

( Tentative Translation )

# Current Status and Issues Surrounding Relationship Banking in Japan

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# Background to Relationship Banking (Part 1)

- Financial Revitalization Program established October 2002
  - At the time this was vital in bringing the NPL problem under control.
  - Major banks: the objective was to reduce the NPL ratio (8.4% per year ending in March 2002) by half within a three-year period.
    - It was necessary to promote the removal of NPL from balance sheets (selling or amortizing = separation from debtors)
  - Regional financial institutions: Considered separately, based on relationship banking, their difference from the major banks (difficulty in separate these from debtors = regional economy).

# Background to Relationship Banking (Part 2)

- Report by the Second Subcommittee of the Financial System Council in March 2003
  - It is correct to resolve the NPL problem of regional financial institutions by promoting all types of efforts to revitalize SMEs and stimulate regional economies.
    - Strengthening of relationship banking functions during the Intensive Improvement period (2003 - 2005)
- FY 2003 - 2005: The First Action Program
- FY 2005 - 2007: The Second Action Program

# Main Item of Action Program

1. Business revitalization and facilitating financing of SMEs
  - Support for business creation and start-ups
  - Strengthening of management consulting and support for client companies
  - Business revitalization of client companies
  - Financing that does not rely excessively on real estate collateral and individual guarantees, etc.
2. Strengthening of management
  - Strengthening of risk management, etc.
3. Improving convenience for regional users
  - Regional contribution, broad revitalization, etc.

# Action Program Results (Part 1)

## (1) Business revitalization and facilitation of financing of Small- and Medium-sized Enterprise (SME)

### ① Strengthening of functions to support creation and opening of new businesses

	FY 2003	FY 2004	FY 2005	FY 2006
Financing by loan products aimed at supporting business startups	1,948 cases ¥17.9 billion	2,817 cases ¥25.0 billion	5,449 cases ¥60.3 billion	6,983 cases ¥74.2 billion
Joint financing with government-affiliated financial institutions, etc.	346 cases ¥37.4 billion	702 cases ¥68.4 billion	809 cases ¥98.7 billion	743 cases ¥80.3 billion
Investments in company promotion funds	¥9.4 billion	¥15.3 billion	¥24.1 billion	¥19.6 billion
Industry cluster support loans	28 cases ¥500 million	68 cases ¥1.4 billion	58 cases ¥1.5 billion	55 cases ¥1.5 billion
Results for support to new cooperative projects	— —	— —	126 cases ¥3.0 billion	142 cases ¥3.7 billion

(Note) The results were summarized based on the responses to questionnaires that were provided by each industry group to financial institutions (totals for regional banks (including Saitama Resona Bank), regional banks II, credit unions and credit associations. The same applies to the following charts.

### ② Strengthening of functions of management consultations and support for client companies

	FY 2003	FY 2004	FY 2005	FY 2006
Deals signed as a result of business-matching	6,228 cases	10,428 cases	15,954 cases	24,000 cases
Corporate bond issue support	—	—	3,690 cases	3,945 cases
M&A support	—	—	245 cases	296 cases
Share listing support	—	—	37 cases	42 cases

	FY 2003 – 2004 ("Intensive Improvement Period")	FY 2005 – 2006 ("Strengthening Focus Area Period")
Rate of ranking improvement of clients where management improvement support efforts were made (excluding normal clients)	24.5%	22.1%

# Action Program Results (Part 2)

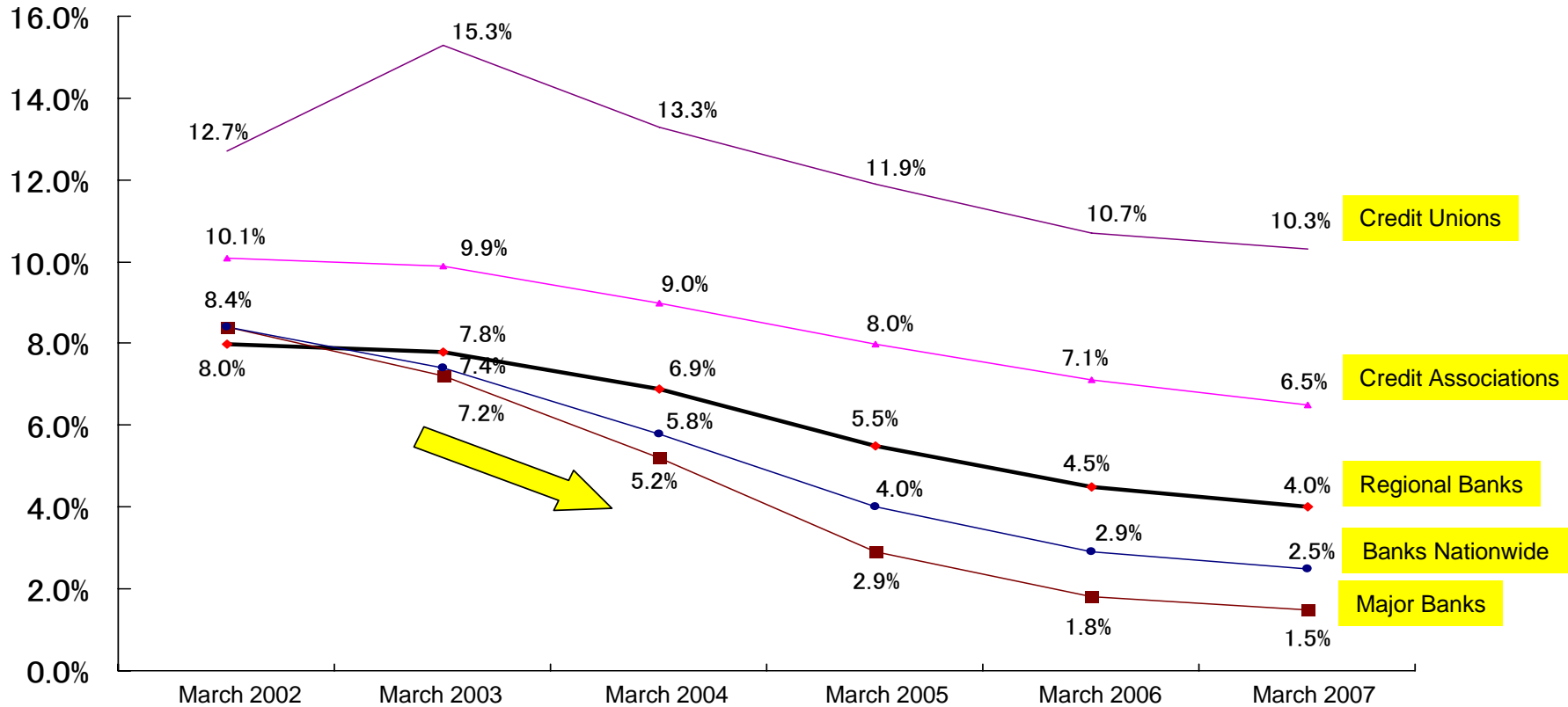
## ③ Proactive efforts for business revitalization

	FY 2003	FY 2004	FY 2005	FY 2006
Debtors having formulated revitalization plans with the assistance from SME Revitalization Support Councils	201 cases ¥230.5 billion	302cases ¥342.2 billion	380 cases ¥357.2 billion	391 cases ¥280.3 billion
Clients for which it was decided to provide Resolution and Collection Corporation support	3 cases ¥60.8 billion	10 cases ¥63.1 billion	22 cases ¥94.2 billion	38 cases ¥117.6 billion
Investment in corporate reconstruction funds	¥10.9 billion	¥16.8 billion	¥16.9 billion	¥16.2 billion
Debt Equity Swaps (DES)	29 cases ¥17.5 billion	33 cases ¥26.1 billion	24 cases ¥19.1 billion	34 cases ¥25.6 billion
Conversion of debt into subordinated loans (DDS)	7 cases ¥5.6 billion	57 cases ¥28.1 billion	64 cases ¥25.7 billion	51 cases ¥16.6 billion
Finance (providing operating capital to companies that are undergoing statutory revitalization)	152 cases ¥56.6 billion	188 cases ¥19.2 billion	136 cases ¥16.0 billion	563 cases ¥19.7 billion

## ④ Promotion of loans without excessive reliance on collateral and guarantees

	FY 2003	FY 2004	FY 2005	FY 2006
ABL (including loans secured by accounts receivable claims)	10,098 cases ¥110.2 billion	19,000 cases ¥173.7 billion	23,585 cases ¥199.8 billion	18,260 cases ¥202.9 billion
Among those, loans secured by chattel	— —	— —	27 cases ¥4.7 billion	153 cases ¥13.1 billion
Loans utilizing financial covenants	2,131 cases ¥33.9 billion	3,632 cases ¥95.4 billion	5,486 cases ¥203.1 billion	4,592 cases ¥238.5 billion
Loans using credit scoring models	136,015 cases ¥1,088.6 billion	191,682 cases ¥1,886.7 billion	250,127 cases ¥2,629.3 billion	211,854 cases ¥2,442.5 billion
Arrangement of syndicated loans (provider)	219 cases ¥299.3 billion	420 cases ¥479.2 billion	567 cases ¥524.5 billion	635 cases ¥670.0 billion
Participation in syndicated loans (lending group)	4,101 cases ¥1,734.3 billion	5,525 cases ¥2,101.0 billion	7,778 cases ¥3,080.7 billion	7,507 cases ¥2,832.9 billion
Underwriting of private placement bonds	2,825 cases ¥433.1 billion	3,185 cases ¥484.1 billion	3,727 cases ¥510.5 billion	3,999 cases ¥493.9 billion

# NPL Ratio Trends by Business Category



\*Figures are based on claims disclosed under the Financial Revitalization Law.

\*Figures for credit unions and credit associations include central financial institutions (Shinkin Central Bank, the Shinkumi Federation Bank)

# Examples of Specific Efforts (Part 1)

## (1) Business revitalization effort: Revitalizing a hot spring resort town

(Higashiyama Hot Spring, Fukushima prefecture)

◎ "Broad" rather than "Point" revitalization

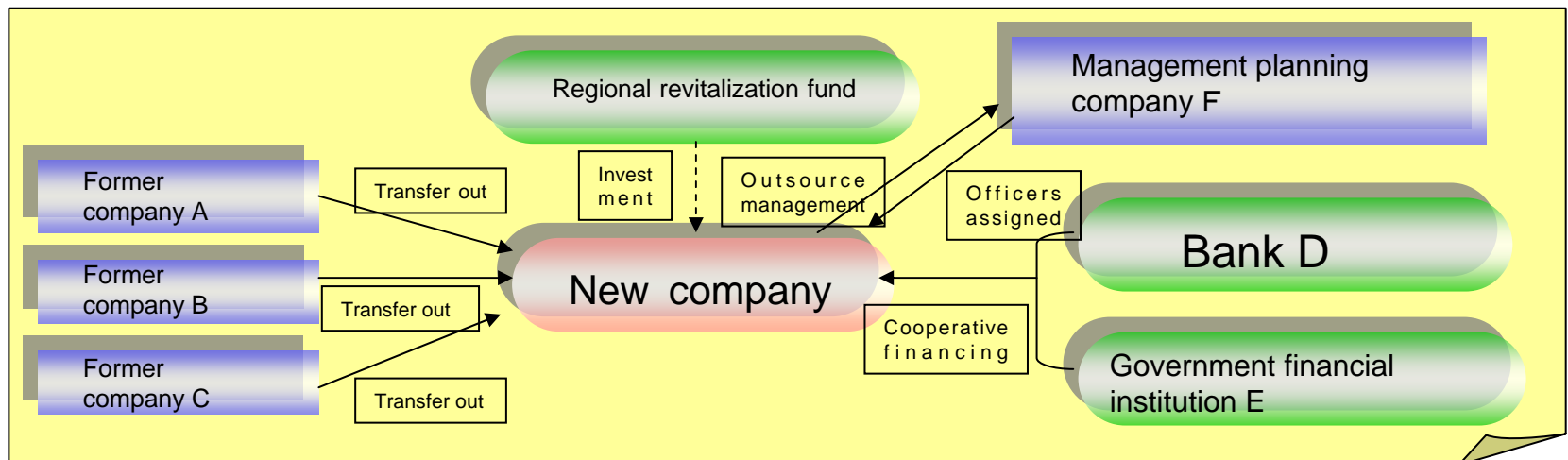
◎ Reorganize of three inns in poor business condition by transferring assets and employees into one new company for management as a single entity

- Consolidation and improvement of management by merging multiple inns
- Implementation of radical management improvement by inviting inn management professionals

◎ Special liquidation upon receiving transfer fee payment from the three inns. Related financial institutions cut credit.

◎ Provision of financing by banks as shown here

Invest through a regional revitalization fund set up in conjunction with (1) cooperative financing and (2) investment companies





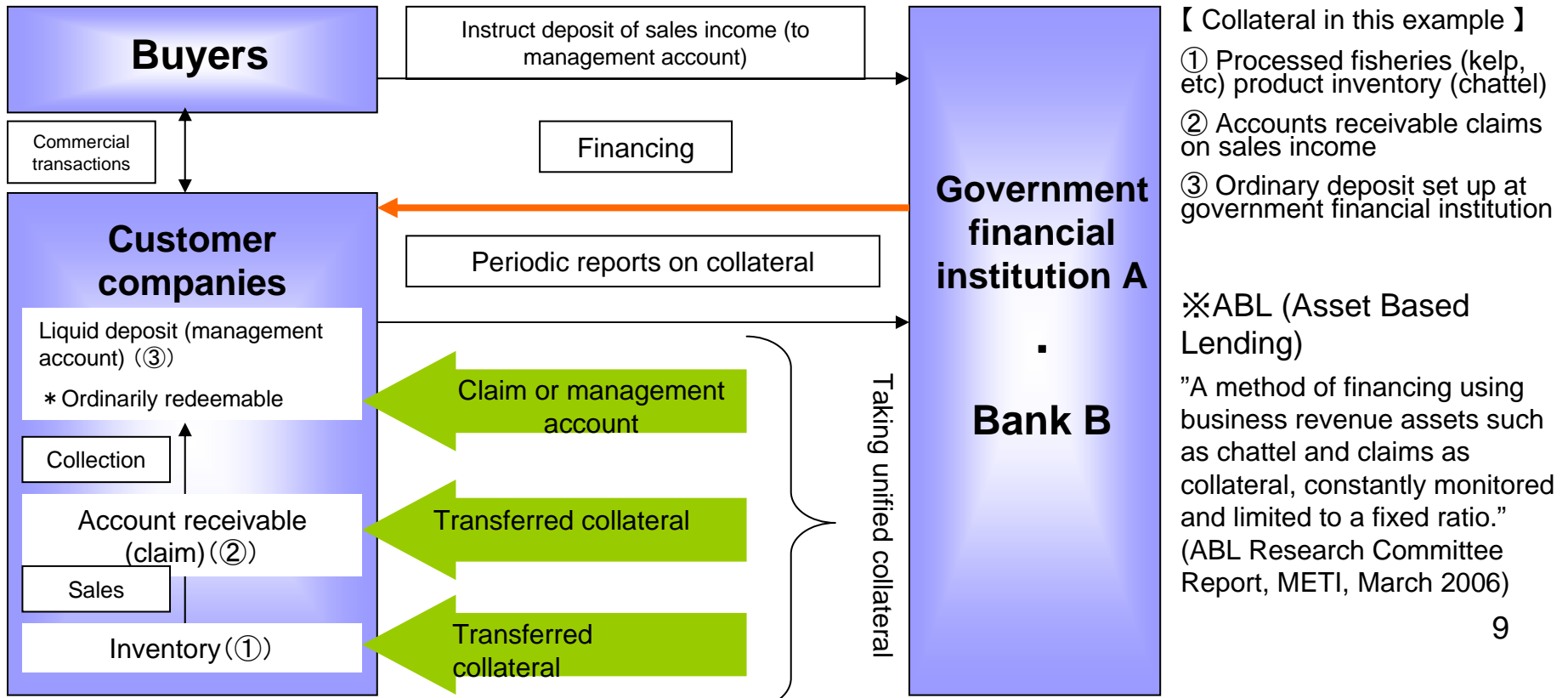
# Examples of Specific Efforts (Part 2)

## (2) Financing that is not excessively dependent on collateral or guarantees:

### Product inventory as collateral (Fukuoka Prefecture)

《Syndicated loan ABL using chattel registration system (first in Japan)》

- ◎ Monitoring of business life cycle, use of inventory, accounts receivable, and liquid deposits as collateral (financing by combined collateral with chattel)
- ◎ Establishment of fixed maximum financing framework
- ◎ Exercising of governance from the viewpoint of borrowers through correct covenants



# Evaluation and Issues Pertaining to Relationship Banking

(From the report by the Second Subcommittee of the Financial System  
Council in April 2007)

1. Awareness of current status
2. Fundamental way of thinking
3. (1) Future concrete efforts  
(2) Promotional structure

# Evaluation and Issues Pertaining to Relationship Banking

(From the report by the Second Subcommittee of the Financial System  
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## 1. Awareness of current status

- Results are improving steadily in terms of the number of cases and amounts.  
The NPL ratio is also declining.
- However, efforts by financial institutions are showing signs of polarizing.
- ① Business revitalization, ② financing that is not excessively dependent on real estate collateral and individual guarantees (ability to clearly judge business value), and ③ regional contribution (broad revitalization) are still insufficient.
- There have been many across-the-board efforts, but “selection and concentration” remains insufficient.
- Increasing profitability is an issue as competition in regional finance gets tougher.

# Evaluation and Issues Pertaining to Relationship Banking

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## 2. Fundamental way of thinking

- In view of the stiffening competition in regional finance, the relationship banking business model (financial services with high added value) is vital in order to increase the profitability of regional financial institutions.
- For that purpose, thorough “selection and concentration” is essential for all regional financial institutions, while understanding the needs of regional customers.
- Sustainable efforts towards regional contribution and broad revitalization that are related to financial institutions’ own profits are also important (win-win relationships).

# Evaluation and Issues Pertaining to Relationship Banking

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## 3. (1) Future concrete efforts

In future, each financial institution will be charged with developing its own concrete measures that emphasize the following three points pertaining to the nature of relationship banking:

- ① Strengthening support for client companies that correspond to company life cycles (establishment, business revitalization, etc.)
- ② Development of full complement of financing measures that are appropriate for small companies, such as financing methods based on an understanding of business value
- ③ Contribution to sustainable regional economies

# Evaluation and Issues Pertaining to Relationship Banking

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## 3. (2) Structure of promotion

- This is not to be a temporary program, but rather a permanent measure for supervisory guidelines.
- It does not require uniform or overall planning and reporting, but rather requires follow ups within ordinary supervision
- Each financial institution will release its own results and examples of its efforts.
  - The FSA will consider introducing or honoring examples of advanced efforts and other initiatives worthy of recognition.