

Approaches for Improving and Maintaining Soundness of Credit Supplementation System

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Problem Awareness

◆ Over the past ten years the Japanese economy was hit by two major crises, namely the Global Financial Crisis and the Great East Japan Earthquake.



◆ Credit Supplementation System played significant roles in overcoming these two major crises.



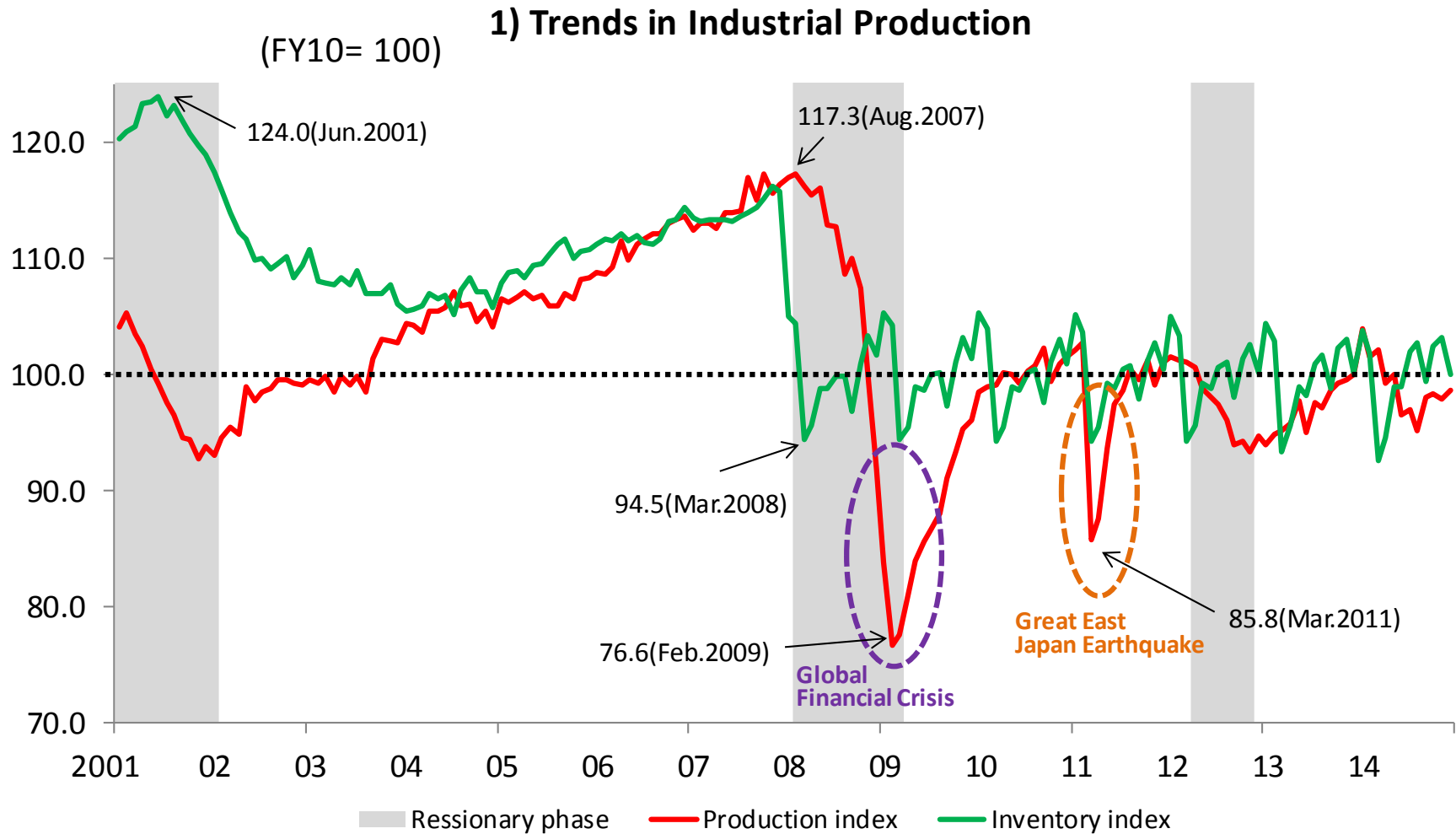
◆ However, as Credit Supplementation System played major roles, the system held huge risks.



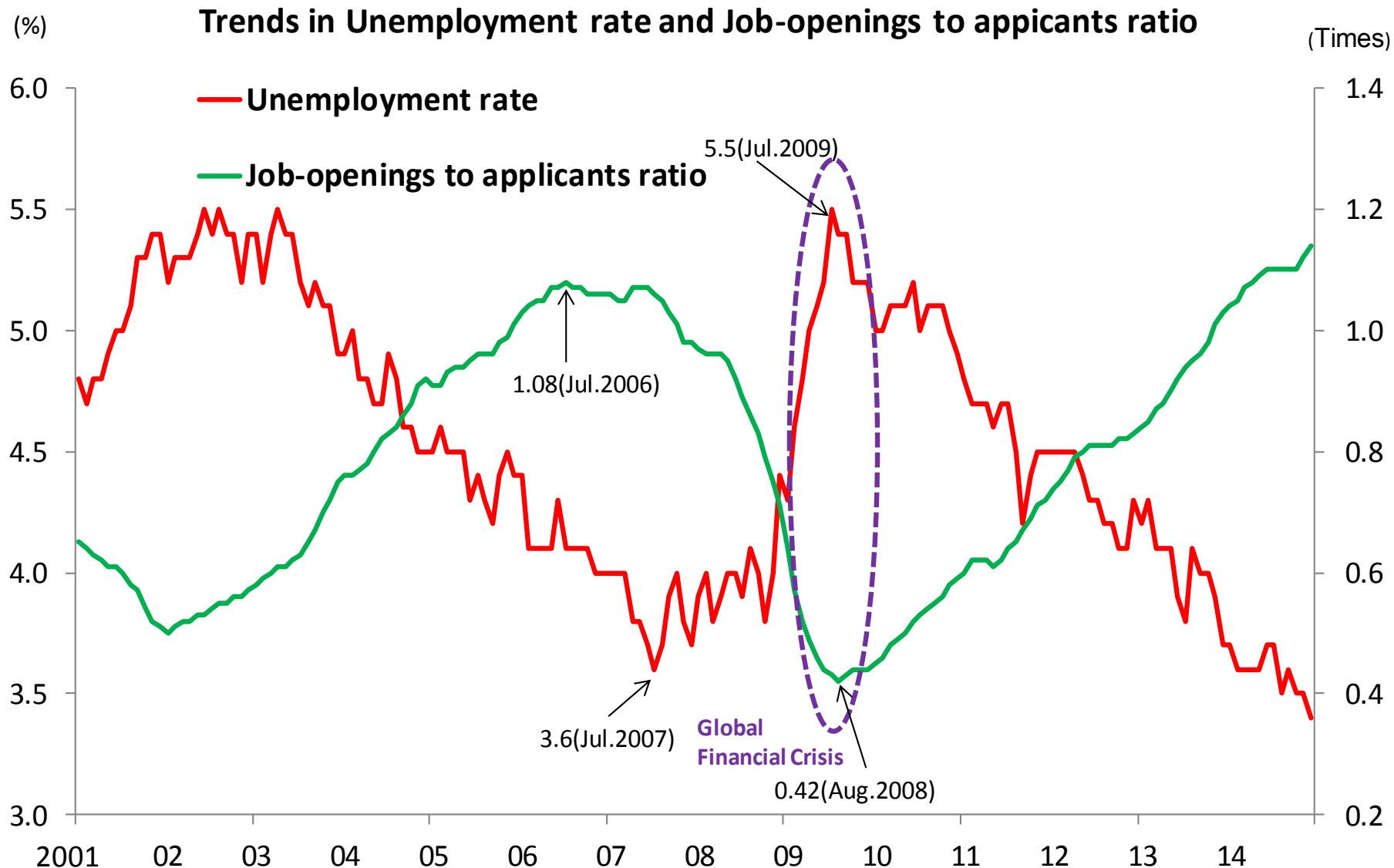
◆ **How can we maintain the soundness of Credit Supplementation System while dealing with these two major crises ?**

1. The Global Financial Crisis, the Great East Japan Earthquake, and Credit Supplementation System

(1) Damage to Japanese Economy from the Global Financial Crisis and the Great East Japan Earthquake



(Source) Ministry of Economy, Trade and Industry. "Indices of Industrial Production".



(Source) Ministry of Internal Affairs and Communications. "Labor Force Survey".
 Ministry of Health, Labour and Welfare. "Employment Referrals for General Workers".

(2) Massive Damage from the Great East Japan Earthquake (March 11, 2011)

- 1) The impact on Japan's society and economy were enormous with 18,465 people killed or missing and with the industrial production index falling sharply.



Boat swept into the center of
Miyako City, Iwate Prefecture



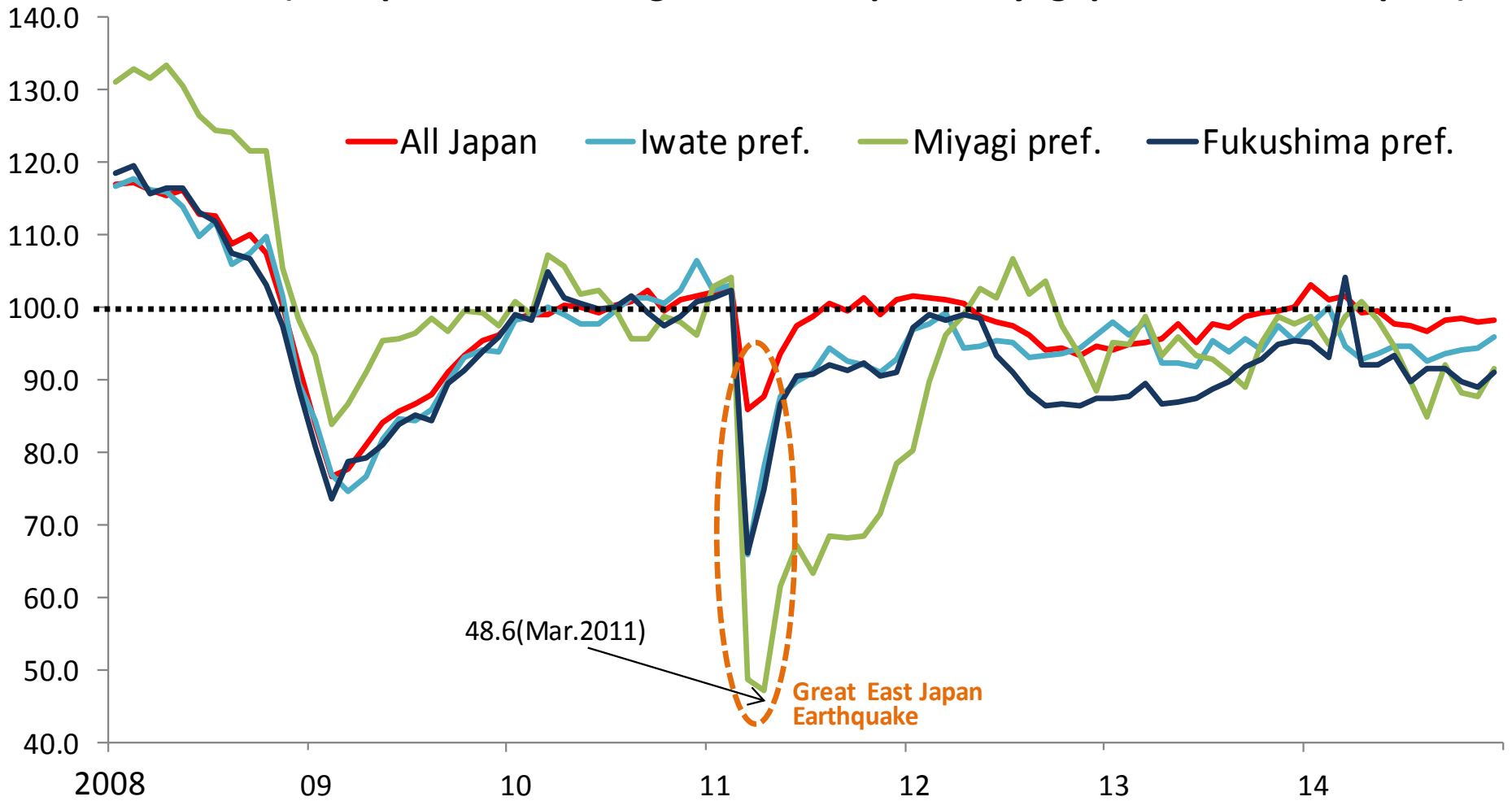
Shopping district buried under rubble
in Ishinomaki City, Miyagi Prefecture

(Source) White Paper on Small and Medium Enterprises in Japan 2011

Trends in Industrial Production

(FY10= 100)

(All Japan/Affected regions : Iwate pref., Miyagi pref., Fukushima pref.)



48.6(Mar.2011)

Great East Japan
Earthquake

(Source) Ministry of Economy, Trade and Industry. "Indices of Industrial Production".

(3) Credit Supplementation System to Overcome the Global Financial Crisis and the Great East Japan Earthquake

1) Establishment of Credit Guarantee Programs, Expansion of Special Treatment of Insurance

[Credit Guarantee Corporations (CGCs)]

- I. Establishment of “Emergency Guarantee Program” and “Great East Japan Earthquake Recovery Emergency Guarantee Program”
- II. Supporting demand for capital due to weakened fund raising capabilities, business reconstruction, and business stabilization

[Japan Finance Corporation (JFC)]

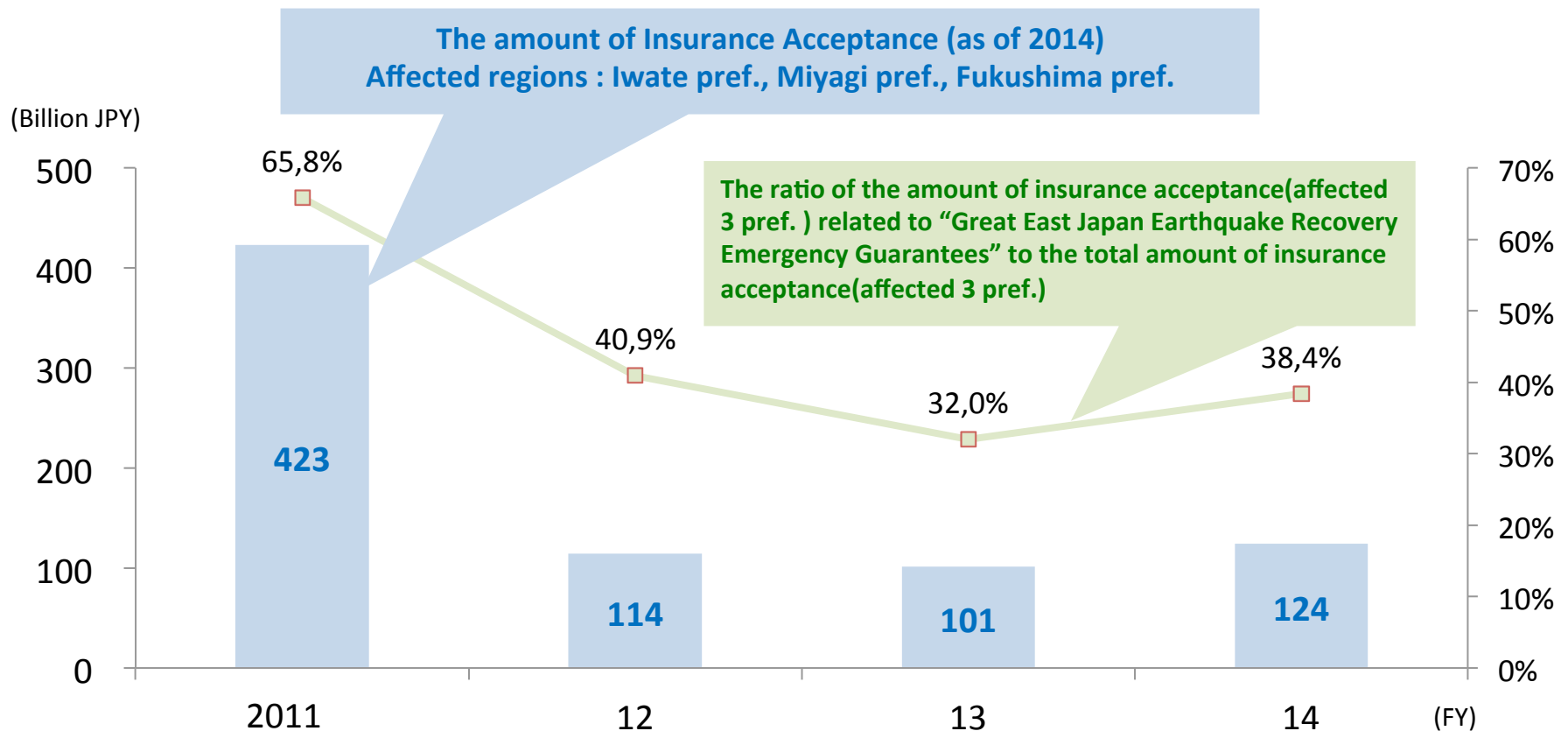
- Expansion of Special Treatment of Insurance for the above credit guarantee programs

	Type of Insurable Funds	Max Amount of Insurance	Insurance Coverage Ratio	Insurance Premium Rate (p.a.)	Guarantee Coverage Ratio
Special Treatment of Insurance Related to					
Business Stability	Business stabilization funds	Additional ceiling of 280 million JPY is set	80%	Ordinary/ No-collateral 0.41%	100%
Great East Japan Earthquake Recovery Emergency Guarantees	Fund for reconstruction, other business stabilization	Additional ceiling is set: 400 million JPY for Ordinary Insurance 160 million JPY for No-collateral Insurance	90%	Ordinary/ No-collateral 0.41%	100%
General Insurance					
Ordinary Insurance	Business funds	200 million JPY	70%	0.25% - 1.69%	80%

2) Actions Taken by CGCs (Credit Guarantee Corporations)

- I. Extended operating hours on weekdays, established weekend consultation desk to better respond to customer needs for financial advice.
- II. Significantly increased guarantee screening officers

◆ Credit Guarantees related to the Great East Japan Earthquake

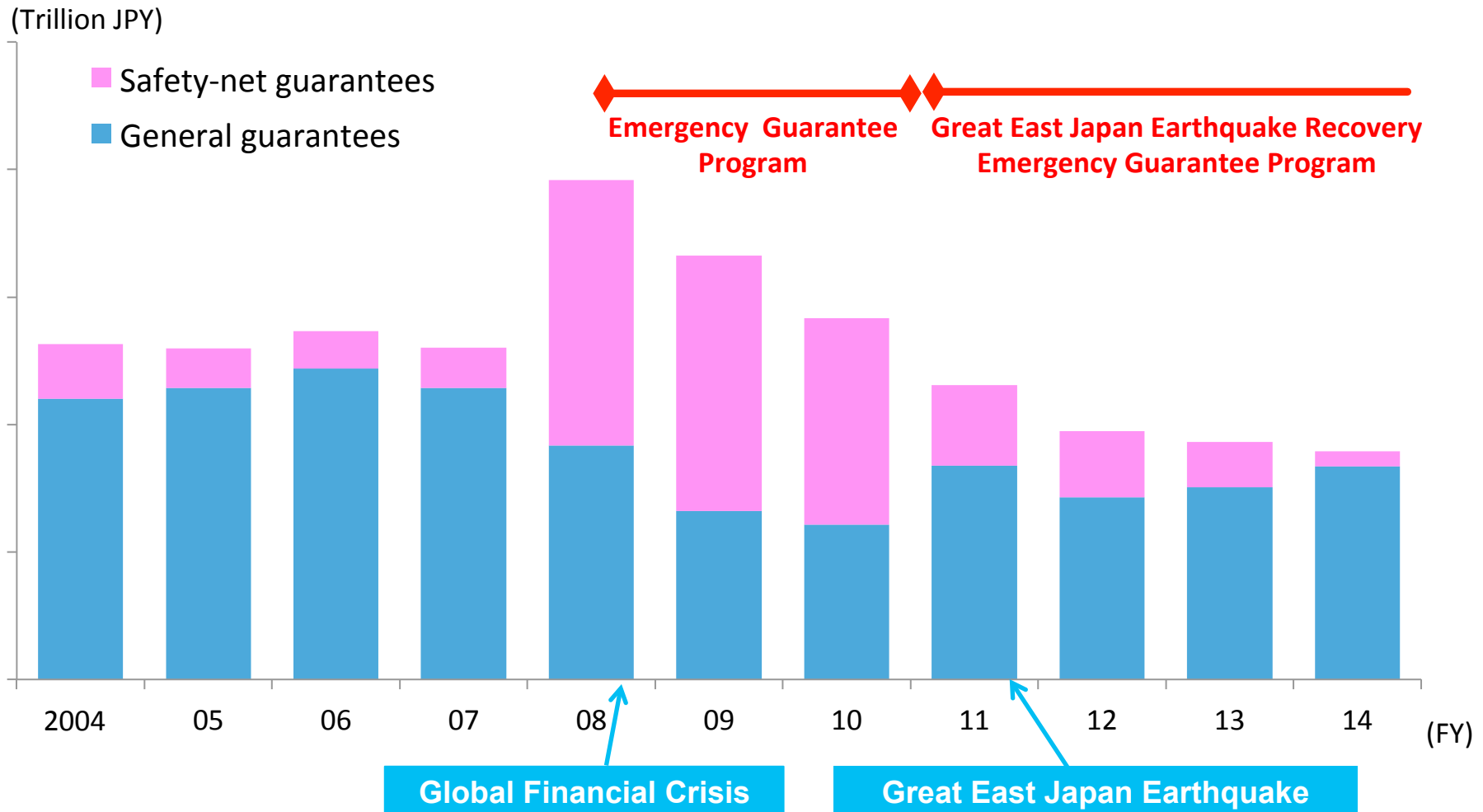


(4) Credit Guarantee Results (guarantees accepted)

1) Amount of Guarantees Accepted

Amount of guarantee acceptance increases during times of economic crisis.

➡ Thus, Credit Supplementation System plays a significant role.



2) Effects of Guarantee Program

◆ Bankruptcies avoided through emergency guarantee program (estimate)

FY	Expected Bankruptcies A	Actual Bankruptcies B	Avoided Bankruptcies C=A-B
2008	10,178	8,283	1,895
2009	23,706	14,732	8,974
2010	18,317	13,065	5,252
Total	52,201	36,080	16,121

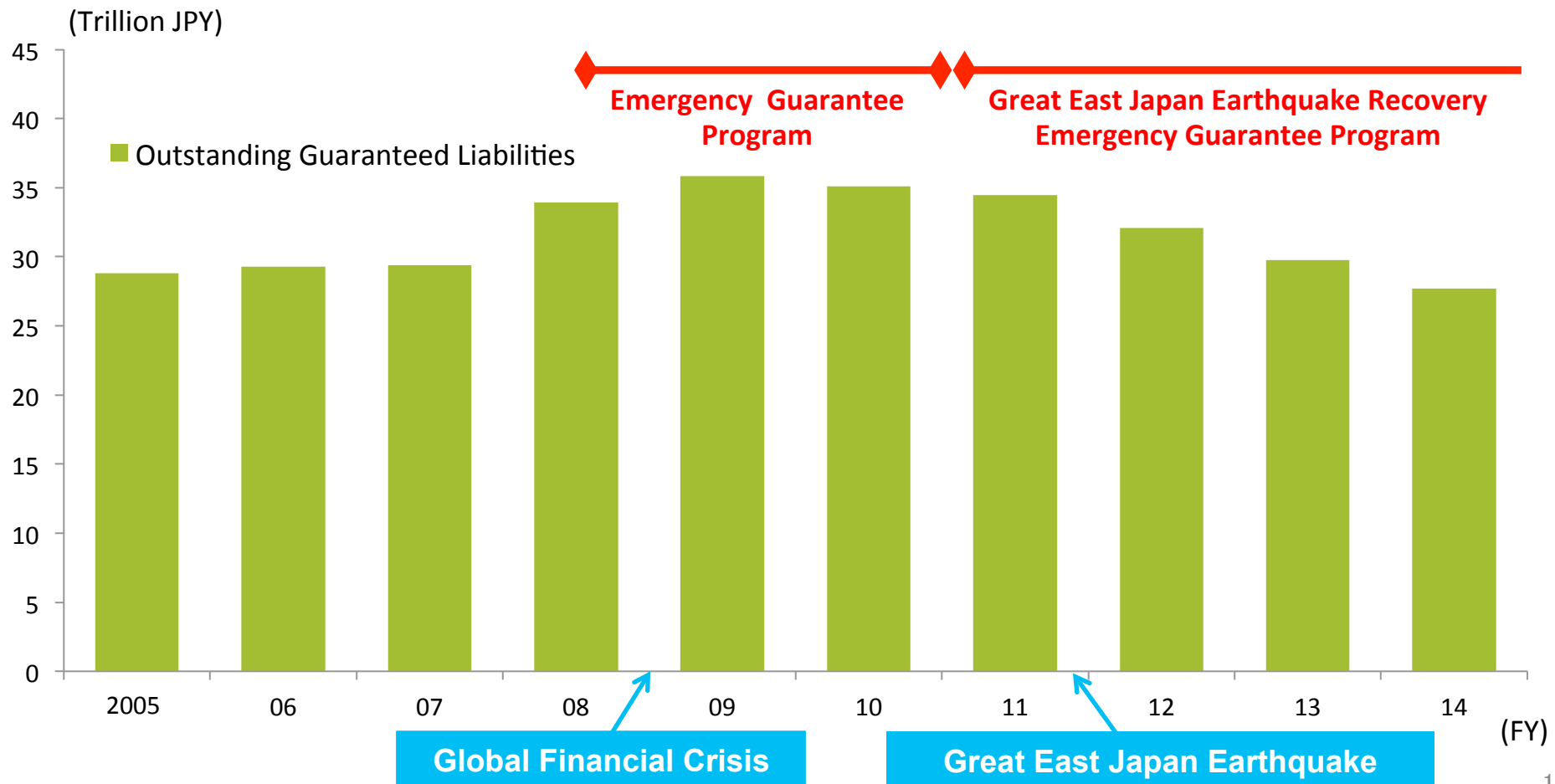
(5) Credit Guarantee Results

Outstanding Guaranteed Liabilities (stock)

The amount of Outstanding Guaranteed Liabilities increases during times of economic crisis.

➡ Outstanding Guaranteed Liabilities underscore the important role filled by Credit Supplementation System.

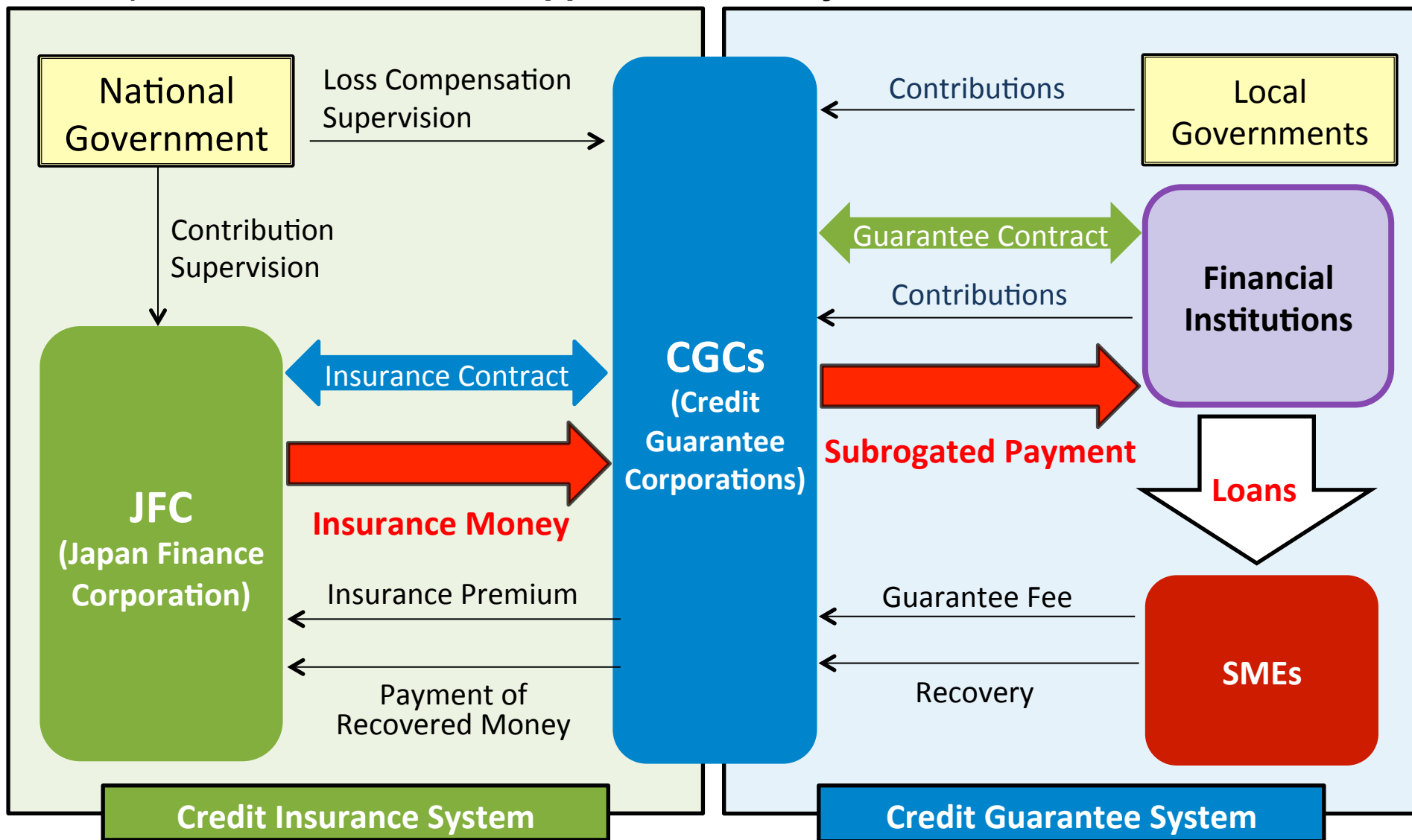
This means that risks increase as the amount of Outstanding Guaranteed Liabilities increases.



2. Approaches for Maintaining / Improving Soundness of Credit Supplementation System

(1) Risk Sharing through Two-tiered System

1) Schematic of Credit Supplementation System



2) Historic Context behind Establishment of Credit Insurance System

- From the 1930s into the 1950s, many Credit Guarantee Corporations were established in regions across Japan (51 CGCs as of 1952).
- A “Guarantee Insurance” system was established in 1952 to cover the risks held by CGCs.
 - With functions similar to the current “Credit Insurance,” the objectives of this system were to reduce losses for CGCs and improve the soundness of their assets.
 - This “Guarantee Insurance” was directly managed by the national government.
- In 1958, Small Business Credit Insurance Corporation (now Japan Finance Corporation) was established. Since that time, credit insurance has been managed by JFC.

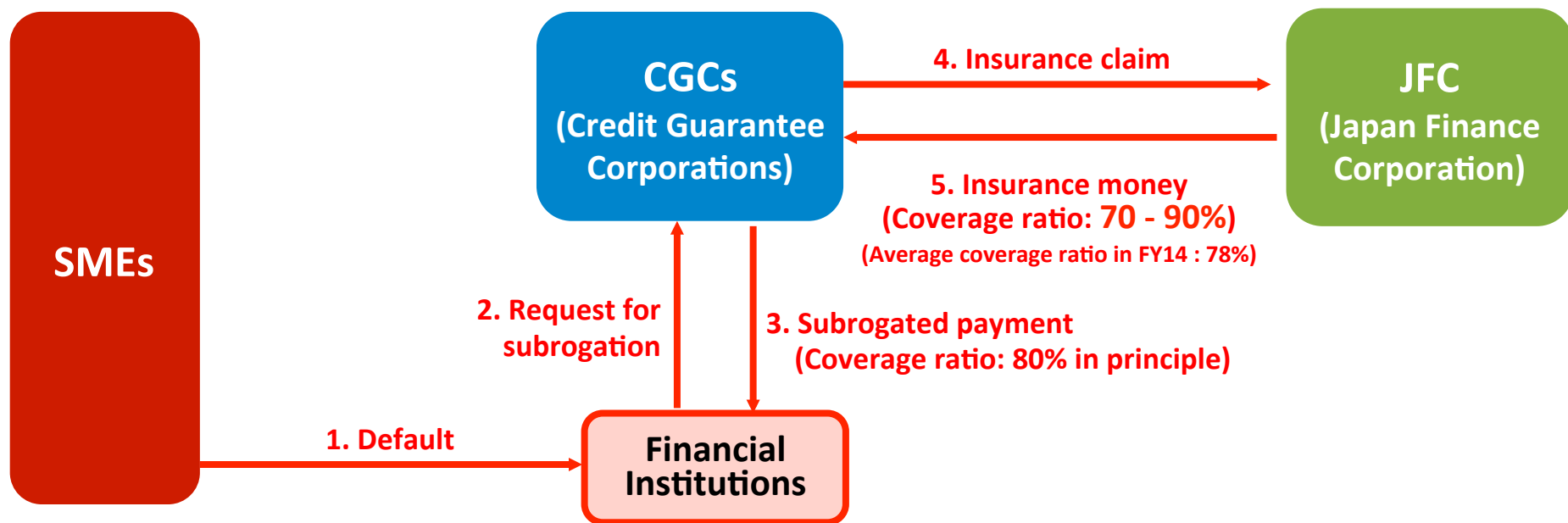
3) Risk Sharing in Credit Supplementation System

I. Subrogated payments

II. Insurance payments

➡ JFC, CGCs and financial institutions share risks.

Subrogation and Insurance Money Payment



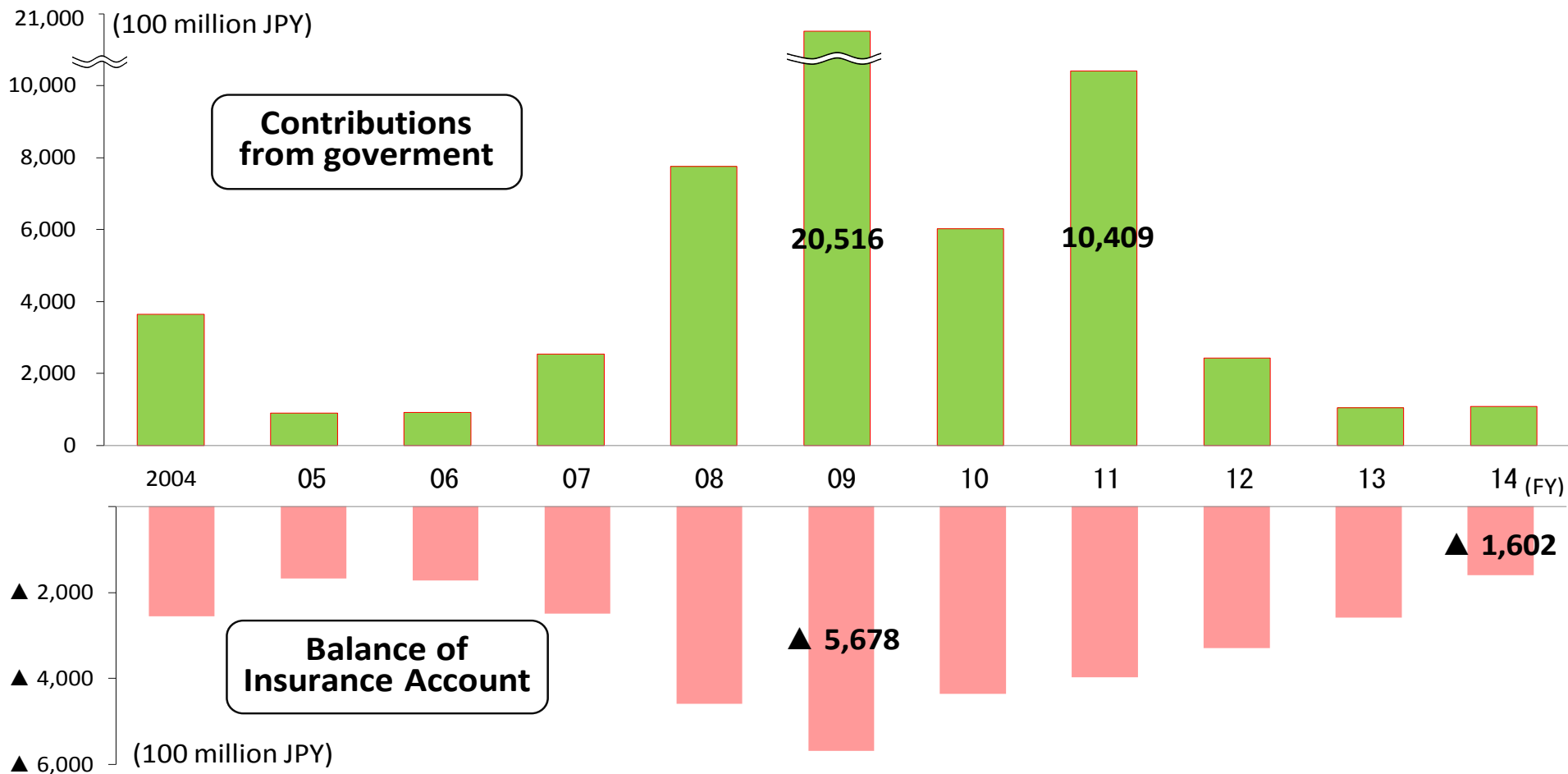
The percentage of risk sharing (In the case of guarantee coverage ratio 80% and insurance coverage ratio 80%)

Financial Institutions	CGCs	JFC
20%	16%	64%

4) Enhancing Financial Base for Insurance (Obtaining Contributions)

- ◆ Large contributions from the national government were received after the Global Financial Crisis in anticipation of deterioration in the balance of insurance accounts.

➡ JFC estimates future anticipated losses and requests contributions from the national government based on these estimates.

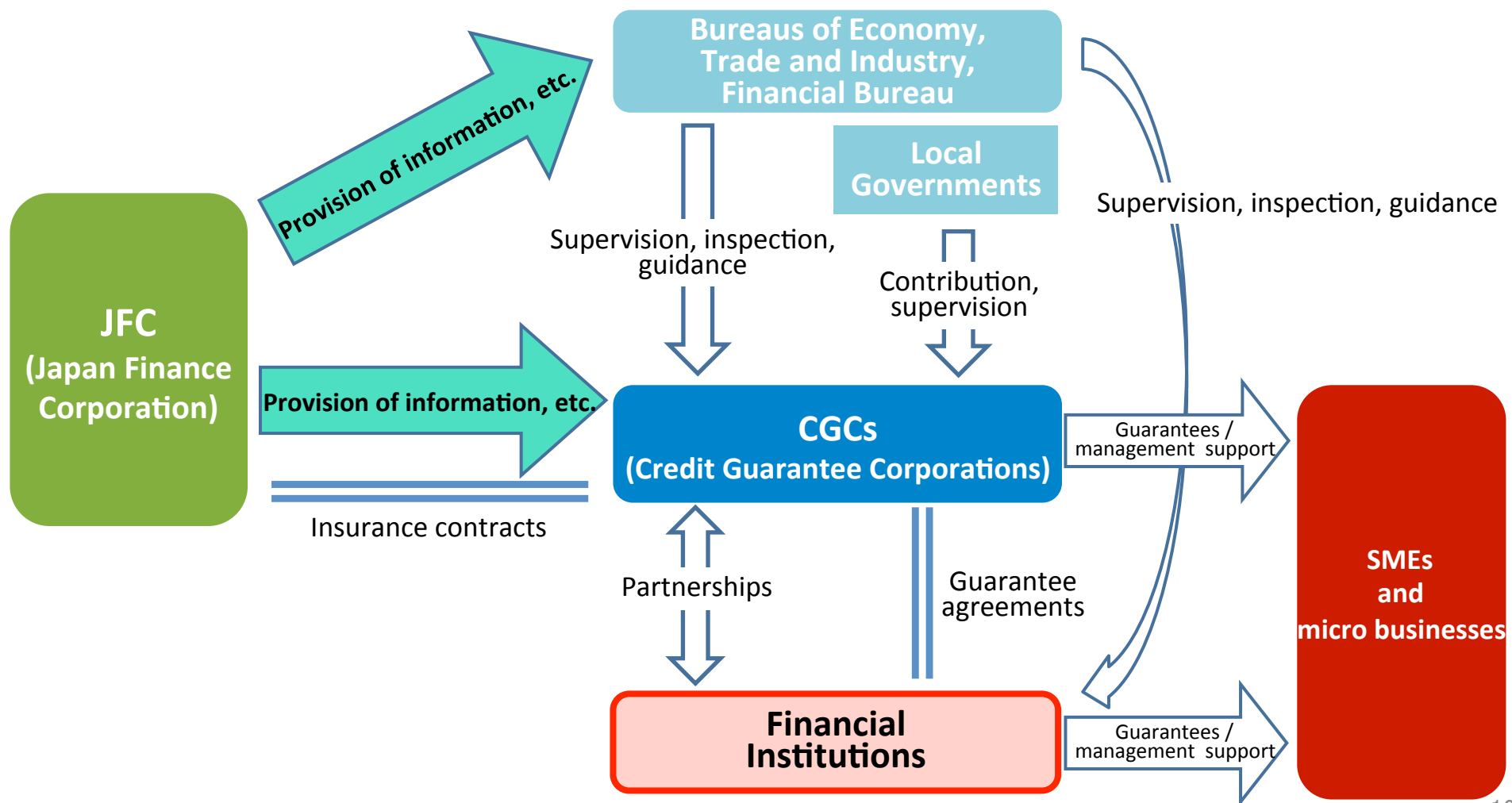


- ◆ The balance of insurance account remained deeply in the red and there are a large number guaranteed SMEs in need of rescheduling. System improvements, including continued enhancements of the financial base, are needed.

6) Analyzing Information, Providing Information to CGCs

- JFC endeavors to understand and analyze the insurance underwriting risks of various CGCs, balances of insurance accounts, and lending by private sector financial institutions to SMEs. It then provides the results of such analyses to CGCs.

➡ Contributes to sustainability and sound management of overall system.



(2) Approaches for Improving and Maintaining Soundness of CGCs (Credit Guarantee Corporations)

1) Enhancing Financial Base

Enriching basic assets is important so that CGCs can conduct sound management and maintain external credit.

● Contributions (A)	Contributions from local governments etc.
● Subsidies (B)	Subsidies from national government to CGCs
● Reserves (C)	Accumulated amount of accepted basic assets from CGCs account surpluses each year

In addition to the basic assets(A+B+C), CGCs hold reserves for changes in balance differences (D).

(Unit: billion yen; FY14)

Assets (A+B)	Reserves (C)	Basic Assets (A+B +C)	Reserves for changes in balance differences (D)
506	1,244	1,750	618

2) Indicator-based CGCs (Credit Guarantee Corporations) Management

- **Basic asset ratio** : Guaranteed Liabilities / Basic Assets

- Each CGC sets allowable limits from the perspective of sound management.
- 60X is the maximum ratio in national guidelines.
- In managing its assets, CGCs utilize the liquid asset ownership ratio (Liquid Assets / Outstanding Guaranteed Liabilities) and other indicators from the perspective of maintaining reserve requirement assets.

- **Maximum amount of guarantees provided to one SME**

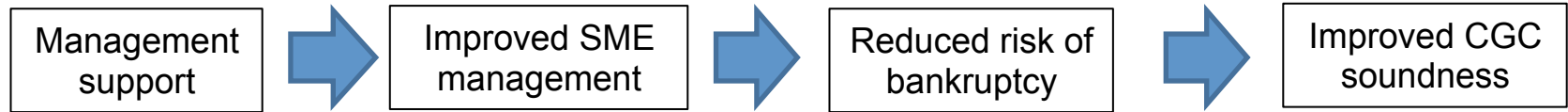
- Indicator for maintaining soundness of CGCs' financial conditions

- **Subrogated payment ratio** : Subrogated Payments for particular year / Outstanding Guaranteed Liabilities for same year

- Analysis of subrogated payment ratio by financial institution groups and SME business types as “Emergency Guarantee Program” results.

3) Management Support by CGC (Credit Guarantee Corporation)

◆ Risk Curtailment through Management Support



Example 1 Business consulting for firms with deteriorating earnings

- Discuss conditions of a firm with a main bank
- Visit the firm, provide management advice
- Propose problem resolution measures after several visits

Example 2 Subsidy for dispatching experts

- Send SME consultants and other experts to companies
- Related expenses subsidized by CGCs

Example 3 Promote utilization of SME support networks

- Networks of local governments, chambers of commerce, CGCs, and SME support organizations working together for smoother SME support
- Provide business expertise guidance and financial support utilizing the functions of each member in the network

3 Summary

- I. The credit supplementation system played major roles in helping overcome the economic crises resulting from the Global Financial Crisis and the Great East Japan Earthquake. Meanwhile, the following approaches have been adopted to maintain the soundness of our systems.
 - (1) Risk Sharing through two-tiered System
 - 1) Covering risk by utilizing credit insurance system
 - 2) Enhancement of financial bases (obtain government contributions in proportion to risk)
 - 3) Insurance risk management (sharing risk analysis and risk information)
 - (2) CGC Approaches
 - 1) Enhancement of financial bases (obtain local government contributions, book reserves)
 - 2) Risk management (utilization of basic asset ratio, subrogated payment ratio)
 - 3) Management support (consulting for SMEs)
- II. JFC will make an effort to improve the soundness of Credit Supplementation System to continue promoting smooth financing for SMEs.

References

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