Japanese Financial System : transformation to the new system*

Research Department**

The Industrial Bank of Japan

IBJ

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1. Recent cases of failed institutions

Many small and medium-sized financial institutions have failed in FY95 reflecting the non-performing loan problem. Land price is still falling and uncertainty about the stability of the Japanese financial system continues to linger.

(Bil.Yen)

	Failed financial institutions	Asset	Non-performing asset	Loss	Financial assistance from Deposit Insurance Corporation
9 1／7	TOHO Sogo-Bank	422	22	22	Loan8
9 2／4	TOYO Shinkin	419	137	137	20
9 3／5	KAMAISHI Shinkin	99	31	31	26
9 3／6	OSAKA FUMIN Credit Coop.	140	55	26	20
9 4／9	GIFU SHOGIN Credit Coop	14	8	7	2.5
9 4／12	TOKYO KYOWA Credit Coop,ANZEN Credit Coop.	220	150	80	40
9 5／2	YUAI Credit Coop.	40	16	7.5	2.8
9 5／7	COSMO Credit Coop.	600	380	250	125
9 5／8	KIZU Credit Coop.	1,300	1,190	959	500
9 5／8	HYOGO Bank	3,700	1,500	790	473
9 5／11	FUKUIKEN DAIICHI Credit Coop.	4.6	2.6	1.9	0.6
9 5／12	OSAKA Credit Coop.	360	269	159	70
9 6／3	TAIHEIYO Bank	1,200	330	265	117
9 6／4	KENMINDAIWA Credit Coop, SANYO Credit Coop.	80	N.A.	N.A.	15
	Total	8,597	4,097	2,734	1,412

(Source)Deposit Insurance Corporation etc

2. Major Depository institutions and failed institutions

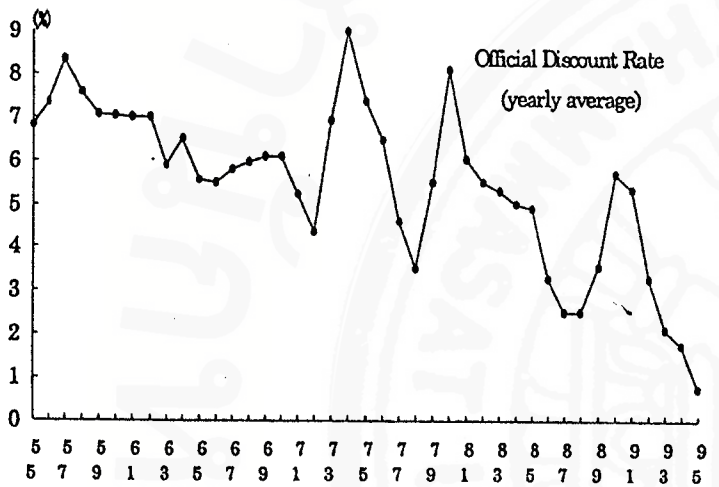
Failed financial institutions have common feature of specializing in small business finance.
Their failure owe to the large credit risk exposure to certain customers like real estate companies.

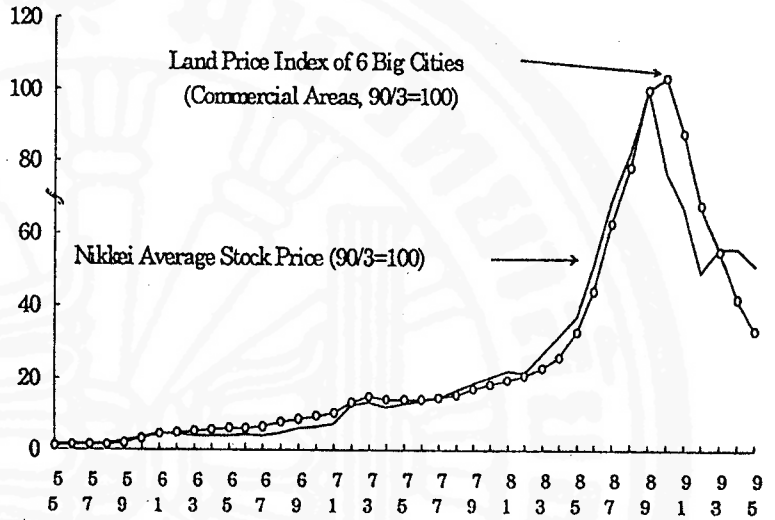
(Trillion Yen)

	Number	Loan	Share	failed financial institutions
City banks	10	278	39%	
Long-term credit banks	3	53	7%	
Trust banks	7	61	9%	
Regional banks	64	137	19%	
2nd-tier regional banks	65	53	7%	TOHO Sogo、HYOGO、TAIHEIYO
[All Banks]	149	582	82%	
Shinkin banks	416	70	10%	TOYO、KAMAISHI
Credit cooperatives	369	17	2%	OSAKA FUMIN、GIFU SHOGIN、TOKYO KYOWA、ANZEN、YUAI 、COSMO、KIZU、FUKUIKEN DAIICHI、OSAKA、KENMINDAIWA、SANYO
Labor banks	47	6	1%	
Shoko-Chukin Bank	1	12	2%	
Norin-Chukin Bank	1	17	2%	
Credit Federation of Agricultural Cooperatives	47	10	1%	
[Credit Cooperatives]	881	131	18%	
[Total financial institutions]	1,030	713	100%	

(Note) Data are as of Mar.96

3. Background of the Non-performing loan problem





Reasons which spurred the Bubble Economy

- Easing measures by the Bank of Japan
- Investment to land and stocks by individuals and corporations
- Existence of land legend
- Equity finance by corporations and lending by financial institutions

Reasons which collapsed the Bubble Economy

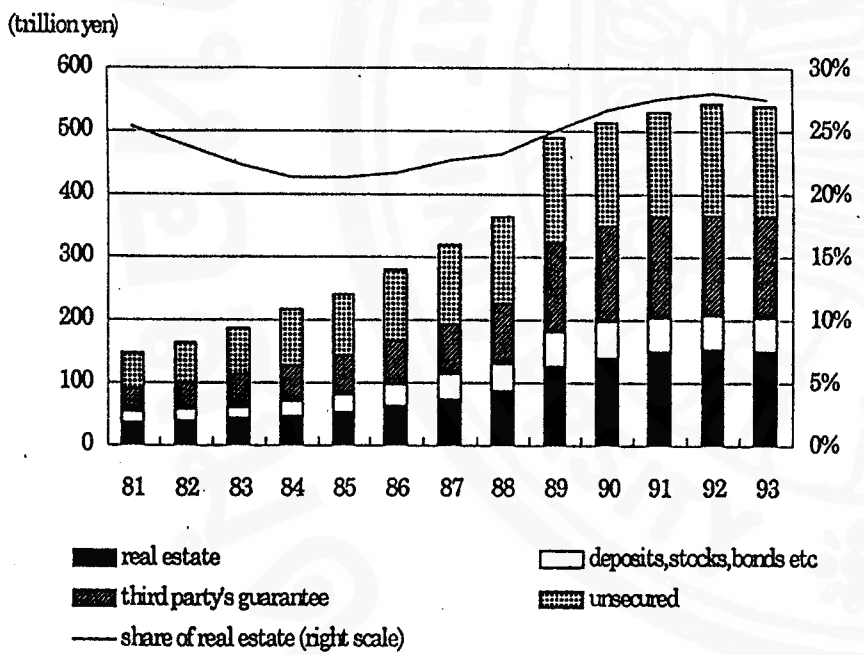
- Tightening measures by the Bank of Japan
- Countermeasures against soaring land price
- Regulation on loans to real estate companies

(Source) BOJ,etc

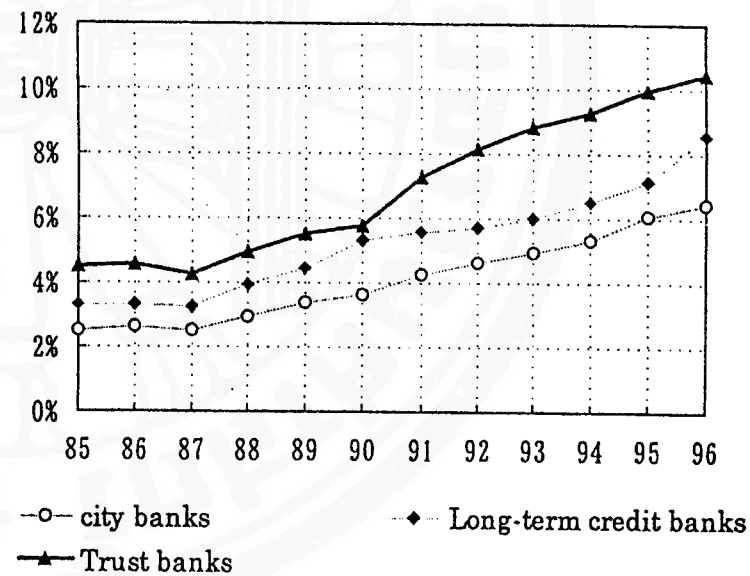
4. Vulnerability of Japanese financial system to asset price depreciation

Japanese financial system is vulnerable to the depreciation of asset prices because about 30% of the loan's collateral is real estate and stock is increasing its share in the banks' asset portfolio.

[Loans outstanding by kinds of collateral]



[Stock as a percentage of total asset]



(Source) BOJ,etc

5. Present situation of "Non-performing loans "

MOF has announced that non-performing loans at the Japanese financial institutions totaled 34.8 trillion yen as of Mar 96.

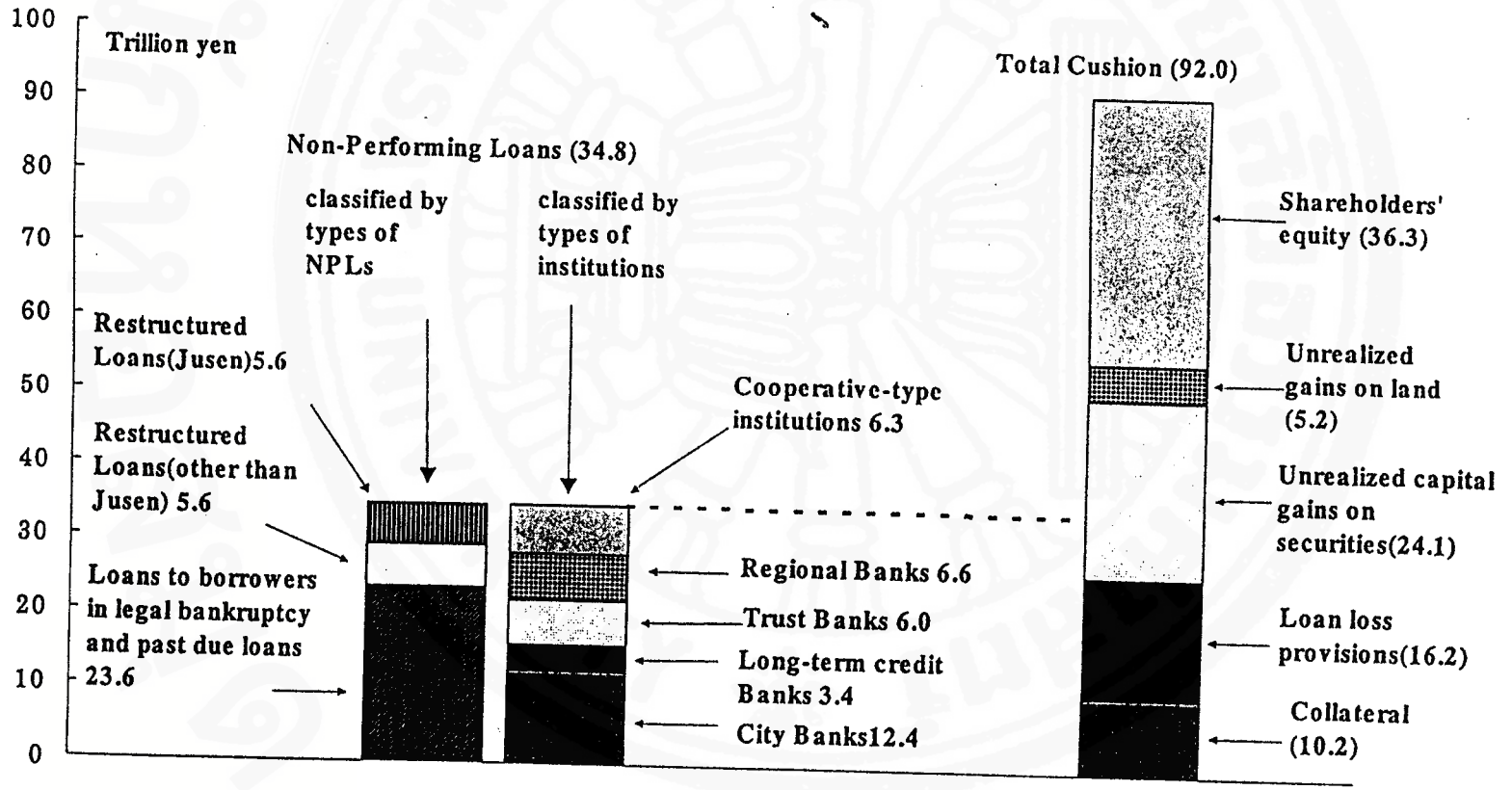
(Trillion Yen)

	Loans to borrowers in legal bankruptcy & past due loans (a)	Restructured Loans (b)	Non-performing Loans (a+b)	Total Loans Outstanding (c)	(a+b)/c
21 Major Banks	13.1	8.8	21.9	391.9	5.6%
1st Tier & 2nd Tier Regional Banks	4.7	2.0	6.6	189.8	3.5%
Cooperative-type financial institutions	5.8	0.5	6.3	131.2	4.8%
Total Financial Institutions	23.5	11.3	34.8	712.9	4.9%

(Source) MOF

6. Manageability of "Non-performing loans " Problem

Japanese financial institutions as a whole is equipped with an ability to overcome the problem. Total cushion exceeds the non-performing loans.



(Notes) 1.Unrealized capital gains on securities is as of Mar.96.
2.Figures for unrealized gains on land and collateral are estimation.

7. Comparison of "Non-performing loans Problem" between Japan & US

The ratio of non-performing loans to total loans in Japan is 4.9% as of Mar.96.
MOF has announced that the ratio in Mar. 95 was about the same in the US at its peak.

	Non-performing Loans (a)	Total Loans (b)	% of Total Loans (a/b)
Japanese Financial Institutions	¥ 34.8 Trillion	¥712.9 Trillion	4.9%
US Commercial Banks & Savings Institutions	$150 Billion	$2,872 Billion	5.2%

(Notes)

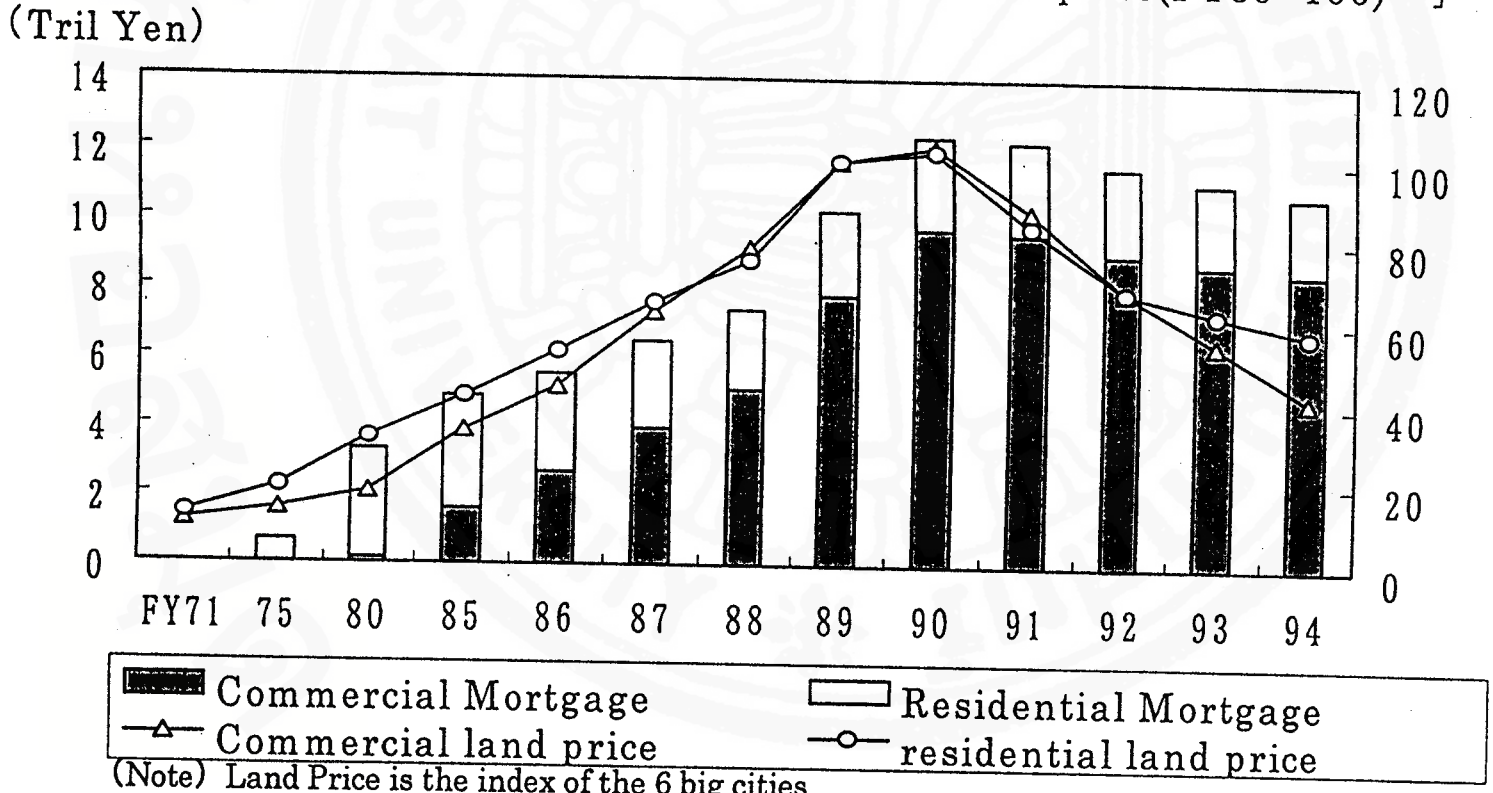
1. Non-performing loans for Japanese financial institutions are Loans to borrowers in legal bankruptcy, past due loans over 6 month and restructured loans, whose reviewed interest rate is under the official discount rate.
2. Non-performing loans for US are Nonaccrual Loans and Loans past due for over 90 days plus OREO at its peak (1991)

(Source) MOF ,FDIC etc..

8. Problems associated with Jusen (Housing Loan Companies)

- Jusen companies were established in the 70s with the purpose of providing housing loans to households.
- In the 80s , Jusen shifted their lending to housing developers and real estate companies.
- Asset quality was significantly deteriorated after the collapse of "bubble economy" and disposal scheme was stipulated by the "law concerning special measures to promote liquidation of the assets and liabilities of designated housing loan corporations" in 1996.

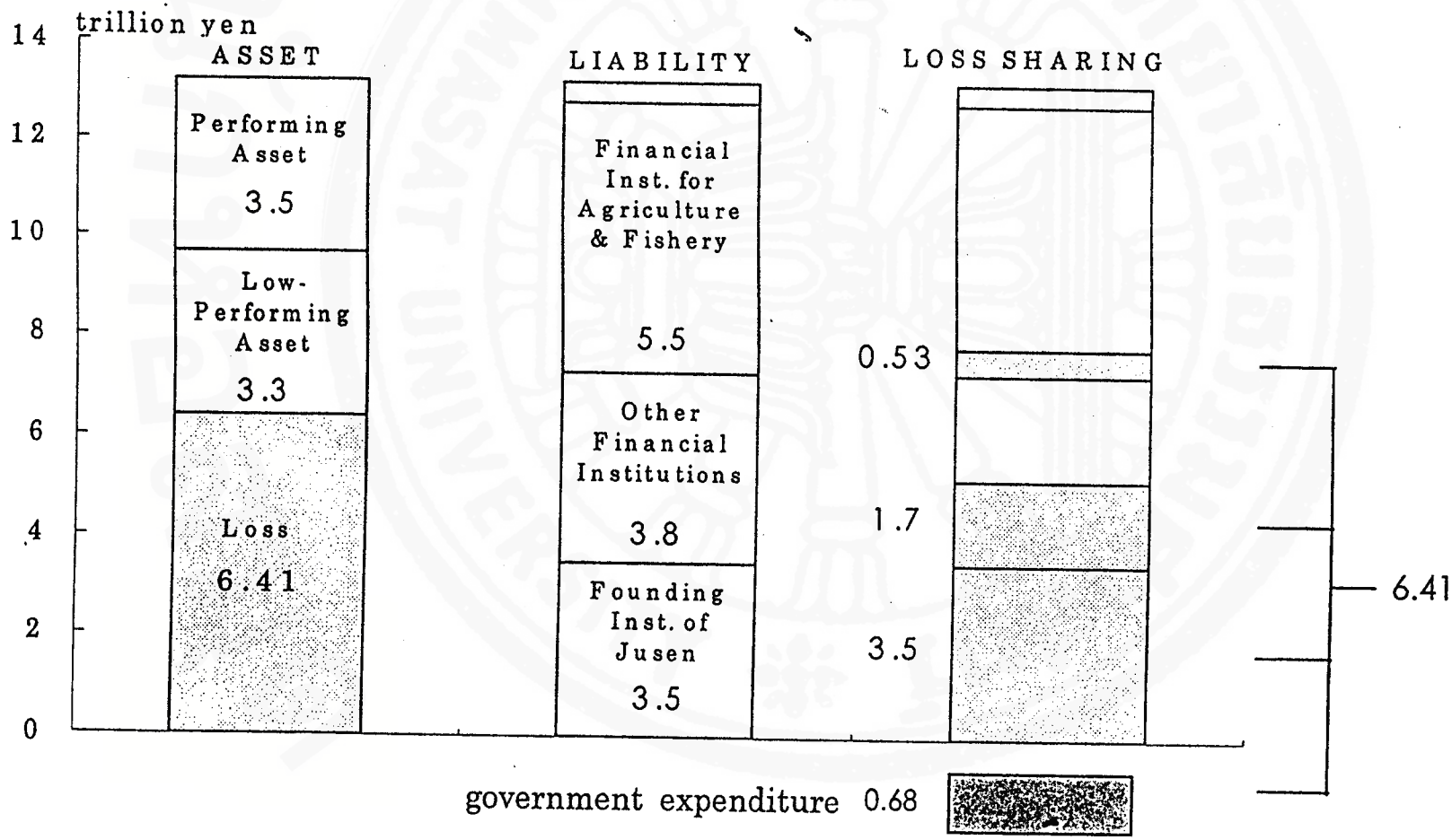
[Loans outstanding and development of land price(FY89=100)]



(Note) Land Price is the index of the 6 big cities

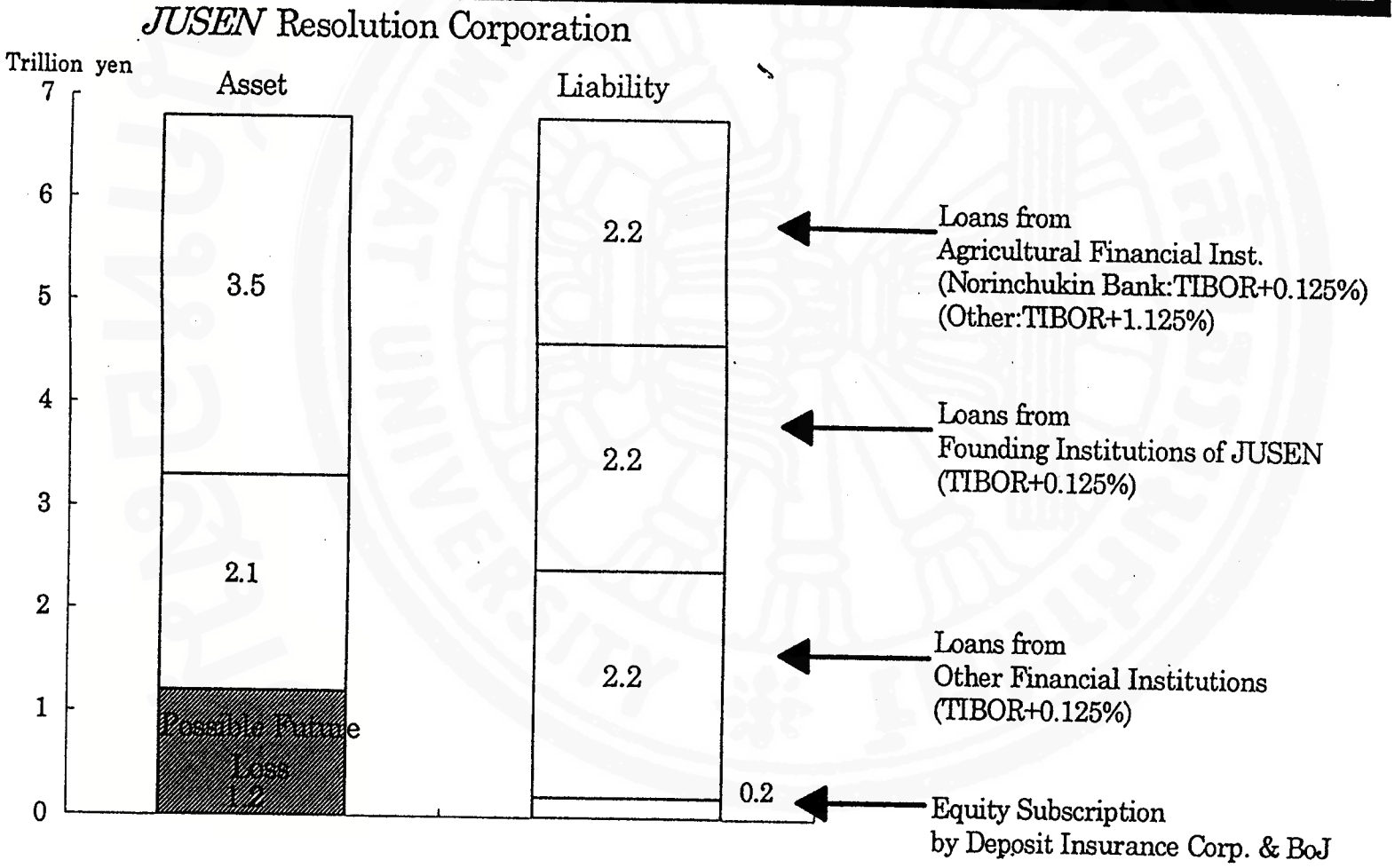
9-1. Disposal scheme of Jusen

Initial loss of 6.41tril yen was shared by the concerned financial institutions and the government.



9-2. Disposal scheme of Jusen

JUSEN Resolution Corporation will dispose asset of 6.7 trillion yen within 15 years.



10. Legal Framework to stabilize the Japanese financial system

1. Amendment Law to the Deposit Insurance Act

1. Establishment of special funds within the Deposit Insurance Corporation, which comprise of "special fund for credit cooperatives" and "special fund for other financial institutions".
   Special insurance premium of 0.036% will be additionally imposed to financial institutions.
2. Reorganization of Tokyo Kyodo Bank into Japanese version of RTC (Resolution Trust Corporation)
   Tokyo Kyodo Bank was established in Mar.1995 to succeed the operation of failed credit cooperatives by the joint investment of BOJ and private financial institutions. Its role is to succeed the operation of failed credit cooperatives which take place in the coming 5 years. It will end its mission after 10 years.

2. Amendment Laws for ensuring the sound management of the financial institutions

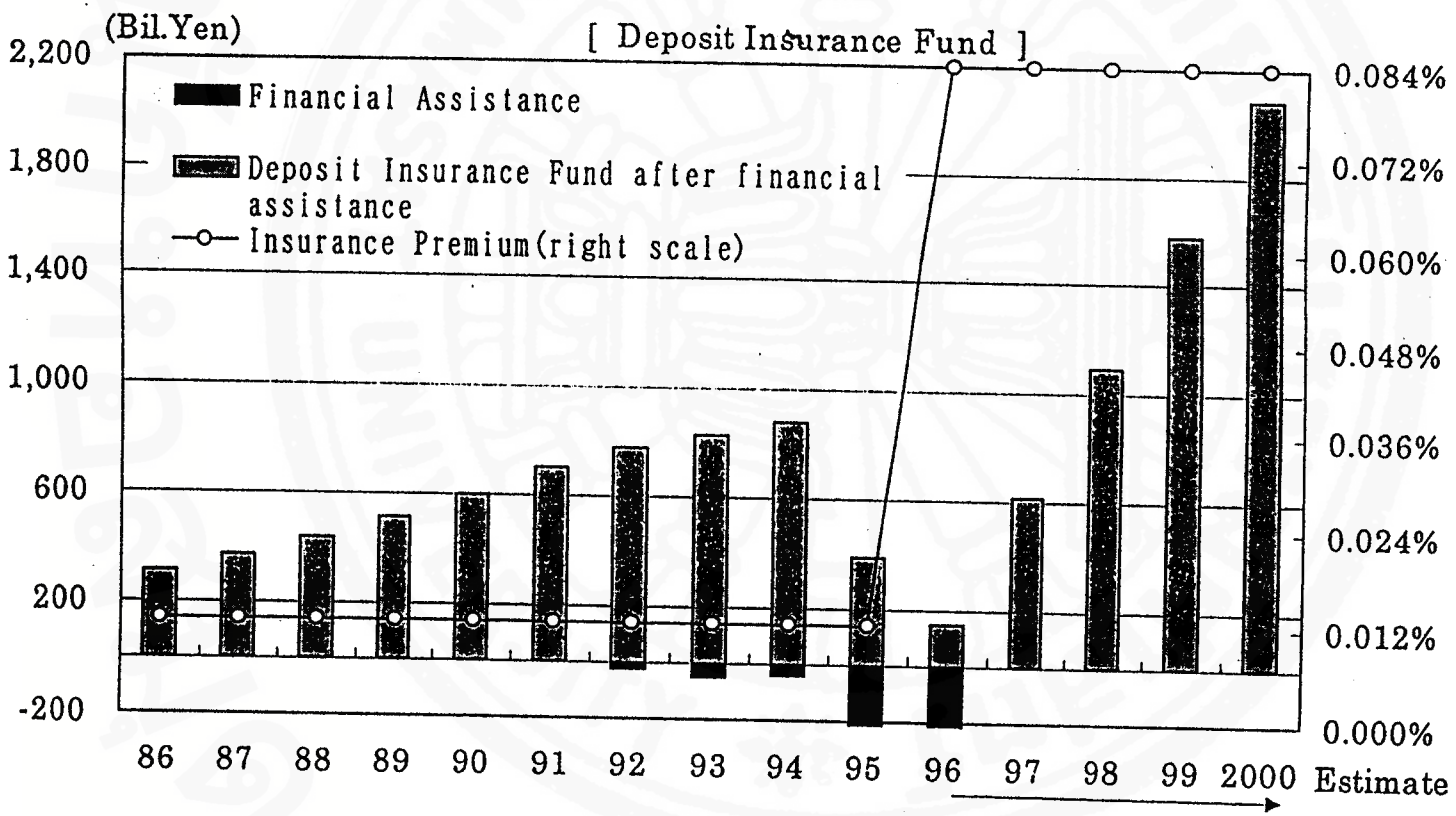
1. Prompt correction of mismanagement by "Prompt Corrective Action"
2. Strengthening the audit on credit cooperatives
3. Improvement in disclosure

3. Law for the special procedure for the reorganization of financial institutions

1. Timely initiation of a disposal procedure
2. The supervisory ministry will be given the right to initiate the disposal procedure
3. Deposit Insurance Corporation will represent the right of depositors when a disposal procedure be initiated

11. Deposit Insurance Corporation

Insurance Premium was raised from 0.012% to 0.084% in 1996
Deposit insurance fund is estimated to reach 2 trillion yen in 2000.



12. Prompt corrective action

Prompt Corrective Action will be introduced from Apr.98 to ensure the sound management of financial institutions.

〔 Prompt Corrective Action according to capital adequacy ratio (Plan) 〕

criteria	BIS ratio	inland ratio	action
1	more than ◎ %	more than ◎ %	simple inspection decreasing the number of inspection
2	more than ○ %	more than ○ %	ordinary inspection & monitoring
3	less than ○ %	less than ○ %	submission of a plan to improve management
4	less than ○ %	less than ○ %	increase capital, decrease the growth of total asset decrease the dividend, abolish and consolidate branches
5	less than ○ %	less than ○ %	decrease the total asset, dividend are not allowed, restriction to take deposits with high interest rate, restrict new business
6	less than ○ %	less than ○ %	regulatory order to suspend business in whole or in part

(Note) Specific standards of capital adequacy ratio will be determined by the end of 1996.
(Source) MOF

13. Disclosure of Non-performing loans

Japanese financial institutions are requested to disclose non-performing loans by the end of FY97.

	Loans to borrowers in legal bankruptcy	Past due loans	Restructured loans	Claims to borrowers to whom the financial institution are providing support
Major 21 Banks	already disclosed	already disclosed	already disclosed	already disclosed
Regional Banks	already disclosed	already disclosed	already disclosed	already disclosed
2nd-Tier Regional Banks	already disclosed	already disclosed	already disclosed	already disclosed
Shinkin Banks	partial disclosure from Mar.96	voluntary	voluntary	voluntary
Credit Cooperatives et al.	voluntary	voluntary	voluntary	voluntary

(Notes)

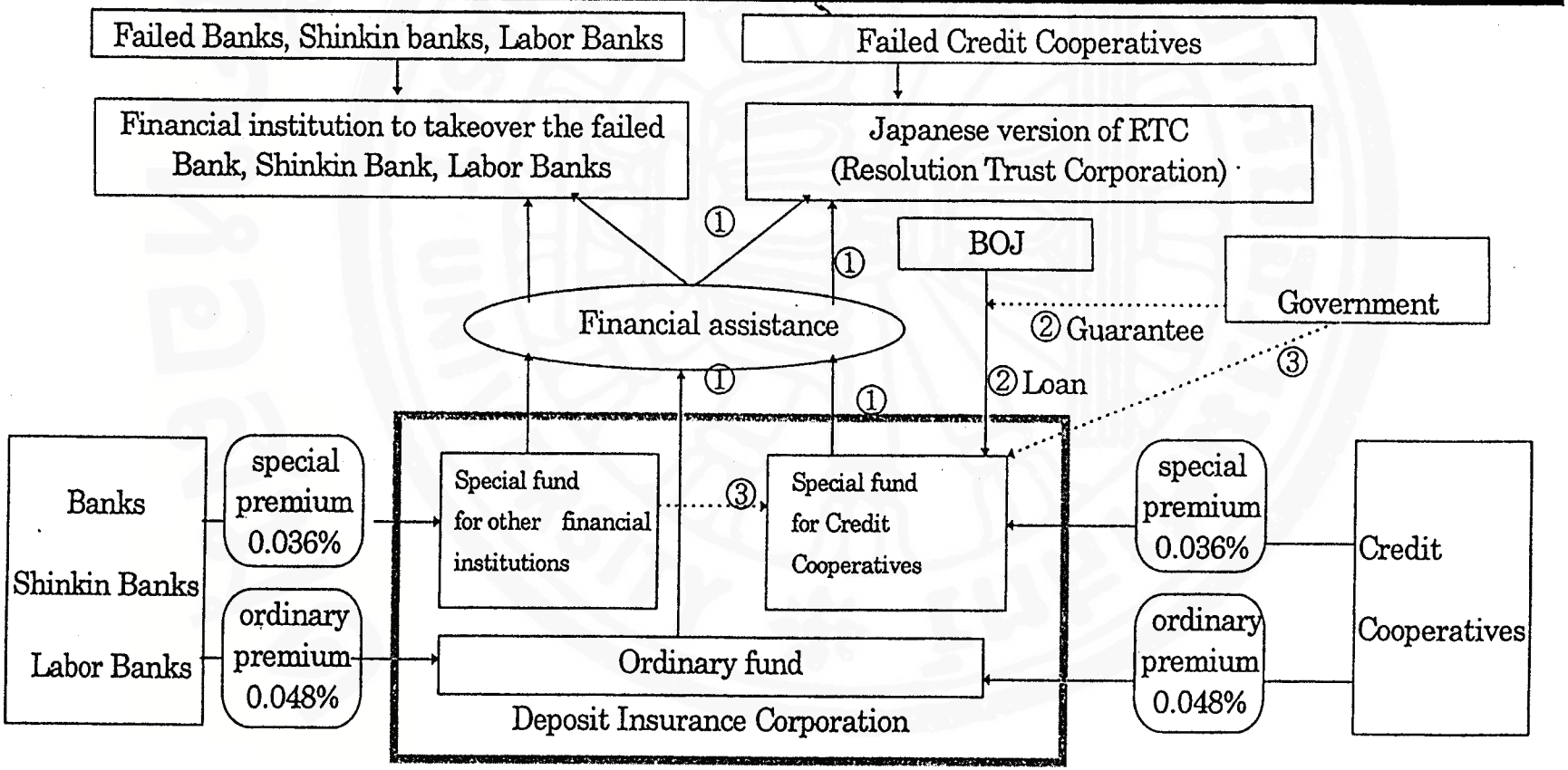
1.Shinkin banks whose deposits is larger than 100bil.yen have disclosed the loans to borrowers in legal bankruptcy from Mar.96.

2.Support by financial institutions means, for example, by waiving the right of a creditor.

14. The Framework for the stabilization of the Japanese financial system

〔 Procedure to bailout the failed credit cooperatives 〕

①Financial assistance to Japanese version of RTC from ordinary fund and special fund.
②When special fund for Credit Cooperatives runs out of funds, BOJ will provide Government guaranteed loan.
③Special fund for Credit Cooperatives will be abolished in 2001.The deficit will be covered by the surplus of the special fund for other financial institutions and by the expenditure of the government.



15. Prospects
---transformation to the new financial system---

