

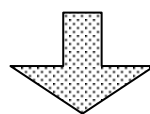
Action Program concerning enhancement of Relationship Banking Functions (Background and Basic Policy Concept)

~ Securing revitalization and sustainability of Small- and Medium- sized Enterprises financing toward solving the Non-Performing Loans problem in small- and medium-sized and regional financial institutions ~

Program for Financial Revival (released on October 30, 2002)

“As to the disposal of NPLs of small- and medium-sized and regional financial institutions*, the FSA aims to develop an “Action Program” within FY 2002, after studying various aspects of “Relationship Banking”, which has different features from those of major banks.”

*: Regional Banks I, Regional Banks II, Shinkin Banks and Credit Cooperatives

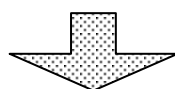


*: “Relationship banking” = A business model of lending by obtaining information including qualities of the management and future prospects of a debtor company based on a long-term relationship

“Toward enhancing functions of Relationship Banking” Report of Second Subcommittee, Sectional Committee on Financial System, Financial System Council (released on March 27, 2003)

<< Promoting the disposal of NPLs based on the characteristics of NPLs held by small- and medium-sized and regional financial institutions >>

1. It is fundamental that **the sustainability of relationship banking is to be secured** by ensuring soundness of both lenders and borrowers through cooperative management of risks and cost sharing with regional Small- and Medium-sized Enterprises
2. It is necessary that NPLs is disposed of **in a way fully acceptable for both lenders and borrowers, while taking due account of impact on regional economies.**
3. It is appropriate to **take it as a basic approach to implement concrete measures toward enhancing functions of relationship banking including developing a framework to dispose of NPLs within a certain period of time, while ensuring soundness of financial institutions through proper write-off and provisioning.** Specifically, it is appropriate that the NPLs problem is to be solved through various measures and efforts to revitalize SMEs and activate regional economies, with setting two years’ “Intensive Improvement Period” regarding regional finance by the end of FY 2004.



Action Program (March 28, 2003)

Ensuring strengthening functions of Relationship Banking during FY 2003 and 2004 (“Intensive Improvement Period”).

<I. Measures to revitalize Small- and Medium-sized Enterprises (SMEs) financing>

1. Strengthening functions to support creation and opening of new businesses
2. Strengthening functions of management consultations and support for client companies
3. Aggressive efforts for prompt business revitalization
4. Strengthening measures for new SMEs financing
5. Developing systems of explanation to customers, Strengthening functions to deal with consultations and complaints
6. Semiannual disclosure of the progress of above measures (by each financial institution and industry)

<II. Measures to ensure soundness and improve profitability>

1. Tightening assessment of assets and credit risk management
2. Developing management systems of earnings and improving profitability
3. Strengthening governance
4. Disclosure of information on contributions to local communities
5. Compliance
6. Ensuring the stability of regional financial system
7. Supervision and inspection system

→ Each financial institution is required to submit the “**Plan for enhancing functions of Relationship Banking**” to the FSA by the end of this August.
The FSA will follow up, compile and publish the progress of the implementation of the plans semiannually.

*: Difficulties in taking the same approach for disposal of NPLs as major banks (pointed out in the report of the Second Subcommittee, Financial System Council)

1. Options for drastic revitalization methods, liquidity of collateral disposal, availability of human resources and others are limited for regional SMEs. Moreover, in case of SMEs, the disposal itself is difficult because assets and liabilities of such enterprises and their owners are integrated.
2. Small- and medium-sized and regional financial institutions do not have enough know-how and well-developed systems on management improvement guidance and corporate revival. If such financial institutions are forced to dispose NPLs too aggressively, even viable SMEs may be forced to go bankrupt or be liquidated.
3. If expeditious disposal is carried out without developing an environment such as smooth mobilization of labors, utilization of human resources, it can give a serious impact on regional economies such as a rapid increase of unemployment.

Action Program concerning enhancement of Relationship Banking Functions (Outline)

~Securing revitalization and sustainability of Small- and Medium-sized Enterprises financing toward solving the Non-Performing Loans problem in small- and medium-sized and regional financial institutions~

Ensuring strengthening functions of Relationship Banking during FY 2003 and 2004 (“Intensive Improvement Period”)

⇒ Each financial institution is required to submit the “Plan for enhancing functions of Relationship Banking” to the FSA by the end of this August.
The FSA will follow up, compile and publish the progress of implementation of the plans semiannually.

《I. Measures to revitalize Small- and Medium-sized Enterprises (SMEs) financing》

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

- Development of human resources who can evaluate potential and technical strength of companies properly (Implementation of the “training to identify capabilities of companies”)
- Establishment and utilization of networks among industries, academics and the government, Establishment of the “Conference on Financing to Support Industrial Clusters”
- Strengthening collaboration with Government Financial Institutions in business operations for venture companies

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

- Development of a framework to provide information for management and business-matching
- Further strengthening of measures for upward transition of loans from “need attention” to “normal” category, and disclosure of actual performance
- Intensive implementation of training programs for improvement of skills to support SMEs

3. Aggressive efforts towards for prompt business revitalization

- Establishment of corporate reconstruction funds for regional SMEs
- Aggressive utilization of Debt-equity Swap, DIP financing and others
- Aggressive utilization of the RCC’s trust-type schemes to revitalize SMEs
- Utilization of the Industrial Revitalization Corporation
- Aggressive utilization of functions of associations to support revitalization of SMEs
- Intensive implementation of training programs for development of human resources to support corporate revival

4. Strengthening efforts for new SMEs financing

- Acceleration of efforts to create new SMEs financing which emphasizes cash flows and does not excessively rely on collateral and guarantee (especially guarantee by third parties). Establishment of a study group, and creation and release of basic concepts of model transaction cases (on Debt-equity Swap, financial covenants and others)
- Aggressive efforts towards securitization and others
- Development and enhancement of credit risk data base and utilization of it (sophistication of assessments of credit risk, setting of proper lending rates, construction of appropriate portfolio and others)

5. Developing systems of explanation to customers, Strengthening functions of consultations and handling of complaints

- Clarification of supervision of systems to explain borrowers important points (such as contract details on lending and guarantee)
- Establishment of “Conference to facilitate regional financing” in each prefecture

6. Disclosure of the progress of above efforts

- Disclosure of the progress of measures mentioned above semiannually by financial institution and industry

《II. Measures to ensure soundness and improve profitability》

1. Tightening assessment of assets and credit risk management

- Implementation of proper self-assessment of assets, write-off and provisioning
- Rigorous examination of rationality of ways to assess collateral
- Introduction of “Credit Risk Improvement Action” regarding large credits in the context of the Early Warning System

2. Developing management systems of earnings and improving profitability

- Development of management systems of earnings
- Development of systems to set interest rates in response to risks

3. Strengthening governance

- Development of disclosure systems by privately-owned banks
- Improvement of governance of corporative financial institutions
- Strengthening monitoring systems regarding quality of management

4. Disclosure of information on contributions to local communities

- Disclosure of information on contributions to local communities by each financial institution
- Enhancement of providing financial information to users from the FSA

5. Compliance

- Rigorous operations of supervisory actions regarding compliance systems

6. Ensuring the stability of regional financial systems

- Immediate application of the “Special Support” framework to systemic risks
- Utilization of the system of capital increase in central organizations of corporative financial institutions
- Development of operational guidelines regarding supervision of banks strengthened with public funds

7. Supervision and inspection system

- Establishment of a comprehensive supervision system based on assessments from various aspects (Development of “comprehensive guidelines for supervision of small- and medium-sized and regional financial institutions”)
- Making well-known and amending the “Supplement to the Financial Inspection Manual: Treatment of Classifications regarding Credits to Small- and Medium-Sized Enterprises”