancing the protection of users and the security, efficiency and convenience of payment and settlement systems, and promoting innovation.

**Third International Conference: “Financial Stability and Financial Sector Supervision:  
Lessons from the Past Decade and Way Forward” (held on December 17, 2007)**

The FRTC holds international conferences for the purpose of studying the state of financial affairs of other countries. The third of its kind, was held on December 17 with the theme “Financial Stability and Financial Sector Supervision: Lessons from the Past Decade and Way Forward,” under the co-sponsorship of the FRTC, the International Monetary Fund's Regional Office for Asia and the Pacific, and the 21 Century COE-Market Quality Project of Keio University. A total of around 150 people from both within and outside Japan participated in the conference, including researchers and representatives of governments, financial institutions and embassies in Tokyo.

Drawing on the lessons from the Asian financial crisis, banking systems in Asia have been strengthened significantly over the last 10 years, resulting in much improved regulatory and supervisory frameworks. These improvements notwithstanding, the rapid evolution of financial markets, including greater competition and the introduction of new financial technologies in derivatives and securitization, has created new challenges, as have the large inflows of capital attracted by the renewed dynamism of Asian emerging markets. Supervisors are responding to these challenges by upgrading their supervisory frameworks, which includes moving towards the adoption of Basel II standards.

At this conference, the participants reviewed the progress in banking reform and financial sector supervision

and inspection over the last 10 years and discussed the readiness of financial systems in Asia to cope with the ongoing changes in the global financial landscape, including the effective implementation of the Basel II standards.

### **Session 1: Banking and Financial Sector Reform after the Crisis**

Session 1 provided an overview of the financial sector reforms implemented over the 10-year period after the Asian financial crisis, and assessed their results. As a case study, the session took up the banking reform and financial sector reforms in Thailand and recognized the weaknesses of the financial system that precipitated and intensified the crisis. It was reported that in order to overcome those weaknesses, Thailand has taken measures such as making the classification of nonperforming loans more detailed, introducing international standards for the valuation of financial products and consolidating financial institutions to enhance efficiency, and plans to implement reform measures such as the introduction of the Basel II standards in step with other Asian countries.

### **Session 2: Bank and Financial Sector Supervision and Examination after the Crisis**

In Session 2, Japan, South Korea, Malaysia and the Philippines reported on the actual implementation of bank supervision and bank inspection before, during and after the crisis, after which discussions were conducted on the future challenges to be tackled in the establishment and enhancement of the frameworks of supervision and inspection.

It was noted that significant improvement had been made in the frameworks of financial supervision and inspection, as exemplified by the enhancement of risk management systems. However, it was also pointed out that optimism about the future is not appropriate, since it is not necessarily successful risk management that has limited the impact of the financial turmoil triggered by the U.S. subprime mortgage problem on Asian financial institutions.

It was recognized that in order to cope with international financial problems, it is essential for the supervisory authorities in individual countries to seek to detect any problem at early stages through enhanced dialogue with the market, and share information and cooperate with their overseas counterparts. In addition, discussions were held on the importance of improving the capabilities of supervisory and inspection staff, so as to keep up with the rapid advance of financial technologies.

### **Session 3: Panel Discussion: Challenges Going Forward**

In the panel discussion, panelists representing the monetary authorities of Japan, Hong Kong and Singapore, financial institutions and credit rating agencies, discussed the immediate challenges confronting the financial sector.

Sustained large capital inflows have expanded liquidity and buoyed up asset prices around the world. Still, the possibility of a major turnaround in global liquidity conditions cannot be denied. Although the risk management techniques used by financial institutions have improved over the past decade in response to the challenges, it was pointed out that the stress tests conducted by them are not adequate. Furthermore, in relation to attempts by some Asian countries to shift the basis of financial regulation from the "rules-based" approach to the "principles-based" approach, it was argued that the appropriate thing to do would be to combine the strengths of these approaches, not to choose one or the other.

It was also pointed out that although micro-policy steps such as the introduction of a new framework of supervision and regulatory enforcement including Basel II, were essential for the stability of the financial system, it was also necessary to implement macroeconomic measures with due consideration of the condition of the national economy as a whole.

Finally, the panel discussion reached a conclusion that, since every new crisis differs from any past crisis, it is essential to not only list the lessons of past crises but also appropriately understand and take advantage of them in dealing with future crises.

\*For information concerning the contents of the program of this conference, please access [International Conference "Financial Stability and Financial Sector Supervision: Lessons from the Past Decade and Way Forward"](#) of the FRTC's website.

### **“Study Group on Financial Experts”**

In order to attain higher competitiveness of Japan's financial and capital markets, it is urgent to secure and develop human resources that shoulder the growth of the market. Moreover, providing human resources that can share the common sense of compliance in markets and authorities will contribute to bringing about a better regulatory environment.

For these reasons, the “Study Group on Financial Experts” was established in the FSA in November 2007. The discussion at this study group is well underway.

As is indicated in the “Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets”, the FSA will develop a proposal on the basic concept around the spring of 2008 and issue it for public comment, then finalize the discussions by summer 2008 to consider the design of the system.

## **FY2007 Interim Financial Results of Major Banks**

Following the announcement of FY2007 interim financial results by major banks, the FSA added up the figures, etc. announced by the respective banks and released the results on November 22, 2007.

The following is a summary of the FY2007 interim financial results of the major banks.

### **1. Profit Status**

Major banks' net core business profits (profits from core banking operations) in the fiscal first half that ended in September 2007 totaled 1.6 trillion yen, roughly unchanged from the same period of the previous year. Interest margins improved only slightly and both the balance of outstanding loans and fee income remained flat, while expenses increased due to a rise in the number of employees.

Net profits in the fiscal first half that ended in September 2007 totaled 0.8 trillion yen, down 0.8 trillion yen from the same period of the previous year. This profit drop was probably due to the absence of the reversal of bad loan provisions that boosted profits in the same period of the previous year, losses related to non-bank operations, and an increase in expenses related to write-offs and bad-loan provisions for both large- and small-lot borrowers.

It should be noted that although losses related to the subprime mortgage problem were limited as of the end of September, such losses warrant close monitoring in view of the continuing volatility of the market.

### **2. State of Financial Soundness**

The average non-performing loan ratio for the major banks in the fiscal first half that ended in September 2007 stood at a relatively low level of 1.5%, roughly the same level as in the fiscal year that ended in March 2007.

The average capital adequacy ratio in the fiscal first half that ended in September 2007 stood at 12.9%, down 0.2 percentage points from the fiscal year that ended in March 2007.

In light of the continued low level of the non-performing loan ratio and the level of the capital adequacy ratio, the financial condition of the major banks can be deemed to remain sound.

## **FY2007 Interim Financial Results of Regional Banks**

Following the announcement of FY2007 interim financial results by regional banks, the Financial Services Agency (FSA) added up the figures, etc. announced by the respective banks and released the results on December 7, 2007.

The following is a summary of the FY2007 interim financial results of regional banks:

### **1. Profit/Loss Status**

The margin of interest on deposits and loans remained roughly unchanged, while fee and commission income increased. As a result, the regional banks' net core business profits in the fiscal first half that ended in September 2007 grew by 35.7 billion yen from the fiscal first half that ended in September 2006, to 990.3 billion yen.

Interim net profits declined by 28.1 billion yen to 374.7 billion yen, due to increases in losses related to the disposal of non-performing loans and losses related to stocks.

### **2. Capital Adequacy Ratio**

The average capital adequacy ratio for regional banks in the fiscal first half that ended in September 2007 continued to rise and stood at 10.5%, up 0.1 percentage point from the fiscal year that ended in March 2007.

### **3. Status of Non-Performing Loans**

The non-performing loan ratio in the fiscal first half that ended in September 2007 stood at 3.9%, down 0.1 percentage point from the fiscal year that ended in March 2007, and less than half the peak level of 8.3% that was reached in the fiscal first half that ended in September 2002.

#### **\*Composition of regional banks:**

As of the fiscal first half that ended in September 2007, there were a total of 110 regional banks, including 64 regional banks, 45 second-tier regional banks and Saitama Resona Bank. As of the fiscal first half that ended in September 2006, there were a total of 112 regional banks, including 64 regional banks, 47 second-tier regional banks and Saitama Resona Bank.