

The Progress of "Program for Financial Revival"

(Provisional Translation)

December 31, 2004

Items	Progress
The FSA strives to normalize the NPLs problems in FY 2004 by reducing major bank's NPL ratio to about half.	Major banks' NPL ratio has been declining steadily toward the target. (8.4% as of March 2002, 8.1% as of September 2002, 7.2% as of March 2003, 6.5% as of September 2003 5.2% as of March 2004 and 4.7% as of September 2004.)
1. New framework for a financial system	
(1) Developing a financial system which the people can rely on without anxiety	
(a) Financial administration for the people	
(b) Securing the stability of the payment and settlement functions	The law on the partial amendment of the Deposit Insurance Law and other related laws was enforced on April 1, 2003.
(c) Enhancing the monitoring system of the FSA	The Task Force on Financial Issues was established on December 27, 2002. Meeting has been held 18 times.
(2) Due consideration to loans to small- and medium-sized enterprises (SMEs)	
(a) Entry of new lenders to SMEs	<ul style="list-style-type: none"> • Approval of banking license will be expedited immediately. • Regarding issues on trust business, the "Law on Trust Businesses" was enforced on December 30, 2004.
(b) Developing financial schemes to support revival of SMEs	The RCC established trust-type schemes to revitalize SMEs on November 22, 2002.
(c) Issuing a "Business Improvement Administrative Order" to a bank which has not achieved its plan for lending to SMEs	This policy has been applied since the settlement of accounts of March 2003.
(d) Ensuring inspections which take account of SMEs' actual conditions	<ul style="list-style-type: none"> • Inspections will be conducted utilizing information including that provided through "Hotline for credit crunch and credit withdrawal" while fully taking account of SMEs' actual conditions of management. • In order to conduct appropriate inspections taking due account of SMEs' actual conditions, the FSA revised the "Supplement to the Financial Inspection Manual: Treatment of Classifications regarding Credits to SMEs" on February 26, 2004. • The FSA has kept people informed about this manual through a series of training sessions for inspectors and explanation to the managers of financial institutions and those of SMEs.
(e) Strengthening the monitoring system on financing to SMEs	
① Creation of a "Hotline for credit crunch and credit withdrawal"	<ul style="list-style-type: none"> • The Hotline has been set up within the FSA (October 25, 2002) and Local Finance Bureaus (November 1, 2002), and the FSA has distributed leaflets on the Hotline to local governments, commerce and industry associations and chambers of commerce and industry.
② Implementation of "Inspections on credit crunch and credit withdrawal"	<ul style="list-style-type: none"> • The FSA publicly announced "The status of acceptance and utilization of information on "Hotline for credit crunch and credit withdrawal" on October 22, 2004.
(3) Termination of Non-Performing Loans Problems towards FY2004	
(a) Strengthening the support system in full cooperation between the Government and the Bank of Japan	
① Provision of liquidity through special loans by the BOJ	This measure will be taken promptly as needed.
② Injection of public funds based on Deposit Insurance Law	This measure will be taken promptly as needed.

③ Dispatch of de facto resident inspectors	The FSA publicly announced "Monitoring on the management of Special Support Financial Institutions" on April 4, 2003.
(b) Managerial reform of "Special Support Financial Institutions"	
① Pursuit of responsibilities of the management	The responsibilities will be clarified rigorously.
② Appropriate management of accounts (a "New account", a "Revival Account")	The FSA publicly announced "Division of accounts for the purpose of accounting management" on April 4, 2003.
③ Monitoring of business plans	The Task Force on Financial Issues was established on December 27, 2002. Meetings have been held 18 times.
(c) Establishment of a new public funds scheme	<ul style="list-style-type: none"> •The WG on the system of Public Funds in the Financial System Council publicly released "Report of the Second Subcommittee regarding the Use of Public Funds for Financial Institutions" on July 28. •The "Law on the Special Measures for Strengthening Financial Functions" went into effect on August 1, 2004.
2. New framework for corporate revival	
(1) Corporate revival through "Special Support"	
(a) Promoting removal of loans from balance sheets	Promotion will be carried out adequately. Fiscal measures will be examined while assessing the balance of accounts for purchase of banks' loan assets by the RCC based on Article 53 of the Financial Reconstruction Law.
(b) Utilization of self-assessments as reference information in judging fair value	The DIC and the RCC publicly announced "The concept of fair value in purchasing NPLs based on the Article 53 of Financial Reconstruction Law" on December 20, 2002.
(c) Credit Guarantee system for DIP Finance	The law was enforced on December 16, 2002. (Partial amendment of the law on credit insurance for SMEs)
(2) Further utilization of the RCC and corporate revival	
(a) Strengthening corporate revival function	•RCC publicly announced "Measures to strengthen the RCC's corporate revival function" on November 22, 2002.
(b) Enhancing the cooperation with corporate reconstruction funds	• The DIC and the RCC publicly announced "The basic policy concerning liquidation and securitization of loans held by the RCC" on December 20, 2002.
(c) Developing a market for loans	<ul style="list-style-type: none"> •The Japanese Bankers Association publicly announced "The report of the Committee for loan markets" on March 28, 2003. •The Japanese Bankers Association publicly announced "The report of the Study Group on the information disclosure at loan markets" on April 9, 2004.
(d) Enhancement of the securitization function	The DIC and the RCC publicly announced "The basic policy concerning liquidation and securitization of loans purchased by the RCC" on December 20, 2002.
(3) Developing favorable environments for corporate revival	
(a) Developing favorable environment for supporting corporate revival	•The Strategic Headquarters for Industrial Revival and Employment Measures asked the relevant ministries and the Cabinet Office to take necessary actions on November 12, 2002.
(b) Responding to the excess-supply problem	•METI publicly announced the "Early Business Revival Guideline" on February 26, 2003.
(c) Developing Guidelines on Prompt Business Revival	•Partial amendment of the Law on special measures for industrial revitalization was enforced on April 9, 2003.
(d) Measures to deal with the stock price volatility risk	-----
(e) Expectation of further monetary easing	-----
(4) New framework for corporate and industrial revival	<ul style="list-style-type: none"> • The Strategic Headquarters for Industrial Revival and Employment Measures determined the "Basic Guidelines for Corporate and Industrial Revival" on December 19, 2002. • The Industrial Revitalization Corporation Act was proclaimed on April 9, and the Corporation was established on April 16, 2003. • The Corporation has approved assistance for 33 companies at present, of which 26 have agreed to purchase each dept.

3. New Framework of the Financial Administration	
(1) Tightening assessment of assets	
(a) Review of assessment standards on assets	
① Acceptance of DCF type methods on provisioning	<ul style="list-style-type: none"> • The Japanese Institute of Certified Public Accountants (JICPA) publicly announced "Audit considerations with respect to the discounted cash flow method used to determine allowance for credit losses by banks and other financial institutions" on February 25, 2003. • The FSA publicly announced the amended Inspection Manual on February 25, 2003.
② Review of the criteria of average remaining period of loans to figure out provisioning	<ul style="list-style-type: none"> • The JICPA publicly announced "Consideration of a specific period in relation to the determination of allowance for credit losses for loans of non-classified or need-attention debtors based on actual experience or estimated probability of credit losses by banks and other financial institutions" on February 25, 2003. • The FSA publicly announced the amended Inspection Manual on February 25, 2003.
③ Harmonized classification of large borrowers among banks	It has been applied to inspections starting from January 2003.
④ Evaluation of Debt Equity Swaps (DESs) at fair value	The FSA requested major banks (November 11, 2002) and the JICPA (November 12, 2002) to apply fair value regardless of the timing of transactions.
⑤ Rigorous examination of reconstruction plans	The Special Team for Examination of Reconstruction Plans was established on December 24, 2002, and it has been examining reconstruction plans in inspections from January 2003.
⑥ Rigorous examination of assessment of collateral	The FSA requested major banks to strengthen use of legal appraisals and to enhance accuracy of self-appraisals (including appraisals by banks' subsidiaries) on March 14, 2003.
(b) Conducting another round of special inspections	The FSA publicly announced "Results of the Special Inspections and Other Measures" on April 25, 2003, "Results of the Follow-up of the Special Inspections" on November 14, 2003, and "Result of the Special Inspections" on April 27, 2004, and November 12, 2004.
(c) Disclosure of the gap between major banks' self-assessment and the result of FSA's inspections	The FSA disclosed the gap between major banks' self-assessment and the result of FSA's inspections on November 8, 2002, September 9, 2003, and September 16, 2004.
(d) Strengthening administrative measures against inadequate correction of self-assessments	The FSA publicly announced the amended Guidelines for Supervision on December 10, 2002.
(e) Declaration by the management regarding the accuracy of financial statements	Based on the report of the Financial System Council (the First Subcommittee) published on December 16, 2002, the FSA amended Cabinet Ordinances for listed companies and others, and requested major banks to implement this measure from the settlement of accounts of March 2003 (March 31, 2003).
(2) Enhancing capital adequacy	
(a) Tax reform for enhancing capital adequacy	
① Introduction of a new tax measure which enables provisioning to be recognized as tax-losses	<ul style="list-style-type: none"> • In this regard, the FSA submitted requests to the relevant ministries and the Cabinet Office on November 7, 2002. • It was announced in the outline of the FY2003 tax reform by ruling parties (December 13, 2002) that tax measures were to continue to be examined, in addition to overall measures including the treatment of deferred tax assets, financial administration, and the business accounting system. • The FSA submitted FY 2004 tax reform requests to the relevant ministries on August 29, 2003.
② Removal of the freeze on the refund carry-back system	<ul style="list-style-type: none"> • In order to realize the tax reform requests, meetings of the "Study group on a tax system concerning capital adequacy of financial institutions" were held two times (on October 16, 2003 and on November 12, 2003.) • In FY2004 tax reform (December 17, 2003), it was announced that these requests would be further examined considering the capital level of financial institutions, corporate accounting system, equality between taxpayers, feasibility as a tax system and effects on financial institutions and fiscal conditions. Carry-over period for tax deficit was extended from 5 years to 7 years (applied to deficits incurred from FY 2001.) • The FSA submitted FY 2005 tax reform requests to the relevant ministries on August 31, 2004.
③ Consideration of the extension of carry-over period for tax deficit	<ul style="list-style-type: none"> • In FY2005 tax reform (December 15, 2004), it was announced that these requests would be further examined considering the capital level of financial institutions, equality between taxpayers, feasibility as a tax system and effects on financial institutions and fiscal conditions.

(b) Proper regulatory treatment of deferred tax assets in calculating capital adequacy ratios	<ul style="list-style-type: none"> •The FSA requested major banks to assess deferred tax assets rigorously on November 11, 2002. •The WG on regulation of capital adequacy ratio under the Financial System Council publicly released "Progress Report: Working Group on Regulation of Capital Adequacy Ratio" on July 28, 2003. •The FSA requested major banks to enhance disclosure on deferred tax assets on October 31, 2003. •The FSA publicly released "Report of the Second Sub-Committee of the Financial Council regarding Regulatory Treatment of Deferrd Tax Assets in Calculating Capital Adequacy Ratios and Other Issues related to Capital Adequacy of Banks" on June 22, 2004.
(c) Verification that deferred tax assets are reasonably assessed	The JICPA publicly announced the president's official notice "Rigorous Audit of the Major Banks by Auditors" on February 25, 2003.
(d) Review of increased capital through the allocation of new stocks to debtors	The FSA publicly announced the amended Guidelines for Supervision on February 21, 2003.
(e) Review of the issues on capital adequacy of banks	<ul style="list-style-type: none"> •The WG on regulation of capital adequacy ratio under the Financial System Council publicly released "Progress Report: Working Group on Regulation of Capital Adequacy Ratio" on July 28, 2003. •The FSA publicly released "Report of the Second Sub-Committee of the Financial Council regarding Regulatory Treatment of Deferred Tax Assets in Calculating Capital Adequacy Ratios and Other Issues related to Capital Adequacy of Banks" on June 22, 2004.
(f) Introduction of external auditing of capital adequacy ratio	<p>The FSA requested major banks and their bank-holding companies to be subject to external audit on the calculation of capital adequacy ratio from the settlement of accounts of March 2003 (April 4, 2003). In addition, the FSA amended the cabinet ordinance of the Banking Law on April 14, 2003.</p> <ul style="list-style-type: none"> •The JICPA publicly announced the Industry Audit Committee Report on this matter on April 15, 2003.
(3) Strengthening governance	
(a) Function of external auditors	<ul style="list-style-type: none"> •The FSA requested the JICPA to conduct this measure on November 12, 2002. •The JICPA publicly announced the president's official notice "Rigorous Audit of the Major Banks by Auditors" on February 25, 2003.
(b) Conversion of preferred stocks into common stocks	<ul style="list-style-type: none"> •The FSA publicly announced "To Improve Corporate Governance of Capital Injected Banks (Major Banks) with Public Funds" on April 4, 2003. •The FSA publicly announced "To Improve Corporate Governance of Capital Injected Banks (Regional Banks) with Public Funds" on June 30, 2003.
(c) Issuance of a "Business Improvement Administrative Order" to a bank which has not achieved its rationalization plan	
(d) Rigorous review of prompt corrective action framework	The FSA publicly announced the amended Guidelines for Supervision on December 10, 2002.
(e) Utilization of the "Early Warning System"	The FSA publicly announced the amended Guidelines for Supervision on December 10, 2002.
4. Future Steps	<ul style="list-style-type: none"> •The Financial System Council publicly announced the report "Toward Enhancing Functions of Relationship Banking" on March 27, 2003. •The FSA publicly announced "Action Program concerning Enhancement of Relationship Banking Functions" on March 28, 2003. •Small- and medium-sized/regional financial institutions submitted plans to enhance functions for Relationship Banking (August 29, 2003.) •The FSA publicly released "Overview of Plans to Enhance Functions for Relationship Banking" on October 7, 2003. •The FSA publicly released "Progress of Plans to Enhance Functions for Relationship Banking in the First Half of FY2003" on January 16, 2004. •The FSA publicly released "Progress of Plans to Enhance Functions for Relationship Banking in FY2003" on June 30, 2004. •The FSA publicly released "Progress of Plans to Enhance Functions for Relationship Banking in FY2003 and in the First Half of FY2004" on December 27, 2004.