

Treatment for Highly Feasible Fundamental Reconstruction Plan upon  
Determining if the lending ranks as restructured loan under the Impact of the  
COVID-19 Infection

In a released notice to related association representatives issued on September 10, 2021 ("Thorough Cash Flow Support, etc. for Companies According to Individual Circumstances"), it is stated that "financial institutions may take flexible measures when determining if the lending ranks as restructured loan, such as extending a period for a highly feasible fundamental restructuring plan, postponing the deadline for formulating a plan, or formulating a plan based on business performances before the outbreak of the COVID-19 infection."

- (i) What is the purpose of incorporating the relevant request?
- (ii) To what extent may a period for a highly feasible fundamental reconstruction plan be extended?
- (iii) To what extent may the deadline for formulating a plan be postponed? Are large companies and leading medium-sized companies also covered, in addition to SMEs?
- (iv) What does it specifically mean to formulate a plan based on business performances before the outbreak of the COVID-19 infection?

[(i) Purpose of the request]

- Even before the spread of the COVID-19 infection, the Comprehensive Guidelines for Supervision stipulate that even if a financial institution has granted a payment moratorium or has otherwise modified loan conditions, when a highly feasible fundamental reconstruction plan is formulated (or if a relevant SME is likely to formulate a plan within one year), the financial institution may treat that the lending does not rank as restructured loan.
- With regard to highly feasible fundamental reconstruction plan, the Comprehensive Guidelines for Supervision present certain requirements as follows:
  - Business conditions after approximately three years (without excluding a reasonable period in consideration of the size of the borrower or the characteristics of its business)

will become favorable without specific problems found in financial conditions.

- Estimates of sales, expenses, earnings and other factors in the plan are sufficiently strict.
  - From the perspective of making the utmost efforts to ensure cash flow support for companies that have been affected by the COVID-19 infection directly or indirectly, the request intends to clarify the meaning of the aforementioned requirements for permitting flexible measures, in light of the following facts:
    - The full impact of the COVID-19 infection is hard to predict.
    - Statements by the Minister and requests issued so far have presented the government's stance to respect financial institutions' decisions concerning loan ranks.\*
- \* With regard to ranks of loans when financial institutions modify loan conditions or provide new loans as cash flow support for companies, the government respects financial institutions' decisions from the perspective of ensuring proper cash flow support for companies affected by the COVID-19 infection, as has been repeatedly requested in the Minister's statements. This "financial institutions' decisions" includes determining if the lending ranks as restructured loans.
- Additionally, the Japanese Institute of Certified Public Accountants (JICPA) also requests that auditors should have appropriate communications with business owners/financial institutions on a timely basis to ensure smooth financial reporting and auditing, based on released notices issued in relation to the COVID-19 infection.\*

\* Concrete examples of released notices include the following:

- A notice titled "Incorporating the Effects of the Novel Coronavirus Pandemic when Making Accounting Estimates under Japanese GAAP" by the Accounting Standards Board of Japan (published on April 10, 2020, and updated on February 10, 2021) states as follows: In making accounting estimates, no assumption of a company is deemed to fall under an error except for evidently unreasonable ones.
- A notice titled "Audit Consideration related to COVID-19 (Part 4)" by the Japanese Institute of Certified Public Accountants (published on April 22, 2020) states as follows: The auditor needs to confirm whether risk management for loan exposures (in particular, loans with modified lending terms and conditions) are treated adequately under the Assessment Standards for Banks and Other Financial Institutions and the Ordinance for Enforcement of the Banking Act, etc., while fully understanding statements by the Minister, etc.
- A notice titled "Audit Consideration related to COVID-19 (Part 7)" by the Japanese Institute of Certified Public Accountants (published on March 2, 2021) states as follows: While it is not appropriate for the auditor to accept overly optimistic accounting estimates made by management, it is also inappropriate for the auditor to regard management's estimates as material misstatement based on overly pessimistic auditor's assumptions that deviate from the reality.

[(ii) Extension of a period for a highly feasible fundamental reconstruction plan]

- Regarding a period for a highly feasible fundamental reconstruction plan, the Comprehensive Guidelines for Supervision originally permitted flexible treatment by stating not to exclude the extension of a reasonable period in consideration of the size of the borrower or the characteristics of its business. Furthermore, in cases where it is difficult to implement restructuring as planned due to the impact of COVID-19, the following may be accepted within the extent considered reasonable in light of a period until the containing of the infection becomes foreseeable:
  - To extend a period for a highly feasible fundamental reconstruction plan
  - To set a longer period (longer than three years or five years)
  - To set a period with a condition that the period may be extended as necessary
  - To reformulate a plan in light of significant changes in business conditions due to the impact of the COVID-19 infection

[(iii) Postponement of the deadline for formulating a plan]

- If it is difficult to proceed with the formulation of a highly feasible fundamental reconstruction plan while the full impact of the COVID-19 infection is hard to predict, the deadline may be postponed within the extent considered reasonable, not limited to within one year, in light of a period until the containing of the infection becomes foreseeable.
- As all companies, irrespective of their business sizes, share the difficulty in predicting the full impact of the COVID-19 infection, and it must be rather difficult to secure sufficient resources for formulating a plan under the currently severe business conditions, postponement of the deadline may be acceptable flexibly for borrowers for which loan conditions were modified after the outbreak of the COVID-19 infection, irrespective of their business sizes.

[(iv) Formulation of a plan based on business performances before the outbreak of the COVID-19 infection]

- Normally, estimates of sales and other factors, in a plan need to be sufficiently realistic in light of the business value and relevant business environment.
- However, if it is difficult to make realistic estimates due to the uncertainty in the overall impact of the infection, it would be acceptable to formulate a plan using a simplified assumption based on business performances before the outbreak of the COVID-19 infection or under a certain presumption, while taking into account the high probability of the restoration of business conditions after the containing of the infection, until the end of the

infection becomes foreseeable.

\* An assumption thus made may be treated as an appropriate one except for a case where a company's certain presumption is evidently unreasonable.

#### (Reference) Examples of flexible measures by some financial institutions

Please refer to the following concrete examples of flexible measures that would also be helpful for other financial institutions.

[Regarding the period for a plan and the deadline for formulating a plan]

- A financial institution sets certain moratoriums on the formulation and implementation of highly feasible fundamental reconstruction plan and simplifies procedures for approving companies that are likely to formulate a plan.
- A financial institution reformulates highly feasible fundamental reconstruction plan in consideration of the impact of the COVID-19 infection. As a reviewed plan is commenced anew, the period for a plan is substantially extended.
- When it is considered difficult to formulate a highly feasible fundamental reconstruction plan by the initial deadline (one year after the date of modification of loan conditions) due to the impact of COVID-19, but is considered possible after the impact of the infection subsides, a financial institution postpones the deadline for one more year.

[Estimates of sales, etc. in a plan]

- When formulating highly feasible fundamental reconstruction plan amid the impact of the COVID-19 infection, a financial institution considers individual companies' business performances before the outbreak of the infection as necessary, and takes into account the current statuses and future forecasts.

[Other]

- Following the special provisions of the Comprehensive Guidelines for Supervision that were applied at the time of the Great East Japan Earthquake, a financial institution also treats large companies or leading medium-sized companies that are judged as being able to formulate a highly feasible fundamental reconstruction plan after the end of the infection as companies that are likely to formulate a plan and does not categorize loans to those companies as restructured loans.