

18 November 2008 (No. of pages: 7)

# Past Financial Crisis Handling in Japan

## Timeline of capital infusions, acquisitions of NPLs and shares

Japanese report: 17 Oct 08

Legal and Tax Research Dept  
**Kazuhiro Yoshii**

### Summary

- Following the G7 call for recapitalization, US and European authorities have announced policies for infusion of public funds
- For reference, this report presents a timeline of Japan's handling of past financial crises, focusing predominantly on the use of public funds to acquire assets and inject capital
- Measures taken have included acquisition of NPLs using public funds, use of public funds to inject capital into banks, etc., full protection for deposits, promotion of write-offs by using discounted cash flow accounting for NPLs, and acquisition of shareholdings by the Banks' Shareholdings Purchase Corporation (BSPC) and Bank of Japan (BOJ)

Handling of Financial Crises in Japan	
1993: Jan	Cooperative Credit Purchasing Company (CCPC) established; funded by private-sector institutions (for the purpose of acquiring non-performing loans with real estate as collateral)
From reporting period ending on 31 Mar 1993	City banks, long-term credit banks, trust banks disclose some NPLs (loans to bankrupt debtors, past-due loans). Regional banks disclose loans to bankrupt debtors.
1995: Jan	Tokyo Kyodo Bank established (with assumption of the business of the failed Tokyo Kyowa and Anzen Credit Associations; assumption of all operations of Cosmo Credit Association Mar 1996).
Aug	Strategy for disposal of Hyogo Bank announced; Midori Bank subsequently established (License granted 31 Oct)
From interim reporting period ending on 30 Sep 1995	Major banks (21 banks at the time) disclosed more NPLs (loans with interest reduced or waived, etc.).
From reporting period ending on 31 Mar 1996	Major banks disclosed more NPLs (loans to entities that the bank is helping reconstruct). Regional banks and second-tier regional banks disclosed past-due loans, loans with interest reduced or waived, etc.
1996: May	<b>Decision to inject Y685 billion of public funds to liquidate 7 "jusen" housing loan companies</b>
Jun	<b>Act on Special Measures concerning the Promotion of Liquidation of the Assets and Liabilities of Jusen Housing Loan Companies passed.</b> <b>Housing Loan Administration Corporation established in Jul based on this act (to acquire, collect, and dispose of NPLs)</b>
Jun	'Three financial laws' passed (Act to Implement Measures for Ensuring the Sound Management of Financial Institutions, Act on Special Treatment of Corporate Reorganization Proceedings and Other Insolvency Proceedings of Financial Institutions, Act to Revise the Deposit Insurance Act)
Sep	Resolution and Collection Bank established based on the 'three financial laws' (through reorganization of Tokyo Kyodo Bank)
Oct	Commencement of special measure for protection of deposits etc. (Full protection for deposits initially applied until 31 Mar 2001. Later extended for one year to 31 Mar 2002)

Dec		Financial System Research Council report proposed greater disclosure of NPLs by financial institutions (seeking disclosure by the year ended 31 Mar 1998 of loans to bankrupt debtors, past-due loans, and loans with interest reduced or waived by all financial institutions, including cooperative structure financial institutions)
From reporting period ending on 31 Mar 1997		Disclosure by all financial institutions of NPLs to the extent of loans to bankrupt debtors, past-due loans, loans with interest reduced or waived, and loans to entities that the bank is helping reconstruct
1997: 1 Apr		Based on the 'three financial laws,' introduction of mark-to-market accounting for trades by securities firms/financial institutions
Nov		Sanyo Securities, Hokkaido Takushoku Bank, Yamaichi Securities fail
1998: Feb		<p><b>Two laws for financial stabilization (Emergency Measures Act for Financial Function Stabilization and Revised Deposit Insurance Act) passed</b></p> <p><b>Making available Y30 trillion of public funds (in the form of Y10 trillion in special government bonds and Y20 trillion in government-guaranteed credit lines) as follows</b></p> <ul style="list-style-type: none"> <li>▪ Y17 trillion: Funds for depositor protection and NPL acquisition under the Revised Deposit Insurance Act</li> <li>▪ Y13 trillion: Funds for capital injection into financial institutions (Preferred stock, subordinated bonds, subordinated loans)</li> </ul> <p>Restructuring plan (management improvement plan) had to be submitted in the case of capital injection</p>
Mar		<b>On the basis of these laws, decisions on capital injection were made by the Financial Crisis Management Committee, chaired by Yoko Sazanami (Total of Y1.8156 trillion injected into 18 major banks and 3 regional banks)</b>
Apr		Under the 'three financial laws,' early corrective measures were introduced based on capital ratios of banks, etc. (Assuming self-assessment of assets)
Jun		Announcement of planned merger between the Long-Term Credit Bank of Japan and Sumitomo Trust & Banking (Negotiations collapsed in Oct)
Oct	12	<p><b>Financial Reconstruction Act passed.</b></p> <ul style="list-style-type: none"> <li>▪ Introduced Financial Reconstruction Commission, Financial Reorganization Administrator, Public bridge bank, temporary nationalization</li> <li>▪ Effective until 31 Mar 2001</li> <li>▪ Government-guaranteed credit lines of up to Y18 trillion available under the Act</li> </ul> <p><b>6 principles for liquidation of financial institutions:</b></p> <ol style="list-style-type: none"> <li>1) Disclosure of financial details of NPLs, etc.,</li> <li>2) Not permitting survival of banks difficult to rehabilitate,</li> <li>3) Clarification of responsibility of shareholders, executives, etc.,</li> <li>4) Protection of depositors, etc.,</li> <li>5) Financial agency functions (maintenance of function as lender)</li> <li>6) Minimization of resolution costs</li> </ol> <p><b>Act to Revise Deposit Insurance Act (leading to establishment of Resolution and Collection Corporation)</b></p> <ul style="list-style-type: none"> <li>▪ Y17 trillion made available as special support funds for deposit protection (Y7 trillion in special government bonds, Y10 trillion in government-guaranteed credit lines)</li> </ul>
	16	<p><b>Financial Function Early Strengthening Act passed</b></p> <ul style="list-style-type: none"> <li>▪ Injection of capital into banks, etc. with inadequate capital</li> <li>▪ Submission of restructuring plan by banks etc. making applications</li> <li>▪ Underwriting requirements for common and preferred shares/subordinated bonds/subordinated loans</li> <li>▪ Requirements for mergers, etc. to rescue failed financial institutions</li> <li>▪ Deadline for applying for capital injection: 31 Mar 2001</li> <li>▪ Government-guaranteed credit lines: Y25 trillion</li> </ul>
	23	<b>The Long-Term Credit Bank of Japan failed, temporary nationalization commenced</b>
Dec		<b>The Nippon Credit Bank failed, temporary nationalization commenced</b>
1999: Mar		<p>Based on the Financial Function Early Strengthening Act, infusion of capital approved for the main 15 banks (Total of Y7.4592 trillion as Y6.1592 trillion in preferred shares, Y1.3 trillion in subordinated bonds and loans)</p> <p>Later augmented as follows:</p> <p>Sep 1999: Y170 billion in preferred shares, Y60 billion in subordinated bonds and loans</p>

		<p>Nov 1999: Y30 billion in preferred shares  Feb 2000: Y20 billion in preferred shares  Mar 2000: Y240 billion in preferred shares, Y45 billion in subordinated bonds  Total infusion reached Y8.342 trillion as Y6.6292 trillion in preferred shares, Y1.405 trillion in subordinated bonds and loans</p>
From reporting period ending on 31 Mar 1999		Introduction of tax effect accounting by financial institutions
<b>Apr</b>		<b>Resolution and Collection Bank and Housing Loan Administration Corporation merged to create Resolution and Collection Corporation (RCC)</b>
2000: 1 Apr		Introduction of mark-to-market accounting for financial products, prohibition of recording gains/losses on cross-trades
2001: 1 Apr		Full introduction of mark-to-market accounting for financial products (also, obligation to assess securities at market price)
<b>1 Apr</b>		<p><b>Revised Deposit Insurance Act enforced (Permanent application after April 2001 of deposit insurance system and liquidation system for financial institutions)</b></p> <ul style="list-style-type: none"> <li>▪ <b>Financial Reconstruction Act's Financial Reconstruction Administrator, public bridge bank system made permanent</b></li> <li>▪ <b>Expansion of circumstances permitting financial assistance (enabling financial assistance when only part of the bank's business is sold off, not just when the whole business is sold off, enabling additional financial assistance after sale of business, merger, etc., enabling financial assistance to failed financial institutions for the purpose of balancing creditors' positions)</b></li> <li>▪ <b>Financial crisis response measures: The following measures are available following decision by Financial Crisis Response Committee</b> <ul style="list-style-type: none"> <li>➢ <b>Deposit Insurance Corporation of Japan (DICJ) takes up shares of authorized financial institutions (recapitalization)</b></li> <li>➢ <b>Financial assistance for failed financial institutions and financial institutions with capital deficit where payoff cost is exceeded</b></li> <li>➢ <b>Acquisition by DICJ of all shares in failed banks with capital deficit (banks under special crisis management)</b></li> </ul> </li> <li>▪ <b>Full protection of deposits, etc., extended to 31 Mar 2002, full protection of liquid deposits until 31 Mar 2003</b></li> </ul> <p>The revised act enables injection of capital, replacing the Financial Function Early Strengthening Act (Banks are excluded from coverage by Financial Function Early Strengthening Act from Apr 2001, coverage for shinkin banks, credit cooperatives is extended by 1 year to Mar 2002).</p>
<b>2002: Jan</b>	<b>4</b>	<p><b>Banks' Shareholdings Restriction Act enforced</b></p> <ul style="list-style-type: none"> <li>▪ <b>Market value of a bank etc.'s shareholdings restricted to the extent of the bank's Tier 1 capital (In principle applied from 30 Sep 2004; extended to 30 Sep 2006).</b></li> <li>▪ <b>Banks' Shareholdings Purchase Corporation (BSPC) established to acquire shareholdings from banks, etc.</b> <ul style="list-style-type: none"> <li>➢ <b>Established through subscription from members (banks, etc.)</b></li> <li>➢ <b>The acquisition accounts used were a general account and special account as follows.</b> <p><b>General account: Used by the BSPC in actively soliciting sales of shares from member banks with the objective of constructing ETFs etc. for sale to the securities firms constructing the funds, and to operating companies wishing to buy back the funds. Shares are sold by BSPC promptly on purchase. Members selling the shares provide the funding required for the purchase.</b></p> <p><b>Special account: Used by the BSPC in acquiring shares for the purpose of providing a safety net. Acquires shares listed on domestic markets (Shares from issues rates BBB-or higher). Upper limit for acquisition (government guarantee) set at Y2 trillion. Member banks provide 8% of the purchase cost of shares sold to the special account.</b></p> </li> </ul> </li> <li>▪ <b>Period of acquisition: Up to 30 Sep 2006</b></li> <li>▪ <b>After period of acquisition has ended, the shares purchased by BSPC shall be sold (Sold from 1 Oct 2006, initially until 30 Jan 2012, then extended to 31 Mar 2017)</b></li> </ul>
	<b>30</b>	<p><b>Banks' Shareholdings Purchase Corporation (BSPC) established and launched on the basis of this law</b></p> <ul style="list-style-type: none"> <li>▪ <b>Purchases made by 30 Sep 2006 totaled Y1.5868 trillion</b></li> </ul>

18 Sep	<p>Bank of Japan (BOJ) announced a policy of purchasing the stockholdings of banks and other financial institutions.</p> <ul style="list-style-type: none"> <li>▪ Total extent of purchases: Up to Y3 trillion</li> <li>▪ Start of purchases: Nov</li> <li>▪ Time limit for purchases: end-Sep 2004</li> <li>▪ Extent of purchases: Shares listed on domestic exchanges (rated BBB- or higher)</li> <li>▪ Purchases made by 30 Sep 2004: Y2.018 trillion</li> <li>▪ Period of sales: 1 Oct 2007-30 Sep 2017</li> </ul>
Oct	<p>Financial Revitalization Program announced; schedule announced in Nov</p> <ul style="list-style-type: none"> <li>▪ Aiming to resolve the NPL problem by FY 2004, introduced the discounted cash flow accounting for reserves (similar to SFAS 114 in the US). Also, revived special inspections, published discrepancies between an entities own inspections and the Financial Services Agency's inspections, etc.</li> <li>▪ Introduction of new system for public funds (leading to Financial Functions Strengthening Act)</li> <li>▪ Raising capital adequacy (introduction of system of tax-free write-offs for reserves, recognition of the efficiency of deferred tax assets, introduction of external audits for capital ratios)</li> <li>▪ Strengthened governance for financial institutions (conversion of preferred shares to common shares, issue of business improvement orders to entities not meeting restructuring plan targets, more rigorous early corrective measures, use of early warning system)</li> <li>▪ Strengthening the framework for corporate restructuring</li> <li>▪ Consideration for loans to SMEs</li> </ul>
2002: 11 Dec	<p><b>Special Measures Act Concerning the Promotion of the Organizational Restructuring of Financial and Related Institutions (mostly enforced on 1 Jan 2003). Introduction of measures for the injection of public funds to restore capital adequacy after mergers, etc. in order to promote the reorganization of financial institutions, etc. These measures are integrated into the Financial Functions Strengthening Act.</b></p>
2003: 31 Jan	<p><b>Revised Shareholdings Restriction Act enforced: BSPC enabled to purchase bank shares held by companies except banks (up to half the amount permitted for special purchases from banks)</b></p>
May	<p><b>Due to more stringent audits of deferred tax assets, the capital ratio of Resona Bank for the year ended 31 Mar 2003 fell to around 2%, lower than the 4% capital adequacy level stipulated for domestic banks. Recapitalized under the Revised Deposit Insurance Act as an authorized financial institution, having shares taken up by the DICJ. Amount of capital injected was Y1.96 trillion (Y296.4 billion in common shares, Y1.6636 trillion in convertible preferred shares)</b></p>
30 Aug	<p><b>Revised Shareholdings Restriction Act enforced</b></p> <ul style="list-style-type: none"> <li>▪ Elimination of need for banks etc. to provide additional 8% of purchase amount for sales to BSPC</li> <li>▪ Raising maximum amount of shares that can be purchased from operating companies except banks(to the same amount as permitted for special purchases from banks)</li> <li>▪ Extension of BSPC lifetime (to 31 Mar 2017)</li> <li>▪ Extension to 30 Sep 2006 of date for ending the limit of bank shareholdings to the amount of Tier 1 capital</li> </ul>
Nov	<p><b>Due to more stringent audits of deferred tax assets, Ashikaga Bank fell into negative equity at its half-year closing (Sep 2003), so a decision was made to place the bank under special crisis management. On 1 Dec, DICJ acquired all the shares, temporarily nationalizing the bank.</b></p>
2004: May	<p>UFJ Holdings announced the sale of UFJ Trust Bank to Sumitomo Trust &amp; Banking.</p>
Jun	<p>UFJ Holdings issued with business improvement orders (for not actively working to implement its own restructuring plan, etc.)</p>
Jul	<p>UFJ Holdings and Mitsubishi Tokyo Financial Group announced integration of businesses</p> <p>Sumitomo Trust &amp; Banking filed injunction with Tokyo District Court to halt the negotiations between UFJ Holdings and Mitsubishi Tokyo (Tokyo District Court rejected the injunction on 11 Aug)</p>
1 Aug	<p><b>Financial Functions Strengthening Act enforced (for applications up to 31 Mar 2008)</b></p> <ul style="list-style-type: none"> <li>▪ Applications for capital injections can be made to the Deposit Insurance Corporation of Japan (DICJ) until 31 Mar 2008, including situations when financial institutions merge or are otherwise reorganized.</li> <li>▪ Financial institutions receiving capital injections must submit a business strengthening plan to be achieved within 3 years of the injection</li> <li>▪ Conditions include the likelihood of enhancing profitability/efficiency, that the financial</li> </ul>

		<p>institution has not failed or gone into negative equity, and in cases not proposing drastic reorganization, that the survival of the institution is essential for the local economy</p> <ul style="list-style-type: none"> <li>▪ Coverage is primarily aimed at regional financial institutions</li> </ul>
Oct		Financial Services Agency (FSA) issues administrative penalty to UFJ bank for evasion of inspections, and files criminal charges
Dec		Financial Reform Program announced; schedule released in Mar 2005
2005: Apr	1	Obligation to use asset-impairment accounting
	4	<b>Financial Services Agency (FSA) makes announcement concerning more stringent governance for banks (major banks) recapitalized with public funds</b>
Oct		Mitsubishi Tokyo Financial Group and UFJ Holdings merged to become Mitsubishi UFJ Financial Group
2006: Nov		<b>Capital injected into Kiyo Holdings under the Financial Functions Strengthening Act (Y31.5 billion in preferred shares)</b>
Dec		<b>Capital injected into Howa Bank under the Financial Functions Strengthening Act (Y9 billion in preferred shares)</b>

Note: Bolding indicates asset purchases and capital injections by public funds(include central bank).