

(Tentative Translation)

The Progress of “Region-Based Relationship Banking” (FY 2003-2006, to the end of the Second Action Program)

I. Introduction

In the "Action Program to Promote Further Enhancement of Region-Based Relationship Banking Functions (FY2005-06)" that was released in March 2005, it is stated that each regional financial institution is to publish its progress status every half-year based on their Banking Promotion Plans (hereinafter referred to as "Promotion Plans"). The Financial Services Agency (FSA) has compiled a summary of the results for all of the financial institutions and has been releasing it to the public.

Since four years has passed under two action programs, including “Action Program Concerning the Enhancement of Relationship Banking Functions” that was released in March 2003, the results of efforts by financial institutions during the period are summarized here.

(Reference) Number of financial institutions covered, 566 financial institutions (as of the end of March 2007)

(65 regional banks (including Saitama Resona Bank), 46 regional banks II, 287 credit unions, 168 credit associations)

II. Efforts by regional financial institutions strengthening functions of Relationship Banking

1. Results of regional financial institution efforts

Below is a summary of the major trends based on the results announced by each financial institution and industry group pertaining to the results and achievements of all financial institutions. (Please see the attached reference for the Summary of Specific Examples of Distinctive Efforts.)

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

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

While joint financing with government affiliated financial institutions to support creation and opening of new business lagged, steady progress has been made as financing with their own business startup support financing products has increased smoothly. In addition, while the amounts have been small, results have increased in new efforts for new cooperative projects, industry and academia cooperation and multi-industry cooperation.

Individual areas include financing for venture companies using intellectual property as collateral, formation of venture company development funds in cooperation with prefectural financial institutions, and formation of funds to invest in and support “second establishment” of new businesses by companies with long histories.

(Reference) Results for FY2006	FY2003	FY2004	FY2005	FY2006
Financing by loan products aimed at supporting business startups	1,948 cases	2,817 cases	5,449 cases	6,983 cases
	¥17.9 billion	¥25.0 billion	¥60.3 billion	¥74.2 billion
Joint financing with government affiliated financial institutions, etc.	346 cases	702 cases	809 cases	743 cases
	¥37.4 billion	¥68.4 billion	¥98.7 billion	¥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	68 cases	58 cases	55 cases
	¥500 million	¥1.4 billion	¥1.5 billion	¥1.5 billion
Results for support to new cooperative projects	-	-	126 cases	142 cases
	-	-	¥3.0 billion	¥3.7 billion

(Note) The results were summarized based on the responses to questionnaires that were conducted 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 is true below.

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

In order to strengthen functions aimed at providing consultation service and useful information to client companies, financial institutions have been proactively engaging in business-matching efforts, such as sponsoring business discussions, and the number of contracts that resulted has grown significantly. Also, results have increased steadily for corporate bond issue support, M&A support, and share listing support.

A variety of management consultations and support efforts can be seen in individual areas, including the sponsorship of exchanges with overseas companies and business successor seminars, the promotion of protection and utilization of intellectual property

rights through the cooperation with external experts, the supporting of regional companies to obtain corporate credit ratings, and the supporting of expansion of sales channels for regional industries.

All financial institutions have continued to support a variety of management improvement efforts in order to upgrade “need attention” loans to the “normal” category, and in the period FY 2005 to 2006 the condition of 22.1% of clients (approximately 15,573) with liabilities (excluding normal clients) where management improvement support was provided, improved, and their debt classification was improved. This rate of rank increase is slightly lower than that of the previous action program (FY 2003 to 2004) as the efforts of all of the financial institutions to support management improvements had already passed through one round, and most of the remaining projects were difficult cases.

(Reference) Results for FY 2006	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

(Reference) Results for FY 2006	FY 2003 – 2004 (“Intensive Improvement Period”)	FY 2005 – 2006 (“Strengthening Focus Spot Period”)
Rate of ranking improvement of clients where management improvement support efforts were made (excluding normal clients)	24.5%	22.1%

3- Proactive efforts for business revitalization

The overall trend in the effort to revitalize businesses has shifted from larger companies to smaller-scale companies, and to more difficult revitalization, although the number of cases in which the SME Revitalization Support Councils was involved has shown a steady increase.

Under such circumstances, support activities utilizing the Resolution and Collection Corporation grew in particular. Furthermore, Debt Equity Swaps (DES) and DIP financing (providing operating capital to companies that are in statutory revitalization) continued to be actively used as revitalization methods.

Individual efforts have included coordination by all financial institutions in a prefecture to jointly establish a regional corporate reconstruction fund to support business revitalization.

(Reference) Results for FY2006	FY2003	FY2004	FY2005	FY2006
Debtors having formulated revitalization plans with the assistance from SME Revitalization Support Councils	201 cases	302 cases	380 cases	391 cases
	¥230.5 billion	¥342.2 billion	¥357.2 billion	¥280.3 billion
Clients where it was decided to provide Resolution and Collection Corporation support	3 cases	10 cases	22 cases	38 cases
	¥60.8 billion	¥63.1 billion	¥94.2 billion	¥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	33 cases	24 cases	34 cases
	¥17.5 billion	¥26.1 billion	¥19.1 billion	¥25.6 billion
Conversion of debt into subordinated loans (DDS)	7 cases	57 cases	64 cases	51 cases
	¥5.6 billion	¥28.1 billion	¥25.7 billion	¥16.6 billion
DIP finance (providing operating capital to companies that are in statutory revitalization)	152 cases	188 cases	136 cases	563 cases
	¥56.6 billion	¥19.2 billion	¥16.0 billion	¥19.7 billion

4- Promoting loans without excessive reliance on collateral and guarantees

The amounts of loans utilizing financial covenants and syndicated loans were increased. As ABL (Asset-Based Lending) are spreading widely, the number of loans secured by chattel is growing fast though the amounts are still small.

Individual efforts have included loans secured by regional product inventory and accounts receivable, formation of syndicated loans with participation of numerous financial institutions to support local companies, and underwriting of private placement bonds for companies that take the environment into consideration in their businesses. In addition, efforts by multiple financial institutions to jointly establish SPC to improve liquidity of loans has been seen.

(Reference) Results for FY2006	FY2003	FY2004	FY2005	FY2006
ABL (including loans secured by accounts receivable claims)	10,098 cases	19,000 cases	23,585 cases	18,260 cases
	¥110.2 billion	¥173.7 billion	¥199.8 billion	¥202.9 billion
Among those, loans secured by chattel			27 cases	153 cases
			¥4.7 billion	¥13.1 billion
Loans utilizing financial covenants	2,131 cases	3,632 cases	5,486 cases	4,592 cases
	¥33.9 billion	¥95.4 billion	¥203.1 billion	¥238.5 billion
Loans using credit scoring models	136,015 cases	191,682 cases	250,127 cases	211,854 cases
	¥1,088.6 billion	¥1,886.7 billion	¥2,629.3 billion	¥2,442.5 billion
Arrangement of syndicated loans (provider)	219 cases	420 cases	567 cases	635 cases
	¥299.3 billion	¥479.2 billion	¥524.5 billion	¥670.0 billion
Participation in syndicated loans (lending group)	4,101 cases	5,525 cases	7,778 cases	7,507 cases
	¥1,734.3 billion	¥2,101.0 billion	¥3,080.7 billion	¥2,832.9 billion
Underwriting of private placement bonds	2,825 cases	3,185 cases	3,727 cases	3,999 cases
	¥433.1 billion	¥484.1 billion	¥510.5 billion	¥493.9 billion

5- Developing a system of explanations to customers; strengthening functions to deal with consultations and complaints

All financial institutions have taken systematic steps such as preparing rules and manuals and establishing committees to improve services, as well as develop systems through such measures as monitoring, including internal audits and training sessions.

A system of explanations to customers has been developing through such steps as exchanging confirmation documents when making loans. These are strengthening their ability to handle customer consultations and complaints, by strengthening headquarters responses and guidance to operating branches on how to handle explanations to customers, by entering complaints in databases, and by conducting questionnaires.

6- Developing human resources

Firms are proactively conducting various training for personnel and encouraging acquisition of certifications. They also send personnel to client locations so they can obtain know-how and implement joint efforts by headquarters and operating branch personnel to gain an understanding of actual conditions in relation to the clients they are supporting, and this has seen some financial institutions improved their judgment.

(2) Strengthening of management functions

1- Enhancing risk management

As application of Basel II (new capital ratio rules) began at the end of March 2007, data processing and systems were being prepared to deal with refined capital ratio calculations and enhanced risk management methods.

2- Developing management systems of earnings and improving profitability

Efforts aimed at building and improving systems for managing overall earnings and the earnings of individual departments and accumulating credit risk data and enhancing risk management have continued.

3- Strengthening governance

In order to strengthen internal controls, specialist and specialized departments have been set up, preparations made for business process checks, and coordination with audit firms strengthened. Also, cooperative financial institutions have set up systems to reflect the ideas of ordinary members and union members other than general employee representatives in informal discussion meetings in all areas with officers and ordinary employee representatives, strengthening the functions of ordinary employee representatives.

4- Strengthening compliance

Efforts to prepare manuals and various training programs and to give guidance to and inspect operating branches in order to prevent scandals and improve employee awareness and to manage client information are proceeding. Firms have introduced internal reporting systems with outside lawyers as points of contact as well as system management in order to correctly ascertain and report suspicious transactions and other matters.

5- Strategic utilization of IT

Cases could be seen of using customer databases to analyze customers for marketing, in addition to utilizing systems to improve efficiency in all types of administrative tasks including loan business. Some also utilized home pages and email and introduced video telephones to provide long distance consultation systems to support customers.

(3) Enhancement of convenience for regional users

Many financial institutions (538 financial institutions) have implemented user satisfaction surveys so as to ascertain user requirements in order to improve convenience for regional users.

There have been cases in which foundations have been established to contribute to the regions in question as well as establishment of loan products for NPOs, which contribute to society. Other efforts towards making contributions to regions that were evident included joint sponsorship with independent administrative agencies of forums aimed at supporting the formation of regional brands, introduction of products aimed at giving preferential interest rates to the companies that take the circumstances into consideration depending on corporate credit ratings, brokerage of housing loans aimed at promoting movement of people into prefectures from elsewhere, offering of preferential interest rate products aimed at supporting countermeasures to the declining birth rate and child raising, and financial and entrepreneurial education.

Financial institutions have been proactively involved in Private Finance Initiative (PFI) to revitalize regions and both the number of cases and sums involved increased in FY2006. Loans connected to awarding grants for city center revitalization projects implemented by local governments, development of products supporting establishment of new stores by SMEs, and Public Private Partnership (PPP) research and assessment have also been evident.

(Reference) Results for FY2006	FY2003	FY2004	FY2005	FY2006
PFI	22 cases	49 cases	71 cases	116 cases
	¥18.7 billion	¥40.9 billion	¥32.6 billion	¥62.5 billion

(4) Status of regional financial institutions' numerical targets

All financial institutions involved voluntarily set their own numerical targets for many of their specific measures recognizing the significance of self-enforcement by information disclosure as region-based Relationship Banking is being promoted.

The status (results) of numerical targets for FY 2006 is being announced for 441 financial institutions.

All financial institutions involved voluntarily set their own numerical targets. Targets whose results are to be announced as of the end of FY 2006 based on their own evaluation of the level of achievement of those targets judge that they have achieved above their targets for about 60% of the numerical targets.

	Numerical target number	Ratio
Number evaluated as having surpassed their target	1,503	62.3%
Number evaluated as having achieved their target	375	15.5%
Number evaluated as having not achieved their target	533	22.1%
Total	2,412	100%

2. Evaluation of regional financial institutions' efforts and future issues

(1) View of regional financial institutions

According to the progress follow-up that Local Finance Bureaus conducted with financial institutions, most financial institutions confirmed that they are making steady progress in their efforts to strengthen the functions of Relationship Banking.

In the four years since efforts to strengthen the functions of Relationship Banking were introduced, most think that they have gotten good results in strengthening functions aimed at supporting the creation and opening of new businesses, and in strengthening the functions of management consultations and support for client companies such as business-matching. As for promoting loans without excessive reliance on collateral and guarantees, most have achieved results using mutual cooperation in syndicated loans, or with products using credit scoring models. Most are also of the opinion that user convenience has improved based on the results of user satisfaction surveys.

As for business revitalization, while progress is being made in regards to expanding the number subject to measures and responding to difficult projects, there are still many challenges, including speeding up the processes, improving judgment, and accumulating and sharing know-how. As for enhancement of convenience for regional users, challenges include conducting surveys on regional user satisfaction and making improvements based on responses, providing information in even more easily

understandable forms to customers, and strengthening cooperation with all kinds of related parties in the regions.

In terms of strengthening of management functions, there are many issues related to building comprehensive risk management, responding to Basel II, building internal control systems from the point of view of compliance, and responding to the Financial Products Transaction Law.

(2) View of users

1- Results of user survey (overall evaluation of effort)

According to the results of the survey (hereinafter referred to as "User Survey") conducted for users and others for the purpose of evaluating small- and medium-sized and regional financial institutions, while more than half responded positively regarding the overall efforts made by strengthen the functions of Relationship Banking, negative evaluations declined. This shows consistent positive evaluations from users. The opinions below are seen as the reasons for these evaluations.

(Positive evaluations)

- Many cases of cooperation with universities, etc., to support venture businesses are evident.
- They are proactively working to provide management consultations, particularly for business-matching.
- They are beginning to emphasize evaluations of managers themselves and trends at worksites rather than balance sheets and other documents.
- They are taking a more flexible stance in financing and are not stuck on collateral and guarantees.
- People don't hear much about problems wherein borrowers are squeezed and loans revoked these days.
- The establishment of regional business revitalization funds is making some progress.
- Compared to some years ago, they are working fairly hard to revitalize regional economies and contribute to regions.

(Negative evaluations)

- While efforts are apparent, actual changes are thus far observable.
- Efforts on the part of financial institutions are scattered, and even within the same financial institution there are differences between branches and employees in the way they handle matters.
- As SMEs have being divided into two groups, "winner group" and "loser group", felt that financial institutions are just as negative as before towards the "losers group", such as companies being reconstructed.
- They are still depending on collateral and guarantees, and judgment ability is still lacking.
- Cooperation between financial institutions is not progressing.

- People don't feel that financial institutions are making an effort to publicize their activities. There are few people among the general public who access individual homepages.

Survey Item	Positive Evaluation	Negative Evaluation
Overall effort to strengthening functions of Relationship Banking	52.6 (45.4)	26.3 (37.4)

(Unit (%), figures within parentheses are the results of the FY 2004 survey, and the reason that the positive and negative evaluations do not total 100% is that some people selected the response "I don't know.")

Furthermore, pertinent to the promotion plans drawn up by each financial institution, there were more negative evaluations than positive ones regarding understandability and contents. The reasons for that include the fact that the contents were all identical without any individuality, the lack of specific examples and accomplishments resulted in people not understanding how this would be linked to improved user convenience, many technical terms were apparent and no evidence of any effort to have more users look at it was apparent.

Also, the area in which most people expected regional financial institutions to work on in the future was "loans without excessive reliance on collateral and guarantees."

2-Evaluation of each measure (effort for business revitalization and facilitation of SME financing)

Among the items relating to business revitalization and facilitation of SME financing in the User Survey, "efforts for strengthening functions to support creation and opening new businesses," "efforts for strengthening functions of management consultations and support for client companies," "efforts for developing a system of explanations to customers; strengthening functions to deal with consultations and complaints," and "developing human resources" received more positive evaluations than negative ones. However, "efforts towards loans without excessive reliance on collateral and guarantees," received slightly more negative evaluations, and "efforts to revitalize businesses" continued to receive more negative evaluations than positives.

The opinions below are seen as the reasons for these evaluations.

(Positive evaluations)

- Efforts to support industry were evident, such as the establishment of venture funds through the cooperation of industry, academia and government.
- Active efforts were made to provide business-matching, contributing to revitalization of industry in the prefectures.
- Proactive efforts were made to revitalize regional industries utilizing SME Revitalization Support Councils.

- The line-up of loan products that do not require collateral or a third party guarantee is becoming sufficient.
- Appropriate response are being given upon declining loans, such as providing specific reasons.

(Negative evaluations)

- The judgment and know-how needed for examining the technological capabilities or future prospects of SMEs is not being fostered.
- They only make financial judgments and don't reach the point of giving advice on improving profitability or management.
- There are insufficient numbers of people with good judgment or the know-how for business revitalization.
- The attitude that places emphasis on collateral and guarantees has not changed.
- System itself is progressing but there are still differences between financial institutions and personnel.

Survey Item	Positive Evaluation	Negative Evaluation
Efforts for strengthening functions to support creation and opening new businesses	39.5 (24.5)	38.3 (48.6)
Efforts for strengthening functions of management consultations and support for client companies	50.7 (33.5)	32.8 (45.5)
Efforts for business revitalization	24.3 (18.5)	40.7 (44.8)
Efforts for loans without excessive reliance on collateral and guarantees	41.6 (20.4)	42.4 (61.2)
Effort for developing a system of explanations to customers; strengthening functions to deal with consultations and complaints	51.7 (27.6)	25.3 (43.7)
Effort for developing human resources (*)	35.6 (34.3)	33.4 (33.3)

(Unit (%), figures within parentheses are the results of the FY 2003 survey (* is the result of the FY 2005 survey), and the reason that the positive and negative evaluations do not total 100% is that some people selected "I don't know" as their response. The same also applies below.)

3- Evaluation of individual measures (efforts to enhance convenience for regional users)

Concerning enhancement of convenience for regional users, while positive evaluations exceeded negatives for "disclosure of information on contribution to local communities", negative evaluations slightly exceeded positives for "establishment of financial institution management focusing on regional users' satisfaction (including service to depositors)." Also, there continued to be more negative evaluations for "coordination with various measures to promote revitalization of regional economies," and for "status of regional contributions (contributions to the regional economy through financial activities, etc.)." The opinions below are seen as the reasons for these evaluations.

(Positive evaluations)

- There is sufficient disclosure of information on the home page and in the disclosure journal.
- ATMs in convenience stores, extended hours for ATMs, and internet banking are extremely convenient.
- Industry, academia, and government cooperation and regional funds are progressing, and they are providing mediation to develop regions and foster companies.
- Various activities such as financial education are evident.

(Negative evaluations)

- Even though information is disclosed, we don't understand how it is connected to regional contribution.
- While things are more convenient, fees of all sorts are high, and relative satisfaction is conspicuously low.
- I'd like to see more situations where financial institutions take initiative.
- I want them to assume a leadership role in negotiations with government institutions with a view to revitalizing local shopping areas.

Survey Item	Positive Evaluation	Negative Evaluation
Disclosure of information on contribution to local communities	42.4 (25.0)	35.3 (46.2)
Establishment of financial institution management focusing on regional users' satisfaction	44.5 (36.4)	45.5 (46.6)
Coordination with various measures to promote revitalization of regional economies (*)	25.3 (24.3)	39.7 (40.8)
Status of regional contributions (contributions to the regional economy through financial activities, etc.)	32.9 (30.3)	43.9 (47.3)

(3) Evaluations of regional financial institutions' effort and future issues

It can be said that efforts aimed at strengthening the functions of Relationship Banking have been achieving steady results overall in the four years of two action programs, in terms of numbers of cases and monetary amounts.

However, users have pointed out that efforts for businesses revitalization, loans without excessive reliance on collateral and guarantees, regional contributions and other areas are inadequate.

Recently the report put together by the Financial System Council's Sectional Committee on Financial System, the Second Subcommittee, "Evaluation of the Effort towards Region-based Relationship Banking and Future Measures," requests continuous effort on the part of all financial institutions regarding the following three items strengthening support for client companies beginning with business revitalization, making thorough efforts to provide appropriate financing methods to SME, beginning with lending that thoroughly appraises company value, and contributing to a sustainable regional economy

using accumulated regional information. In that event it would be necessary to “correctly understand regional user needs, and to link feedback to management strategy.

While we expect further effort from all regional financial institutions based on the above items, this agency intends to provide the necessary follow up.

End

(Reference)

Major Results of Efforts by Regional Financial Institutions to Promote Strengthening Functions of Relationship Banking

(Units: Cases ¥ million)

Item	Results for 2006							
			Regional banks		Credit unions		Credit associations	
	Cases	Amount	Cases	Amount	Cases	Amount	Cases	Amount
Financing by loan products aimed at supporting business startups	6,983	74,250	3,088	32,368	3,298	34,888	597	6,994
Investments in company promotion funds	/	19,652	/	14,714	/	4,893	/	45
Joint financing with government affiliated financial institutions	743	80,320	303	53,333	417	25,689	23	1,298
Industry cluster support loans	55	1,502	37	1,006	15	330	3	166
Support for new cooperative projects	142	3,760	42	2,101	99	1,639	1	20
Deals signed as a result of business-matching	24,000	/	19,542	/	4,240	/	218	/
Share listing support	42	/	37	/	5	/	0	/
Corporate bond issue support	3,945	/	3,775	/	169	/	1	/
M&A support	296	/	241	/	53	/	2	/
Debtors having formulated revitalization plans with the assistance from SME Revitalization Support Councils	391	280,385	270	231,138	116	47,704	5	1,543
Clients for whom it was decided to provide Resolution and Collection Corporation support	38	117,627	35	115,452	2	2,138	1	37
Companies that created revitalization plans based on voluntary liquidation guidelines	23	66,979	17	53,867	6	13,112	0	0
Investment in corporate reconstruction funds	/	16,203	/	14,390	/	1,505	/	308
DES	34	25,661	29	24,923	5	738	0	0
DDS	51	16,648	37	14,253	11	2,254	3	141
DIP financing	563	19,749	481	13,181	77	6,500	5	68
Loans utilizing financial covenants	4,592	238,556	1,681	178,442	1,121	49,308	1,790	10,806
Loans using credit scoring models	211,854	2,442,547	154,050	1,773,933	54,088	630,290	3,716	38,324
Loans secured by ABL (including loans secured by accounts receivable claims)	18,260	202,903	7,547	126,510	9,090	65,732	1,623	10,661
Among those loans secured by chattel	153	13,141	118	11,850	30	1,023	5	268
Loans secured by intellectual property rights	13	2,399	12	2,319	1	80	0	0
Non-recourse loans	285	352,343	279	349,834	6	2,509	0	0
Credit liquefaction, securitization (including CLO)	2,941	277,739	1,680	246,087	1,112	27,905	149	3,747
Securitization (CLO)	2,246	61,248	1,003	30,986	1,096	26,547	147	3,715
Arrangement of syndicated loans (provider)	635	670,001	590	653,888	45	16,113	0	0

Participation in syndicated loans (lending group)	7,507	2,832,985	6,508	2,664,017	944	161,680	55	7,288
Underwriting privately placed bonds	3,999	493,976	3,802	475,966	196	17,960	1	50
Financing to PFI	116	62,510	88	55,265	27	7,231	1	14
Loan with loan products for SME with relatively accurate financial statements	22,722	338,798	16,357	262,430	5,557	64,011	808	12,357