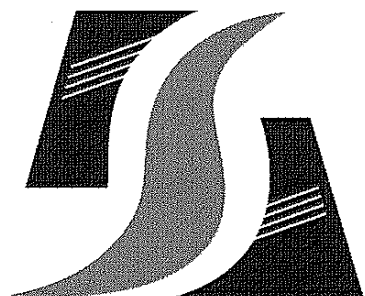


(Tentative Translation)

Experience and Current Status of Regional Financing in Japan



January 2008
Financial Services Agency

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Financial
Services Agency

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I . History of Japan's Financial System

1. Period from the End of the War to 1964 (Postwar Restoration, High Economic Growth)

Domestic Situation, etc.	System Development, etc.
<ul style="list-style-type: none"> ● End of World War II (1945) <div data-bbox="324 494 1115 654"> 1945~1947 Zaibatsu dissolution “Antimonopoly Law,” “Deconcentration Law” enforced Establishment of the Fair Trade Commission </div> ● Korean War (1950~1953) <div data-bbox="324 710 1115 869"> 1950~1953 Korean War boom The Japanese economy recovered to its pre-war level </div> <div data-bbox="324 909 1115 1101"> 1955~1957 Jinmu boom “The postwar period is over.” Three holy durables (black-and-white TVs, washing machines, refrigerators) </div> <div data-bbox="324 1125 1115 1348"> 1958~1961 Iwato boom “Doubling National Income Plan” “Investment feeding on investment” Mass production/mass consumption </div> 	<p>1948 “Securities and Exchange Law” enforced</p> <div data-bbox="1370 518 1977 582"> Separation of banking, securities businesses </div> <p>1949 “Foreign Exchange and Foreign Trade Control Law” enforced</p> <p>1951 “Sogo Bank Law,” “Credit Association Law” enforced</p> <div data-bbox="1429 734 1966 798"> Specialized financial institution system </div> <p>1952 “Long-Term Credit Bank Law” enforced</p> <p>1954 “Foreign Exchange Bank Law” enforced</p> <div data-bbox="1299 933 1977 997"> Separation of domestic, overseas financial markets </div> <div data-bbox="1205 1053 1966 1348"> <p>Indirect finance-centered financial system during the high growth period</p> <pre> graph LR Household[Household] --> FinancialInstitutions([Financial Institutions]) FinancialInstitutions --> Companies[Companies] Companies --- HeavyIndustries[Heavy industries] </pre> </div>

(Note) The Banking Law was enacted in 1927.
The Insurance Business Law was enacted in 1939.

2. Period from 1965 to 1984 (High Economic Growth, Two Forms of Internationalization)

Overseas Situation	Domestic Situation	System Development, etc.
<ul style="list-style-type: none"> ● Vietnam War (1960~1975) <div>1971 Nixon Shock Suspension of dollar-gold convertibility</div> <div>1971 Smithsonian Agreement US\$=¥360→¥308</div> <ul style="list-style-type: none"> ● 4th Middle East War (1973) <div>1973 Shift to the floating exchange rate system</div> <ul style="list-style-type: none"> ● Iranian Revolution (1978~1979) Iran-Iraq War (1980~1983) <div>America Reaganomics Twin deficits</div>	<ul style="list-style-type: none"> ● Tokyo Olympics (1964) <div>1965~1970 Izanagi boom New three holy durables (color TVs, air-conditioners, cars) Increasing pollution World's 2nd largest GDP</div> <ul style="list-style-type: none"> ● Osaka Expo (1970) <div>1972 Plan for Rebuilding the Japanese Archipelago</div> <div>1973 1st Oil Shock Rampant inflation (wholesale prices rose 37% Y/Y)</div> <div>1973~1974 Credit tightening</div> <div>1978 2nd Oil Shock</div>	<div>1965 Securities market crisis Bank of Japan special loan to Yamaichi Securities</div> <div>1966 Start of government bond issuance Enhanced international competitiveness of the manufacturing sector → Increase in exports</div> <div>1971 "Deposit Insurance Law" enforced</div> <div>1975 Start of deficit-covering government bond issuance Massive government bond issuance Reliance on government bonds</div> <div> <div>Household</div> <div>Financial institutions</div> <div>Government</div> </div> <div> <p>Total Exports FY1965 Approximately 8.5 billion</p> <p>↓</p> <p>FY1975 Approximately 55.8 billion</p> <p>FY1970 4.2%</p> <p>↓</p> <p>FY1980 32.6%</p> </div> <div>1979 Start of interest rate liberalization</div> <div>1980 "Law for Partial Revision to the Foreign Exchange and Foreign Trade Law" enforced</div> <div>Liberalization of external transactions in principle</div> <div>1981 "Banking Law (fully revised)" enforced</div>

3. Period from 1985 and after 1989 (Bubble Economy, Subsequent Adjustments)

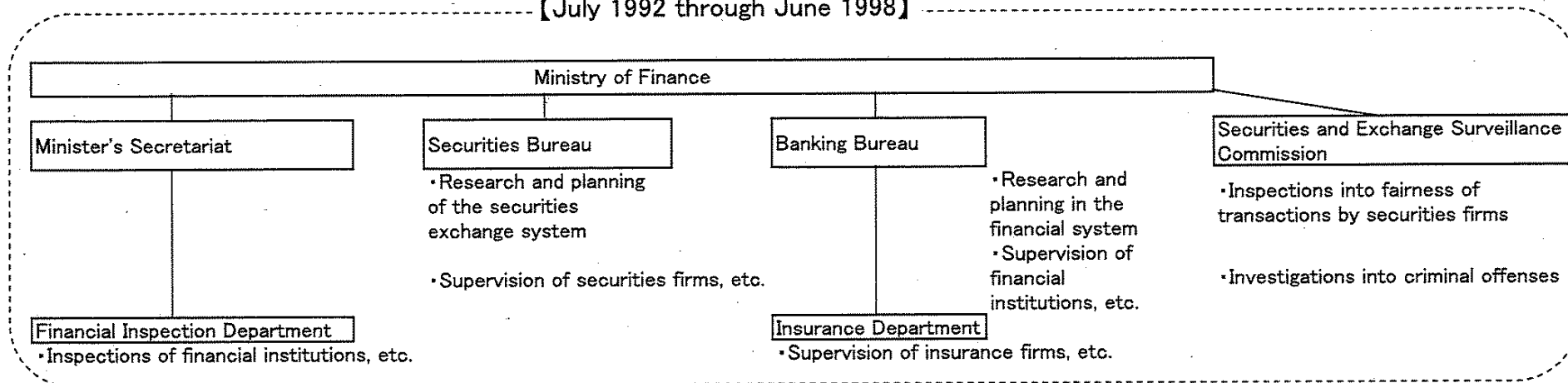
Overseas Situation	Domestic Situation	System Developments, etc.
<div>1985 Plaza Accord</div> <div>Yen appreciation against the U.S. dollar</div> <div>1987 Louvre Accord</div> <div>Halt to dollar decline, stability of exchange rates</div> <ul style="list-style-type: none"> ● Black Monday (1987) ● End of the Cold War (1989) Fall of the Berlin Wall, Tiananmen Square incident in China ● Iraq's invasion of Kuwait (1990) ● Soviet breakup (1991) ● Establishment of the EU (1993) 	<div>1985 Foundation of NTT, JT</div> <div>1987 Foundation of JR</div> <div>"Resort Law" enforced</div> <div>1986~1991 Bubble boom</div> <div>Sharp rises in stock, land prices Myth of ever-rising land prices Nikkei Average all-time high ¥38,915 (Dec. 29, 1989)</div> <div>1989 "Consumption Tax Law" enforced</div> <div>Recruit scandal (Takeshita Cabinet en-masse resignation)</div> <div>1995 Hanshin-Awaji Earthquake</div> <div>1997 Consumption tax rate raised to 5%</div>	<div>1988 "Law for Partial Revision to the Securities and Exchange Law" enforced</div> <div>Introduction of insider trading regulations</div> <div>1989 Application of "Act on Financial Institutions' Merger and Conversion" provisions</div> <div>Conversion of sogo banks to ordinary banks</div> <div>1990 Notice on total loan amount control</div> <div>1991 Securities/banking scandals</div> <div>1992 Establishment of the Securities and Exchange Surveillance Commission</div> <div>1993 "Financial System Reform Law" enforced</div> <div>BIS capital adequacy rules introduced</div> <div>1994 Completion of interest rate liberalization</div> <div>1995 Daiwa Bank NY Branch scandal</div> <div>1996 Prime Minister's instruction on "Japanese Big Bang"</div> <div>1998 "Bank of Japan Law (fully revised)" enforced</div>



II . Major Post-Big Bang Financial Developments

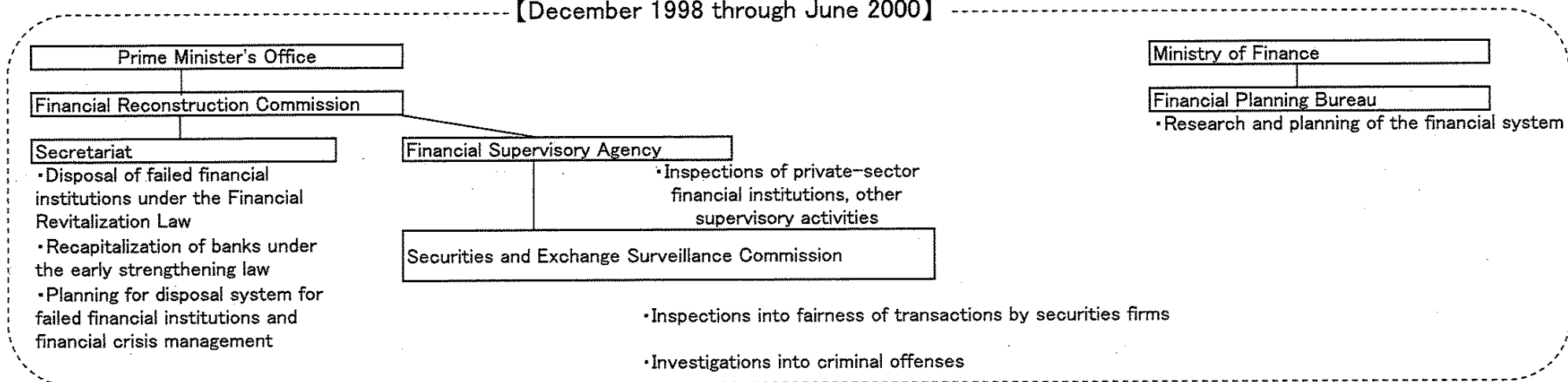
1. Changes to Financial Administration Structures

-----【July 1992 through June 1998】-----



※ June 1998 "Financial Supervisory Agency" established

-----【December 1998 through June 2000】-----

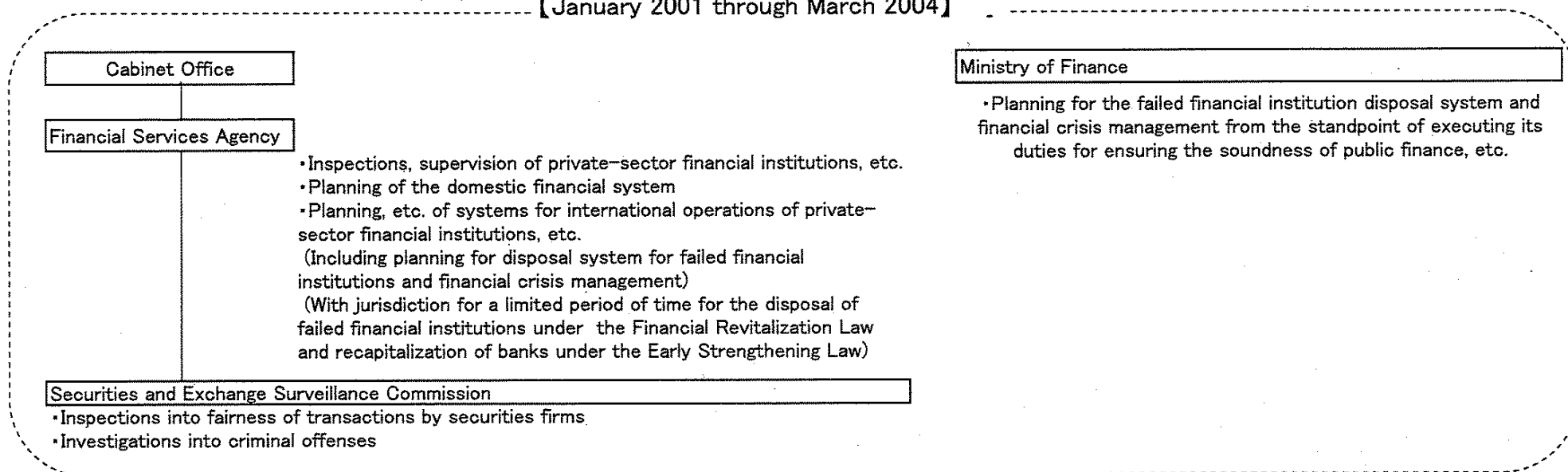


※ July 2000

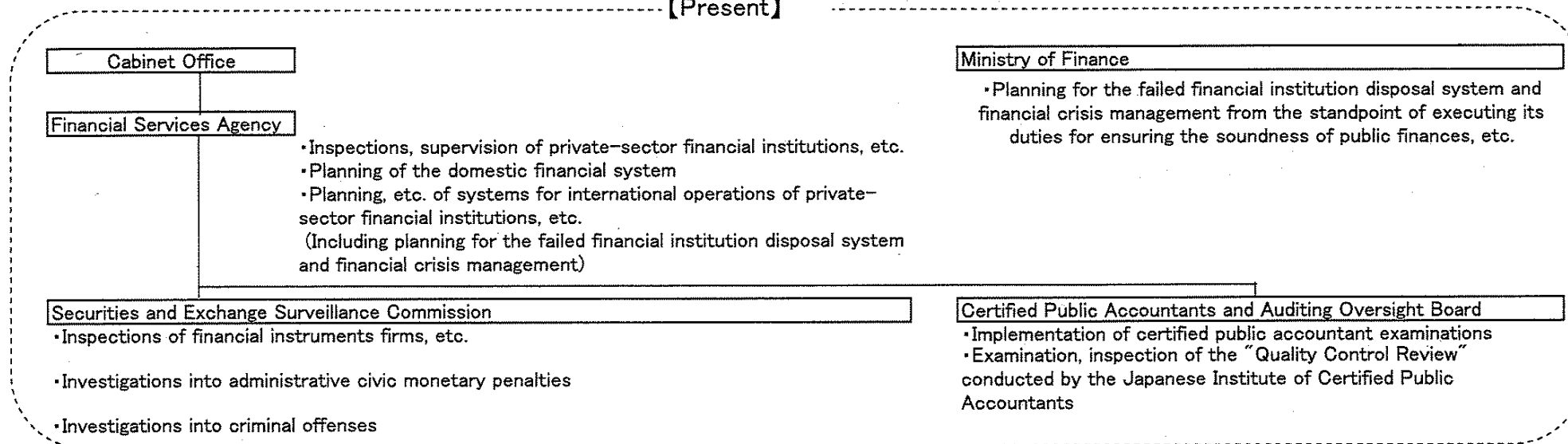
Functions of financial system research, planning transferred from the Ministry of Finance

Establishment of "Financial Services Agency"

↓
【January 2001 through March 2004】

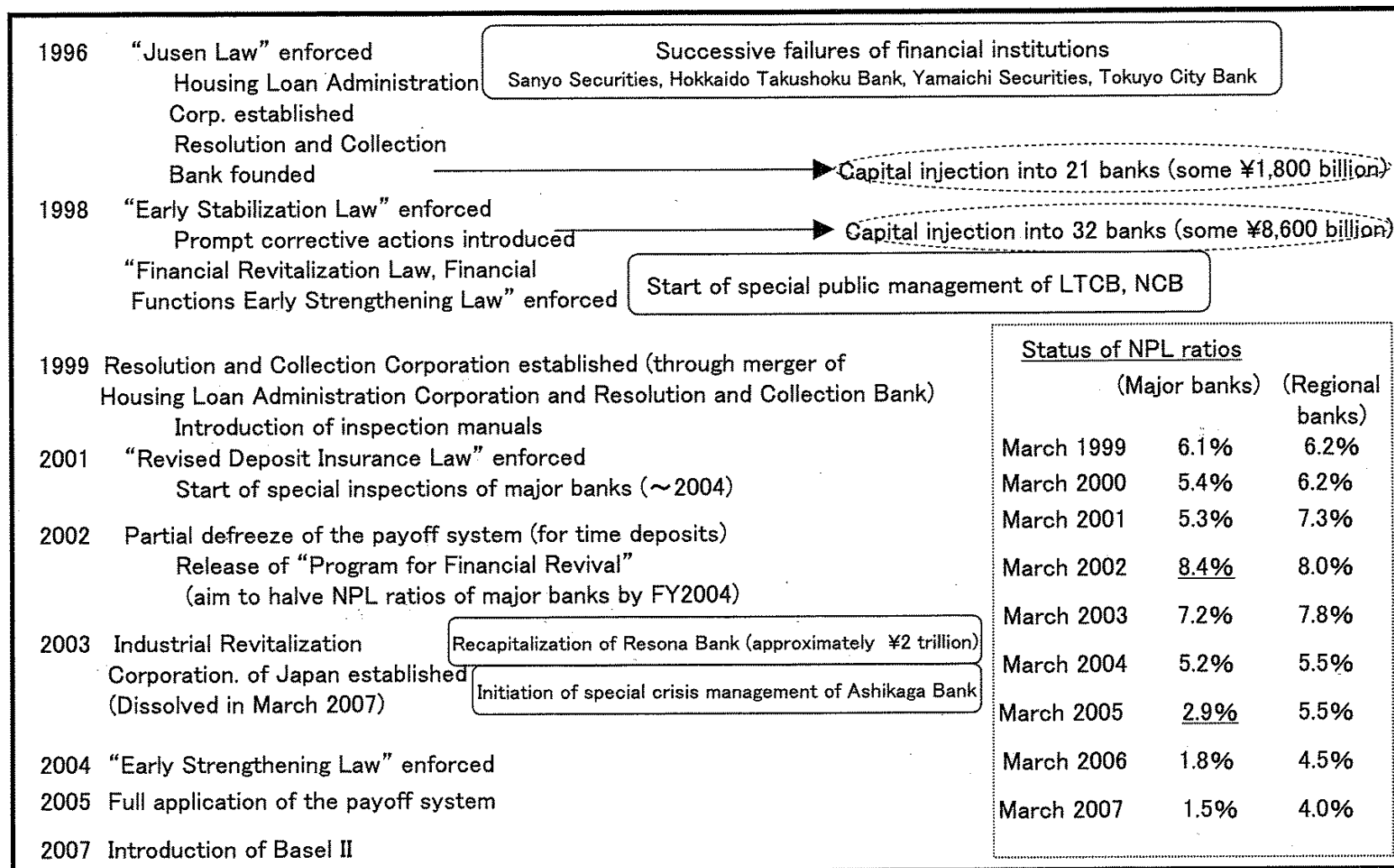


↓
【Present】

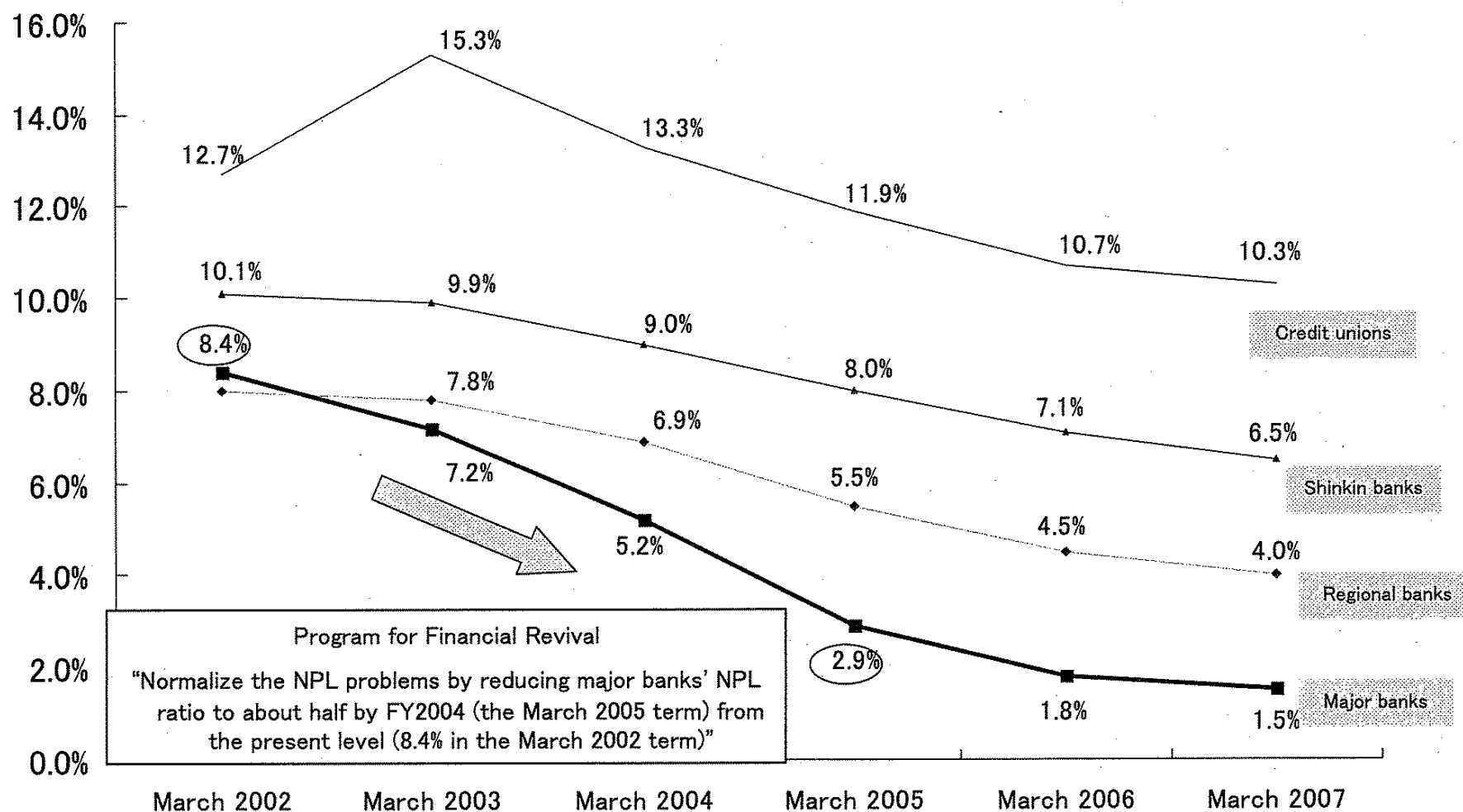


2. Financial System Stability

① Course of Events in the Development of the Financial System



② Progress in Non-Performing Loan Disposal



※ Figures are based on loan claims disclosed under the Financial Revitalization Law

※ Figures for shinkin banks and credit unions include those for their central organizations (Shinkin Central Bank, Shinkumi Federation Bank)



III. Efforts Pertaining to Relationship Banking

Developments in Relationship Banking

October 30, 2002	Release of "Program for Financial Revival"
March 27, 2003	Release of "Toward Enhancing Relationship Banking Functions," Report on the Second Subcommittee, Sectional Committee on Financial System, Financial System Council
March 28, 2003	Release of "Action Program Concerning Enhancement of Relationship Banking Functions" (1st AP)
December 24, 2004	Release of "Program for Further Financial Reform"
March 28, 2005	Release of "Summary of Discussions on the Evaluation of the Results of 'Action Program Concerning Enhancement of Relationship Banking Functions' (Chairman's Memorandum)"
March 29, 2005	Release of "Action Program Concerning Enhancement of Relationship Banking Functions (FY2005-2006)" (2nd AP)
April 5, 2007	Release of "Evaluation of Relationship Banking Efforts and Further Responses," Report on the Second Subcommittee, Sectional Committee on Financial System, Financial System Council
August 24, 2007	Release of Partial Revision to "Comprehensive Guidelines for Supervision of Small- and Medium-Sized and Regional Financial Institutions"

Action Program Concerning Enhancement of Relationship Banking Functions (Basic Approach)

—Securing Revitalization and Sustainability of Financing for Small- and Medium-Sized Enterprises toward Solving Non-Performing Loan Problems at Small- and Medium-Sized and Regional Financial Institutions—

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

“Regarding the disposal of NPLs of small- and medium-sized financial institutions[※], an action program shall be prepared within FY2002 after examining with multiple criteria the modality of relationship banking, which has different characteristic features from those of major banks. (※) Regional banks, second-tier regional banks, shinkin banks and credit unions)

※ “Relationship Banking”= A business model of lending based on information on quality of the management and future prospects of a borrower company obtained via long-term, sustained relationship

“Toward Enhancing Relationship Banking Functions,” Report on the Second Subcommittee, Sectional Committee on Financial System, Financial System Council (released on March 27, 2003)

《Promotion of disposal of NPLs held by small- and medium-sized financial institutions based on characteristic features of such NPLs》

- It is fundamental to **maintain the sustainability of relationship banking** by ensuring the soundness of both borrowers and lenders through collaborative management of risks and sharing of costs with small- and medium-sized enterprises (SMEs) in regions.
- It is necessary to dispose of NPLs in a **manner fully acceptable to both lenders and borrowers while bearing in mind potential impacts on regional economies**.
- It is appropriate to **follow the basic approach of implementing concrete measures toward the enhancement of relationship banking functions**, including development of systems for disposal of NPLs within a certain period of time while **ensuring the soundness of financial institutions through adequate write-offs and provisions**. Specifically, it is appropriate to solve the NPL problem by promoting various efforts to revitalize SMEs and reactive regional economies while designating a two-year period until the end of FY2004 as the **“Intensive Improvement Period”** regarding regional finance.

Action Program

Certainly ensure the strengthening of relationship banking functions during FY2003~2004 (“Intensive Improvement Period”)

Ⅰ. Measures to revitalization of SME financing

1. Strengthening of functions to support business inauguration, opening of new businesses
2. Strengthening of management consultation and support functions for client firms
3. Proactive efforts toward early business revitalization
4. Strengthening of efforts toward new SME financing
5. Development of systems for explanations to clients, strengthening of consultation and complaint handling functions
6. Disclosure of progress (semiannual disclosure by each financial institution and industry)

Ⅱ. Measures to ensure the soundness and enhance profitability

1. Stricter assessment of assets and credit risk management
2. Development of profitability management systems and enhancement of profitability
3. Strengthening of governance
4. Disclosure of information on contributions to local communities, etc.
5. Compliance
6. Ensuring stability of regional financial systems
7. Supervision and inspection systems

⇒ All financial institutions are required to submit the “Plan for Enhancing Relationship Banking Functions” by the end of August 2003. The FSA will follow up on these plans, and compile and publish progress reports semiannually.

※ Difficulty in taking the same off-balance sheet approach to the disposal of NPLs as major banks (as pointed out in the above-mentioned report by the 2nd Subcommittee of the Financial System Council)

- ① Regional SMEs have only limited options of drastic corporate revitalization methods, liquidity of collateral disposal and availability of human resources. Moreover, in case of SMEs, disposal of NPLs itself is difficult because assets and liabilities of such enterprises and owners are inseparably integrated.
- ② Small- and medium-sized and regional financial institutions do not have sufficient know-how on management improvement guidance and corporate revitalization or well-developed systems for such services. If they are pressed to dispose of NPLs unduly, even viable SMEs may be forced to close down or go into liquidation.
- ③ If rapid disposal of NPLs is sought without developing an adequate environment such as facilitation of labor mobility and better utilization of human resources, it could have a serious impact on regional economies, including increased unemployment.

Developments Regarding the New Action Program (FY2005~2006)

Action Program Concerning Enhancement of Relationship Banking Functions (March 28, 2003, FSA)

Certainly ensure the strengthening of relationship banking functions during FY2003~2004 ("Intensive Improvement Period")

《I. Measures to revitalization of SME financing》

1. Strengthening of functions to support business creation, opening of new businesses
2. Strengthening of management consultation and support functions for client firms
3. Proactive efforts toward early business revitalization
4. Strengthening of efforts toward new SME financing
5. Development of systems for explanations to clients, strengthening of consultation and complaint handling functions
6. Disclosure of progress (semiannual disclosure by each financial institution and industry)

《II. Measures to ensure the soundness and enhance profitability》

1. Stricter assessment of assets and credit risk management
2. Development of profitability management systems and enhancement of profitability
3. Strengthening of governance
4. Disclosure of information on contributions to local communities, etc.
5. Compliance
6. Ensuring of regional financial system stability
7. Supervision and inspection systems

Program for Further Financial Reform (December 24, 2004, FSA)

"The FSA will strive to further promote relationship banking, through cooperation with other government agencies and utilization of Local Financial Bureaus, from the standpoint of revitalizing and reactivating regional economies in a competitive environment, facilitating SME financing including support for business creation in regions, and encouraging the strengthening of the management power of small- and medium-sized and regional financial institutions. To this end, the FSA will develop a new action program that incorporates the existing action program on the basis of the evaluation of performance, etc. under the existing program.

"Working Group on Relationship Banking" of the 2nd Subcommittee of the Financial System Council
(Six meetings and two regional conferences (in Fukuoka and Osaka) since February 7, 2005)

Summary of Discussions on the Evaluation of the Results of "Action Program Concerning Enhancement of Relationship Banking Functions" (March 28, 2005, "Working Group on Relationship Banking" of the Second Subcommittee of the Financial System Council)

《Commendable achievements》

- Re-realization by financial institutions of roles they play in regions
- Improvement in lending attitudes and borrower support efforts
- Progress in development of basic systems for promotion of relationship banking
- ⇒ A certain measure of commendation due for financial institutions' efforts during "Intensive Improvement Period"

《Insufficiencies》

- Nature of relationship banking not necessarily understood
- "Something-for-everyone" approach in financial institutions' plans, divergent efforts and performance
- Still insufficient in business revitalization efforts, ability to identify promising businesses
- Insufficient information disclosure to users, etc.

《Expectations on New Action Program》

- (1) Continued promotion of relationship banking
- (2) Promotion of relationship banking on accurate understanding of its nature
- (3) Promotion by "selection and concentration" based on regional characteristics, etc.
- (4) Promotion of information disclosure and discipline thereby, etc.

New Action Program (FY2005~2006)

Pursue Further Promotion of Relationship Banking during FY2005~2006

《1. Business revitalization, Facilitation of SME financing》

- (1) Strengthening of functions to support business creation, opening of new businesses
- (2) Strengthening of management consultation and support functions for client firms
- (3) Proactive efforts toward early business revitalization
- (4) Promotion of lending without excessive reliance on collateral and guarantees, etc.
- (5) Development of systems for explanations to clients, strengthening of consultation and complaint handling functions
- (6) Human resources development

《2. Strengthening of management power》

- (1) Improvement of risk management systems
- (2) Development of profitability management systems and enhancement of profitability
- (3) Strengthening of governance
- (4) Strengthening of compliance system
- (5) Strategic utilization of IT
- (6) Strengthening of functions of central organizations of cooperative financial institutions
- (7) Inspection and supervision systems

《3. Enhancement of conveniences of regional users》

- (1) Disclosure of information on contributions to local communities
- (2) Improved data on the state of SME financing
- (3) Establishment of financial institution management focusing on satisfaction of regional users
- (4) Coordination with various policy initiatives for promotion of regional revitalization
- (5) Questionnaire surveys regarding the evaluation by users, etc.

⇒ All financial institutions are required to submit and publish the "Plan for Promoting Relationship Banking" by the end of August 2005 and also disclose the progress semiannually.

Overview of Progress in Relationship Banking (FY2003~2006 through the End of the Second Action Program)

I Summary of performance as announced by regional financial institutions (a total of 566 FIs, including regional banks, shinkin banks and credit unions)

1. Lending for business creation and new business openings made steady progress. While syndicated loans with government-affiliated financial institutions were sluggish, own loan for supporting business creation, etc. increased smoothly.

	< FY2003 >	< FY2004 >	< FY2005 >	< FY2006 >
• Loan products for supporting business creation	1.9K cases ¥17.9 b.	⇒ 2.8K cases ¥25.0 b.	⇒ 5.4K cases ¥60.3 b.	⇒ 6.9K cases ¥74.2 b.
• Syndicated loans with govt-affiliated FIs	0.3K cases ¥37.4 b.	⇒ 0.7K cases ¥68.4 b.	⇒ 0.8K cases ¥98.7 b.	⇒ 0.7K cases ¥80.3 b.

2. Business improvements of borrower firms provided with business improvement support financing dipped slightly from achievements under the First Action Program, as FI efforts in this area have already run their course and remaining cases are all difficult to handle. Cases of business matching rose substantially.

• Upgrade rate for firms with improvement support	<FY2003~2004 (1st AP)>	24.5%	⇒	<FY2005~2006 (2nd AP)>	22.1%
• No. of business matching contracts (Excluding healthy borrowers)	6.2K cases	⇒	10.4K cases	⇒	15.9K cases ⇒ 24.0K cases

3. Regarding business revitalization, amid increases in small-scale and/or difficult cases, the use of councils for SME revitalization support rose steadily. DES (debt-equity swaps) and DIP finance remain popular among revitalization methods.

• Firms with revitalization plans worked out by SMT revitalization support councils	201 cases ¥230.5 b.	⇒	302 cases ¥342.2 b.	⇒	380 cases ¥357.2 b.	⇒	391 cases ¥280.3 b.
• Firms receiving RCC support	3 cases ¥60.8 b.	⇒	10 cases ¥63.1 b.	⇒	22 cases ¥94.2 b.	⇒	38 cases ¥117.6 b.
• Capital subscription to corporate revival funds	¥10.9 b.	⇒	¥16.8 b.	⇒	¥16.9 b.	⇒	¥16.2 b.
• DES (debt-equity swap)	29 cases ¥17.5 b.	⇒	33 cases ¥26.1 b.	⇒	24 cases ¥19.1 b.	⇒	34 cases ¥25.6 b.
• DDS (conversion of debt into subordinated loans)	7 cases ¥5.6 b.	⇒	57 cases ¥28.1	⇒	64 cases ¥25.7 b.	⇒	5 cases ¥16.6
• DIP finance	152 cases ¥56.6 b.	⇒	188 cases ¥19.2 b.	⇒	136 cases ¥16.0 b.	⇒	563 cases ¥19.7 b.
(Provision of operational funds to firms in legal revitalization procedures)							

4. Regarding lending without excessive reliance on collateral and guarantees, amounts of lending using financial covenants and syndicated loans increased. In addition, ABL is spreading widely, with chattel collateral lending soaring in particular, though still small in absolute numbers.

• Loan products using financial covenants	2.1K cases	¥ 33.9 b.	⇒	3.6K cases	¥ 95.4 b.	⇒	5.4K cases	¥ 203.1 b.	⇒	4.5K cases	¥ 238.5 b.
• Syndicated loans	219 cases	¥ 299.3 b.	⇒	420 cases	¥ 479.2 b.	⇒	567 cases	¥ 524.5 b.	⇒	635 cases	¥ 670.0 b.
• Lending on chattel, assigned claims collateral (chattel collateral lending)	10.0K cases	¥ 110.2 b.	⇒	19.0K cases	¥ 173.7 b.	⇒	23.5K cases	¥ 199.8 b.	⇒	18.2K cases	¥ 202.9 b.
	(No individual data		⇒	(same as left)		⇒	27 cases	¥ 4.7 b.	⇒	153 cases	¥ 131 b.

5. On enhanced conveniences for regional users and regional revitalization, various efforts are being made in accordance to regional characteristics, with lending to PFI projects showing a particularly large increase.

	< FY2003 >		< FY2004 >		< FY2005 >		< FY2006 >
• Lending to PFI projects	22 cases	¥ 18.7 b.	⇒	49 cases	¥ 40.9 b.	⇒	71 cases ¥ 32.6 b. ⇒ 116 cases ¥ 62.5 b.

«Reference : Progress in numerical goals voluntarily set by regional financial institutions»

Of numerical goals set voluntarily by regional financial institutions, self-evaluation on numerical goals for which they disclosed progress (performance)

○ “Achievements top goals” about 62%

○ “Achievements roughly in line with goals” about 16%

○ “Achievements fall short of goals” about 22%

II Evaluation of relationship banking efforts and future challenges

1. Views of regional financial institutions

While many of them generally positively regard their efforts toward the strengthening of relationship banking functions as making steady progress, some cite speedier business revitalization, enhancement of abilities to identify promising businesses, strengthening of compliance, and provision of information to users as challenges to be undertaken.

2. Views of users (evaluation of overall efforts)

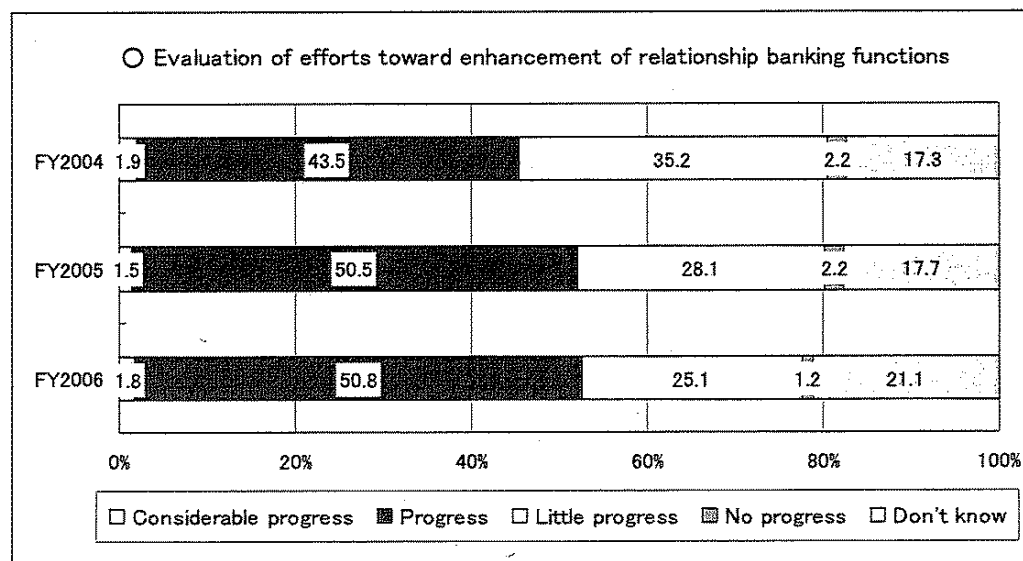
Based on the results of questionnaire surveys on users, users with positive views of efforts toward the strengthening of relationship banking rose to exceed the majority, while those with negative overall evaluation declined.

(Positive evaluation)

- Making active business matching efforts in particular, including management consultations
- Beginning to focus on business managers or actual business developments, rather than financial statements
- Far fewer cases of reluctant lending attitudes or aggressive recovery of outstanding loans
- Compared with a few years ago, making considerable efforts to contribute to revitalization of regional economies and to regions

(Negative evaluation)

- View that while efforts are apparent, results have been minimal
- Financial institutions vary in efforts, with divergent attitudes even between branches and employees of the same institutions
- Still reliant on collateral and guarantees, with apparent lack of ability to identify promising businesses



3. Views of users (Evaluation of individual measures)

(1) Efforts to facilitate business revitalization and SME financing

Users with positive evaluation continue to outpace those with negative evaluation for such matters of support for business creation and opening of new businesses, management consultations and support, systems for explanations to customers and consultation and complaints handling, and human resources.

However, negative evaluation still exceeds positives, albeit only slightly, regarding lending without excessive reliance on collateral and guarantees, while negative viewers continue to outnumber positives concerning efforts for business revitalization.

Survey item	Stronger business creation, new business opening functions	Stronger management consultations, support functions	Efforts for business revitalization	Lending without excessive reliance on collateral and guarantees	Development of systems for explanations to customers, strengthening of consultation and complaint-handling functions	Development of human resources (※)
Positive evaluation	39.5 (24.5)	50.7 (33.5)	24.3 (18.5)	41.6 (20.4)	51.7 (27.6)	35.6 (34.3)
Negative evaluation	38.3 (48.6)	32.8 (45.5)	40.7 (44.8)	42.4 (61.2)	25.3 (43.7)	33.4 (33.3)

(Unit:%, figures in parentheses are FY2003 results (※indicates FY2005 results). The gap between the sum of positive and negative viewers and 100% indicates the proportion of "Don't s know" replies. The same is applicable to below.)

(2) Efforts for enhancement of conveniences for regional users

While the positive evaluation tops the negative evaluation on disclosure of information, the negative evaluation still exceeds the positive evaluation, though only slightly, about the establishment of management based on the satisfaction of users. Negative viewers continue to outnumber positive viewers concerning cooperation for regional revitalization and regional contributions.

Survey item	Information disclosure on regional contributions, etc.	Establishment of FI management focusing on satisfaction of regional users	Coordination with various policy measures for promotion of regional revitalization (※)	State of regional contributions (contributions to regional economies through financial activities, etc.)
Positive evaluation	42.4 (25.0)	44.5 (36.4)	25.3 (24.3)	32.9 (30.3)
Negative evaluation	35.3 (46.2)	45.5 (46.6)	39.7 (40.8)	43.9 (47.3)

III Conclusions

Overall, relationship banking, in terms of the number of cases addressed and amounts involved, have achieved steady performance during the four years of the two action programs, but users point out that regional financial institutions' efforts are still insufficient in such areas as business revitalization, lending without excessive reliance on collateral and guarantees, and contributions to regions.

The report recently presented by the Financial System Council called on financial institutions to make continued efforts in the three specific areas of "stronger business revitalization and other support for client firms," "thorough adoption of fund-providing methods suitable for SMEs, including lending methods focusing on business value" and "sustainable contributions to regional economies with utilization of accumulated information on regions," and also found it necessary for them, in continuing these efforts, to "accurately understand user needs and feed them back into management strategies."

The FSA expects individual financial institutions to redouble their efforts in light of the views of users and the Council's Report, and will make supervisory follow-ups as necessary.

Evaluation of the Current Situation of Relationship Banking and Responses Going Forward
—Toward Establishment of A Sustainable Business Model Using Accumulation of Regional Information—
《Outline of Report on the Second Subcommittee, Sectional Committee on Financial System, Financial System Council》

Present Situation

《Achievements so far》

- Performance in terms of no. of cases, situation steadily improving
- Basic concept, individual methods sinking in and taking firm root
- NPL ratios fell. Now shifting from “emergencies” to “normal times” measures

《Insufficiencies, challenges》

- Polarization trend in financial institutions’ efforts
- Insufficiencies in business revitalization, lending without excessive reliance on real estate collateral, personal guarantees
- Still halfway to profitability enhancement
- Examples turning into a checklist, with financial institutions simply trying to cover items in the list, as some have pointed out
- Criticism that the program approach with a two-year timeframe and semiannual reports restricting latitude of financial institutions’ management, providing inadequate motivation for them to seek efforts that produce quick results

《New environment》

- Intensified competition with major banks, new developments concerning Yucho Bank, policy finance reform, etc.
- With the aging population with declining birthrate and public finance deterioration, there are many problems in regions, including the hollowing-out of local industries, hollowing-out of core urban areas, and polarization between big cities and regions through these developments
- From the viewpoint of supporting challenges for second chances, it is necessary to pursue comprehensive revitalization of regional economies. The challenge is to turn business revitalization at various points” into “broad” region-wide

Basic Approach

- Confirmation of need for relationship banking
 - It is necessary to establish, deepen relationship banking business models for survival of regional financial institutions
 - It is essential to recognize costs, grasp client and regional needs and thoroughly pursue and deepen “selection and concentration” in order to earn profits commensurate with costs
- Regional financial institutions can contribute to broad region-wide revitalization
 - They have roles to play in information and human resources, on top of their roles as cornerstones of regional information networks and fund providers
 - Adequate responses to these needs bring business opportunities for making profits
- Appropriate commitment
 - It is important to make sustainable contributions to regions that could bring profits while fully aware of costs involved

Specific Measures, Promotion Systems

【Specific measures】

- Specific measures commonly required of financial institutions are limited to the following three related to the very nature of relationship banking:
 1. Stronger support for client firms according to their lifecycles
 2. Thorough adoption of fund-providing methods suitable to SMEs, including lending methods focusing on business value
 3. Sustainable contributions to regional economies with use of accumulated information on regions
 Specific measures are left to each financial institution.
- Continue calls on cooperative financial institutions to strengthen their management bases, while promoting comprehensive approaches through improved functions of central organizations and industry bodies
 - Expect individual institutions to make efforts and contribute to regions on the strength of their cooperative nature
 - Expect central organizations and industry bodies to seek cooperation with other institutions on the strength of their nationwide networks, and further utilize their functions of managing surplus funds from individual cooperative institutions

【Promotion systems】

- Permanent approaches incorporated in supervision guidelines, instead of program-based approaches
- Follow up on relationship banking efforts through regular supervision without requiring preparations and reporting of uniform, “something-for-everyone” plans
- Promotion of voluntary disclosure and governance through public pressure
- Disclosure of performance roughly once a year, and publication of specific examples
- Stronger cooperation with relevant organizations, ministries and agencies at both central and regional levels

Concerning Future Supervisory Framework for Relationship Banking Efforts

“Evaluation of the Current Situation of Relationship Banking and Responses Going Forward” (Outline)

(Report on the Second Subcommittee of the Financial System Council, April 5, 2007)

- Need for and basic approach to relationship banking
 - It is necessary to establish, deepen relationship banking business models for survival of regional financial institutions
 - It is essential to recognize costs, grasp client and regional needs and thoroughly pursue and deepen “selection and concentration” in order to earn profits commensurate with costs
 - Can contribute to broader revitalization of regions (there are roles to be played in information and human resources beyond roles as fund providers)
 - Appropriate commitment (It is important to make sustainable contributions to regions that could bring profits while fully aware of costs involved)
- Specific measures for relationship banking
 - Specific measures commonly required of financial institutions are limited to the following three related to the very nature of relationship banking. Specific measures are left to each financial institution.
 - ① Stronger support for client firms according to their lifecycles
 - ② Thorough adoption of fund-providing methods suitable to SMEs, including lending methods focusing on business value
 - ③ Sustainable contributions to regional economies with use of accumulated information on regions
- Systems for promoting relationship banking
 - (1) Development of systems at financial institutions
 - Development of internal systems conducive to enhanced profitability, “selection and concentration” of management resources
 - Development and utilization of human resources responsive to needs of regional users, stronger cooperation with parties concerned
 - (2) Requests for financial institutions
 - Clarification of prioritized items and objectives in medium-term management plans, etc., publication of achievements
 - Understanding of user needs and their feedback into management strategies
 - (3) Administrative involvement
 - Follow up on contents and progress of voluntary management plans through regular supervision without requiring formulation and reporting of uniform plans
 - Publication of achievements roughly once a year, and of specific examples of relationship banking efforts
 - Grasping of users’ voices and publication of results
 - Promotion of voluntary disclosure and governance through public pressure (requests for disclosure of principal performance figures, provision of opportunities for financial institutions to announce their achievements, etc.)
 - (4) Development of systems of administrative authorities (stronger cooperation with relevant ministries and agencies at both central and regional levels)

“Comprehensive Guidelines for Supervision of Small- and Medium-Sized and Regional Financial Institutions” (Outline)

II-5 Promotion of Relationship Banking

1. Significance

- (1) Background
 - The report concludes that regional financial institutions, based on their achievements so far, should continue to make relationship banking efforts
 - As the report says that relationship banking should be promoted under the permanent framework of regular supervisory administration, the guidelines for supervision expressly refers to the promotion of relationship banking
- (2) Basic approach
 - ⇒ Clearly state anew the points described in the report described in the left column.

2. Major points of observation

- (1) System development (verification of systems at financial institutions)
 - Development of internal systems to make relationship banking conducive to enhanced profitability
 - State of thorough “selection and concentration” of management resources
 - Disclosure of basic policies for relationship banking promotion (whether they are expressly stated in medium-term management plans) and measures to keep employees thoroughly informed
 - Development and utilization of human resources, and stronger cooperation with parties concerned
 - Grasping of user needs and their feedback into business strategies, reflection of user evaluation results on business operations
- (2) Specific measures (verify active efforts in the following three areas. Specific methods are left to the discretion of individual financial institutions, with items cited in the Report listed simply as examples of desirable efforts)
 - ① Stronger support for client firms according to their lifecycles
 - ② Thorough adoption of fund-providing methods suitable to SMEs, including lending methods focusing on business value
 - ③ Sustainable contributions to regional economies with use of accumulated information on regions

3. Supervisory methods, responses

- On the basis of free competition, respect for management decisions in line with self-responsibility, and governance through the eyes of users in regions, the PSA provides motivation and prepare an environment for relationship banking to deepen and take firm root
- Pay due heed to the positioning of relationship banking in overall management strategies and depth of efforts being made, instead of simply sticking to quantitative evaluation of individual methods
- (1) Grasping of efforts being undertaken
 - Regular follow-ups via comprehensive hearings and hearings with top executives (contents and progress of voluntary management plans)
 - Compilation and publication of performance once a year
 - Annual surveys to grasp users’ voices and publication of survey results
- (2) Governance through information disclosure and market discipline
 - Disclosure of principal performance figures and achievements of efforts on the websites of the PSA and the Ministry of Finance
 - Holding of symposiums at least once a year in each prefecture or by each Regional Financial Bureau
 - Introduce and commend examples of advanced measures and measures desirable for broader application once a year

Concerning Guidelines for Supervision of Small- and Medium-Sized and Regional Financial Institutions in Program Year 2007

Qualitative Improvement of Financial Regulation

Shift in dimensions of financial regulation

- Efforts toward the strengthening of relationship banking efforts made steady progress under the two successive action programs. Going forward, the FSA will continue to promote relationship banking under the permanent framework based on the supervisory guidelines.
- With revitalization of Japan's financial and capital markets becoming the prioritized policy agenda, the quality of financial regulation and supervision are being tested anew.



Qualitative improvement of supervision

- (1) Optimal combination of rule-based supervision and principles-based supervision
- (2) Responses to priority issues through effective utilization of administrative resources
- (3) Focus on incentives for financial institutions and respect for their self-help efforts
- (4) Further enhancement of transparency and predictability of administrative responses

In addition, the FSA will pay attention to whether financial institutions are following appropriate business management at the leadership of top executives under the principle of self-responsibility, and also continue to seek stronger cooperation with inspection-related departments and Local Financial Bureaus

Priority Areas

1. Promotion of relationship banking

As financial institutions addressed various measures to strengthen relationship banking, these measures made steady progress generally. However, further promotion is deemed necessary as users have pointed out insufficiencies in such areas as “efforts for business revitalization,” “lending without excessive reliance on collateral and guarantees” and “contributions to regions.” The FSA will continue to follow up on efforts in these areas that pertain to the very nature of relationship banking.

- (1) Stronger support for client firms according to their lifecycles
- (2) Thorough adoption of fund-providing methods suitable to SMEs
- (3) Sustainable contributions to regional economies

2. Thorough protection of and enhancement of conveniences for users in regions

While financial institutions are expected to provide financial services in response to customer needs, they are also being called upon to make further efforts for the protection of users in light of the enforcement of the Financial Instruments and Exchange Law. In addition, there is the heightening need for responses to prevent the use of financial services by organized crime. Given these circumstances, the FSA will focus on the following matters in supervision:

- (1) Improvement and strengthening of systems for explanations to customers and consultation and complaint-handling functions
- (2) Compliance
- (3) Stronger and thorough measures to prevent financial crimes and ensuring of appropriate responses to customers
- (4) Establishment of management systems for customer information
- (5) Ensuring adequacy of system risk management systems
- (6) Ensuring of appropriate business management at outsourced

3. Risk management systems according to risk profiles

It is essential for financial institutions to improve and strengthen risk management systems and secure the confidence of depositors, etc. in order to promote relationship banking. Given the trend toward increased management of assets with complicated risk profiles and major risk scenarios for interest rate and market developments, the FSA will focus on the following matters for appropriate risk management in supervision:

- (1) Ensuring reliability of asset assessment and credit risk management
- (2) Development of market risk management systems
- (3) Responses to Basel II