

※ This Policy differs slightly from “Important Policy of Administrative Reform”(December 24, 2005 Cabinet Decision).

Provisional Translation

Basic Policy on the Reform of Policy-based Finance

November 29, 2005

Council on Economic and Fiscal Policy (CEFP)

In light of the document “On the Reform of Policy-based Finance” compiled by the Council on Economic and Fiscal Policy (CEFP) on December 13, 2002, a fundamental reform of Policy-based Finance will be conducted according to the basic policies provided below. Policy-based Finance will shift over to a new system starting in FY2008.

1. Basic principles

(1) Policy-based Finance will be limited to the three functions below, and all others will be withdrawn.

- 1) Assistance for fund procurement to small- and medium-sized enterprises and individuals.
- 2) Finance essential for securing resources abroad and Japan’s international competitiveness vital for its national policies.
- 3) Yen loans (having both Policy-based Finance and development assistance functions).

(2) Policy-based Finance will be reduced by half to realize a “small and efficient government”

- 1) A 50% reduction of the ratio of lendings outstanding to GDP will be realized by the

end of FY2008.

- 2) New financial burdens will not be created.
 - 3) Reduction efforts will be continued through “Market Testing” and the establishment of evaluation and monitoring organizations, even after restructuring.
 - 4) Those organizations that will be privatized will aim for full-scale privatization.
- (3) An emergency response system to deal with crises (disaster and terrorism, and financial crises) utilizing private financial institutions will be developed.
- (4) Efficient management method of Policy-based Finance institutions will be sought.
- 1) Efforts will be made to complement private financial institutions through such measures as partial guarantee, securitization, and indirect loans.
 - 2) The practice of government bureaucrats taking up posts in the top management level of Policy-based Finance institutions will be immediately abolished.
 - 3) The organization will be streamlined and business operation made more efficient at the new organization established through integration and consolidation.

2. Classification of each function of Policy-based Finance

Each function of the Policy-based Finance currently under operation will be classified into: (type a) those that will be withdrawn from Policy-based Finance, (type b) those that will be carried on since they are necessary for Policy-based Finance, and (type c) those that are necessary for the time being, but will be withdrawn in the future.

(1) Development Bank of Japan (DBJ)

1) Loans are provided to major and leading medium-sized enterprises. Various forms of financing, including not only loans from the market but also corporate bonds and stocks, are available for enterprises today, as opposed to the high-growth period of the Japanese economy when the nation as a whole was short of capital. As such, there is no need to provide these loans as part of Policy-based Finance, and therefore this function will be withdrawn from Policy-based Finance. (type a)

(2) The Shoko Chukin Bank (type a)

1) As full banking services provided are the same as those provided by private financial institutions, such as savings and discounting promissory notes, this function will be withdrawn from Policy-based Finance.

2) Cooperative financing is provided targeting affiliated groups and this should in nature be conducted on a membership basis under the spirit of mutual assistance of the participants. Therefore this function does not need to be supported by Policy-based Finance.

(3) Japan Finance Corporation for Municipal Enterprises (type a)

1) The bank functions as an organization which issues cooperative bonds of local public entities. As this function does not need to be conducted under the Policy-based Finance scheme, it will be withdrawn from Policy-based Finance.

(4) Japan Finance Corporation for Small and Medium Enterprise

1) Ordinary loans are provided as a quantitative complement. Moreover, Japan is now

facing financing surplus nationwide, as opposed to the high-growth period of Japanese economy when the nation as a whole was short of capital. Therefore there is no longer a need for the government to provide a quantitative complement even to small- and medium-sized enterprises. As such, this function will be withdrawn from Policy-based Finance. (type a)

2) Special loans will continue to be provided for the limited purpose of policy guidance as it has been clearly indicated in the national policy for small- and medium-sized enterprises. (type b) Reviews will be conducted periodically, and special loans will be withdrawn from Policy-based Finance as there is less need for them. (type c)

(5) National Life Finance Corporation

1) Loans for business funds to small- and medium-sized enterprises which private small and medium financial institutions find difficult to provide from the viewpoint of their profitability will be carried on as part of Policy-based Finance. (Includes managerial improvement loans and environmental health business loans) (type b)

2) Educational loans will continue to be provided as part of Policy-based Finance, but to a more limited target group by lowering the income limit in light of the demand for small funding amounts from the low-income earner group. (type b) Functions that may be substituted by the scholarship system of private financial institutions or the Japan Student Services Organization will be withdrawn from Policy-based Finance. (type a)

(6) Agriculture, Forestry and Fisheries Finance Corporation

1) Only the function of the super-long term low interest rate loans for the agriculture, forestry and fisheries industry which cannot be substituted by capital markets will be carried on as part of Policy-based Finance. (type b)

2) Financial services for the food industry provided to major and leading medium-sized enterprises will be withdrawn from Policy-based Finance. (type a) As for services provided to small- and medium-sized enterprises, only 10-year or longer loans will be carried on as part of Policy-based Finance. (type b)

(7) Japan Bank for International Cooperation (JBIC)

1) Considering the importance of the overseas economic cooperation function (yen loans) serving the Official Development Assistance (ODA) function that the private sector is not able to provide, this function will be carried on as a separate function from the other Policy-based Finance. (type b)

2) The international financing functions (trade finance, investment finance, untied loans) will be withdrawn from Policy-based Finance (type a), except for securing resources abroad and ensuring Japan's international competitiveness vital for its national policies. (type b)

(8) The Okinawa Development Finance Corporation

1) The functions equivalent to those of finance corporations in the rest of Japan will be treated in the same manner as those elsewhere in the country—they will be either withdrawn from or carried on as part of Policy-based Finance. (type a, type b)

2) Systems specific to Okinawa as well as its special interest rate systems will be carried on as part of Policy-based Finance, taking into account their historical and geographical particularity, etc. (type b)

3. Form of the new organization

The following describes the most efficient form of the new organization based on the classification of each function given above.

(1) Organizations to be withdrawn from Policy-based Finance

1) Development Bank of Japan currently in operation

- The overall organization will be fully privatized as it is desirable for many functions to be in place in order to maintain the new financial technology development function.
- A minimum level of transition measures will be implemented to be financially self-reliant.

2) The Shoko Chukin Bank currently in operation

- The bank will be fully privatized as an organization which will provide full banking services to small- and medium-sized enterprises of affiliated groups.
- Minimum level of transition measures will be implemented for the adequate financial basis.

3) Japan Finance Corporation for Municipal Enterprises currently in operation

- The organization will be abolished and shifted to a structure which utilizes the capital markets and others.

(2) Organization to be carried on as part of Policy-based Finance

1) The following organizations will be integrated based on the idea of formulating one Policy-based Finance institution.

- National Life Finance Corporation (educational loans to be reduced)
- Japan Finance Corporation for Small and Medium Enterprise (excludes ordinary loans)
- Agriculture, Forestry and Fisheries Finance Corporation (excludes loans for food industry provided to large enterprises, etc.)
- The Okinawa Development Finance Corporation (excludes loans abolished due to their equivalence to those provided elsewhere in Japan)
- Japan Bank for International Cooperation (excludes trade and investment finance)

2) However, as for the Japan Bank for International Cooperation, considerations will be necessary not only from the perspective of its economic and financial functions, but also from the following perspectives in order to effectively implement strategic aid policies as a national policy. As such, the “Study Group on Overseas Economic Cooperation (provisional name)” comprised of intellectuals will be established under the leadership of the Chief Cabinet Secretary, and the specific details of integration will be determined by the end of this fiscal year taking into account both the results drawn from the considerations by the Study Group conference and this Basic Policy.

(i) Form of the Policy-based Finance function for strategic use of Official Development Assistance (ODA) and effective implementation of overseas economic strategy keeping in mind to compete with foreign countries.

(ii) Realigning its relationship with other organizations providing assistance for the

purpose of “visibility of Japan’s ODA.”

(iii) Form of the system within the government for planning and implementing a strategic assistance policy.

(3) Policy on the format and design of the organization that will carry on the functions to be kept as part of Policy-based Finance

1) The organization will be positioned as a corporation similar to special companies or incorporated administrative agencies.

2) In designing the details of the organization, strong governance will be established with thorough accountability through such measures as clarifying management responsibilities and disclosure of information on business contents. At the same time, a structure will be considered so as to utilize and enhance its expertise.

3) Specific details of the structure will be considered in order to develop a system which deals with crisis situations, utilizing private financial institutions.

4) Methods such as partial guarantee, securitization and indirect loans will be utilized as much as possible in implementing Policy-based Finance.

4. Process in shifting to the new organization, submission of related bills, etc.

(1) The Headquarters for the Promotion of the Reform of Policy-based Finance (provisional name) (Chief of the Headquarters: Prime Minister, Deputy-Chief of the Headquarters: Minister of State for Administrative Reform, etc.) will be established inside the Cabinet to

implement a Cabinet-led reform of Policy-based Finance after this.

(2) The Government will start preparing to formulate related bills on the reform of Policy-based Finance immediately in line with this Basic Policy. Furthermore, the Government will engage in more detailed system design and compile its final draft at the Headquarters by the end of this fiscal year, as well as decide on the timing of submission of these related bills to the Diet.

(3) During the above-mentioned procedures, reports will be made to the CEFPP as necessary.

(4) The administrative tasks related to this Headquarters will be carried out by the Secretariat for the Promotion of Administrative Reform inside the Cabinet Secretariat under the leadership of the Minister of State for Administrative Reform. As such, the system of this Secretariat will be developed.

5. Other points of concern

1) Close and thorough assessment on assets and liabilities (due diligence) will be implemented in such occasions as organizational restructuring and privatization, and those deemed unnecessary will be sold or returned to the national treasury.

2) The reform of Policy-based Finance will be implemented so as not to generate any adverse effect on people currently receiving loans or owners of issued bonds.

3) For those functions that are necessary as Policy-based Finance for the time being, a system will be developed to review their necessity in the future through utilizing such methods as market testing. This includes the establishment of evaluation and monitoring

organizations, etc.

4) With regard to finance-related tasks similar to those of Policy-based Finance institutions conducted by incorporated administrative agencies, public interest corporations and others, each responsible ministry will conduct a review in light of the objective of this Basic Policy, and a report will be compiled under the Minister of State for Administrative Reform by the end of FY2006. Out of these organizations, review will be conducted on incorporated administrative agencies for which the revision deadline is in FY2006 under the framework of the review following the termination of the medium-term target period. Review will also be conducted ahead of the original schedule for incorporated administrative agencies for which the deadlines are in FY2007 and FY2008.

Note from “On the Reform of Policy-based Finance”(November 29,2005 Agreement between the Government and the Ruling Parties)

As for the Okinawa Development Finance Corporation, the Government and the ruling parties agreed as follows;

The Okinawa Development Finance Corporation will exist in its current form until FY2011, the last year of the Okinawa Development Plan. Subsequently, it will be consolidated into the integrated organization, while maintaining its functions autonomously in line with the Okinawa development program.