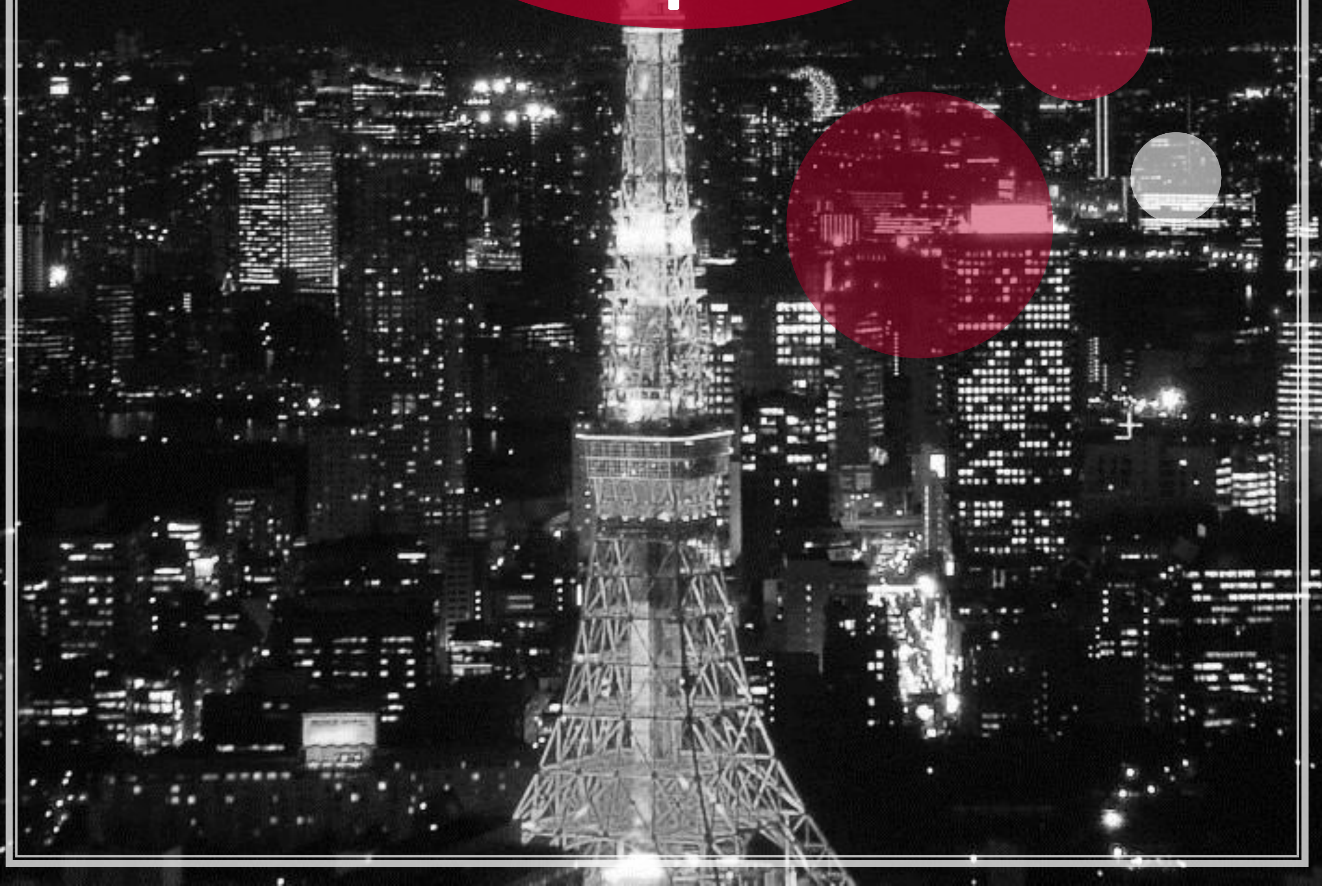
# JAPAN'S EXPERIENCE IN NPL RESOLUTION

## Activities of RCC and Other Asset Management Companies



# I. Growth of Non-Performing Loans (NPL) in Japan: Causes and Initial Response

In the second half of the 1980s, stock market and real estate prices in Japan tripled. The Bank of Japan's interest rate hikes in the early 1990s led to a sharp decline in speculative investments, which in turn reduced asset demand. Within three years, the stock market lost 60% of its peak value (reached in 1989), while land prices depreciated by more than half.

The decline in stock and real estate prices could have resulted in significant losses for banks and other financial institutions due to the large volume of stocks and real estate loans on their balance sheets. However, in the first years following the market crash, financial institution bankruptcies were relatively rare and mostly limited to small organizations. Large banks and the government delayed acknowledging the real scale of non-performing loans (NPL), hoping for price recovery.

Additionally, banks were reluctant to write off bad loans due to strict tax regulations, which allowed loan loss deductions only after bankruptcy procedures or foreclosure processes determined the exact loss amounts.

In 1993, Japanese banks jointly established the **Cooperative Credit Purchase Corporation (CCPC)** to help resolve problem loans. However, according to the IMF, the "clear objective" of CCPC's creation was to provide banks with tax benefits when writing off loans.

# I. Growth of Non-Performing Loans (NPL) in Japan: Causes and Initial Response

CCPC was a private organization with 162 member institutions that contributed an initial capital of **7.9 billion yen (~74 million USD)** and financed the repurchase of non-performing loans (NPL). CCPC provided tax benefits for banks based on recognized losses from transferred loans.

Overall, CCPC acquired NPLs with a **nominal value of 15.4 trillion yen (~136 billion USD)** at an estimated value of **5.8 trillion yen (~51 billion USD)**. However, it was liquidated in 2004.

Despite CCPC's creation, two major credit unions—**Tokyo Kyowa Credit Union** and **Anzen Credit Union**—went bankrupt in December 1994. In response, the **Bank of Japan** established the **Tokyo Kyodo Bank (TKB)** to take over these credit unions' assets.

In August 1995, TKB also absorbed the assets of other failed credit unions and one bank. Its capital was provided by private financial institutions and the Bank of Japan.

In 1996, TKB was reorganized into the **Resolution and Collection Bank (RCB)**, with **75% of its shares transferred to the Deposit Insurance Corporation of Japan**. In total, RCB managed the assets of **45 failed banks and credit unions**. Like most asset management companies, RCB focused on debt collection, restructuring, and the liquidation of distressed assets.

# I. Growth of Non-Performing Loans (NPL) in Japan: Causes and Initial Response

Apart from banks and credit unions, the financial crisis also severely impacted **housing loan corporations (jusen)**, which were created by banks in the **1970s**. Following financial deregulation and increasing mortgage competition in the **1980s**, jusen shifted to riskier lending. As property prices fell, **seven jusen companies were liquidated** in agreement with creditors, investors, and the Ministry of Finance.

A special audit ordered by the Ministry of Finance revealed that **74% of all jusen loans were non-performing**. In response, the Japanese Parliament created the **Housing Loan Administration Corporation (HLAC)** in **1996** to manage jusen assets.

HLAC was a **100% subsidiary** of the **Deposit Insurance Corporation of Japan** with a capital of **200 billion yen (~1.8 billion USD)**. It was tasked with resolving approximately **200,000 problematic jusen loans**, amounting to **4.7 trillion yen (~43 billion USD)**. In addition to its main function, HLAC also provided compensation for losses caused by illegal banking practices.

# I. Growth of Non-Performing Loans (NPL) in Japan: Causes and Initial Response

Besides market crashes, rising corporate bankruptcies, and banks' reluctance to write off NPLs, the Japanese financial system suffered from the long-standing practice of "evergreening"— granting loans to insolvent firms while repeatedly restructuring their debts to conceal their true financial status.

Furthermore, Japan lacked standardized asset classification and disclosure systems. The government only started implementing classification standards after the crisis by gradually tightening requirements for financial transparency.

Despite this, the true volume of NPLs remained uncertain. By official estimates, the total NPL volume in 2001 was 36.8 trillion yen (~302 billion USD). However, private analysts estimated the actual volume to be between 100 and 250 trillion yen (~822 billion – 2 trillion USD).

# I. Growth of Non-Performing Loans (NPL) in Japan: Causes and Initial Response

As the crisis worsened, Parliament passed the Financial Stabilization Law, allowing the government to allocate: • 17 trillion yen (~135 billion USD) to protect depositors of failed banks • 13 trillion yen (~103 billion USD) for bank recapitalization However, these capital injections failed to stabilize the situation, leading to public dissatisfaction and a change in government leadership. The new government enacted the Emergency Recapitalization Law, approving an additional 7.5 trillion yen (~60 billion USD), which calmed the markets but did not solve the underlying NPL crisis.

As part of the financial crisis response, supervisory institutions were restructured: • In 1998, the Financial Supervisory Agency (FSA) was created, taking over regulatory functions from the Ministry of Finance. • The Financial Reconstruction Commission (FRC) was also formed, overseeing bank bankruptcies and capital injections. • In 2001, FRC and other regulatory bodies were merged into a single entity—the Financial Services Agency (FSA).

# II. Creation of the RCC: Objectives and Activities

The Corporation for Debt Settlement and Collection (RCC) was established as a result of the merger of the Housing Loan Management Corporation (HLAC) and the Debt Settlement and Collection Bank (RCB) through amendments to the Deposit Insurance Act and the Financial Rehabilitation Act.

The decision to merge the two asset management companies was announced in 1998, and on April 1, 1999, RCC began its operations.

The goal of the corporation was to accelerate the rehabilitation and collection of overdue loans transferred from bankrupt financial institutions through a fair and transparent process, with the aim of minimizing government expenditures.

RCC was authorized to acquire assets both from bankrupt organizations and from solvent financial institutions. RCC also "inherited" the functions of HLAC and RCB in managing problem assets received from failed and bankrupt credit cooperatives.

In addition, in accordance with the Operational Recapitalization Act, RCC acquired preferred shares and subordinated debt from institutions that received capital injections from government funds. It also exercised control over capital injections and determined the terms of capital underwriting through the Financial Reconstruction Commission (later through the Financial Services Agency).

# II. Creating an RCC

## Capitalization, Staff, Asset Buyback Mechanisms

The RCC was created as a subsidiary of the Japanese Deposit Insurance Corporation. The initial capital of the RCC was formed through government funds in exchange for bonds issued by the Japanese Deposit Insurance Corporation, amounting to 212 billion yen (1.9 billion USD). The RCC was headed by Kohei Nakabo, who had been president of HLAC since its inception in July 1996. The corporation's staff was formed from former employees of HLAC and RCB. By 1999, the RCC employed about 1,900 staff members.

As previously mentioned, the Financial Rehabilitation Law provided the RCC with an opportunity to buy assets from solvent financial institutions.

The process of accepting applications from "healthy" banks wishing to sell NPLs (non-performing loans) began in June 1999. After reviewing the applications, the RCC, in collaboration with the Japanese Deposit Insurance Corporation, made proposals regarding the pricing of assets offered by banks for buyback

The asset buyback program was extended multiple times, with the final deadline for receiving applications set for March 31, 2005.

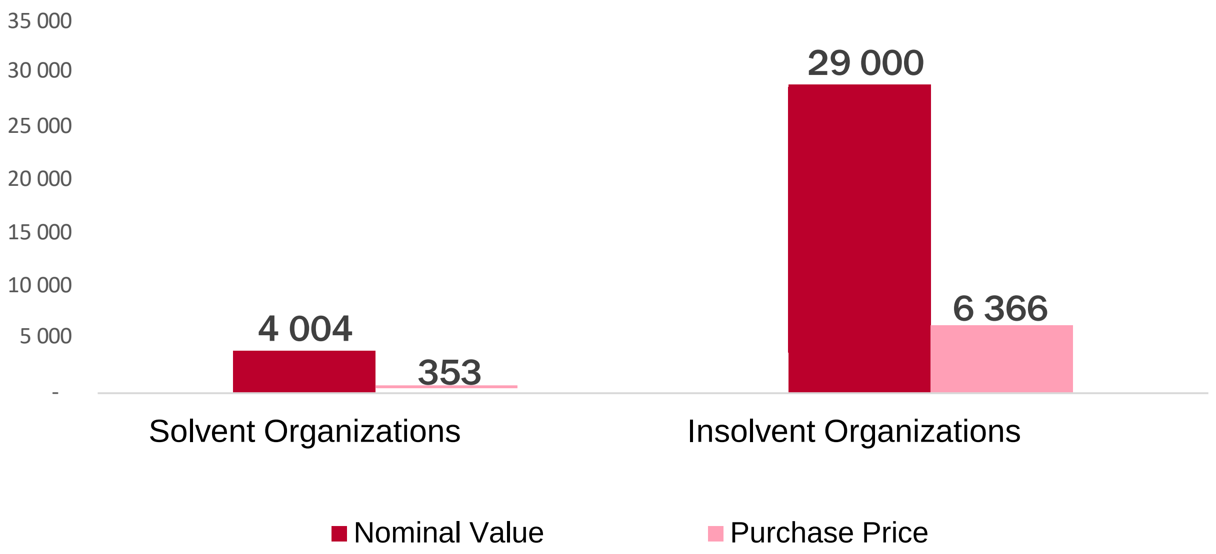
Regarding insolvent institutions, in the process of their resolution, in addition to the RCC and the Japanese Deposit Insurance Corporation, the Financial Services Agency and courts were also involved to ensure the smooth transfer of business and assets of the distressed company to a buyer.

# III. Asset Valuation of the RCC
# Approaches to Valuation

The RCC did not disclose the methodology for determining the purchase price. In the early years of its operations, the corporation acquired assets at a significant discount to avoid recognizing losses in its portfolio, which was driven by the escalating political situation and growing public discontent.

By October 2001, the RCC was purchasing assets at an average of 3.8% of their book value, and in some cases, it even offered 1 yen for low-liquidity assets. This, in turn, led to a lack of incentive for banks to sell their distressed loans to the RCC.
In this regard, in January 2002, amendments were made to the Financial Rehabilitation Law, allowing for the purchase of RCC assets at market value.

Asset Value of the RCC, billion yen



# IV. Asset Management of the RCC

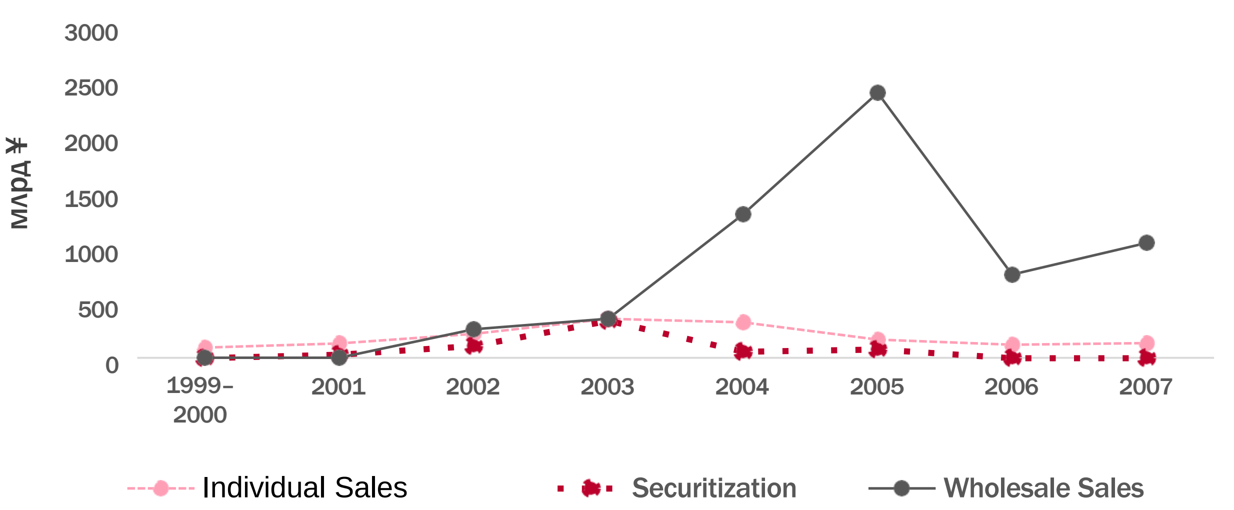
## Recovery Strategy and Integration of Assets into the Economy

In the early years of its operations, the corporation's asset management mechanisms were limited to the collection and sale of pledged property.

Subsequently, to expedite the NPL resolution process, the government began expanding the powers of the RCC. Thus, starting in 2001, the RCC was granted the right to securitize loans and sell them to investors, and from 2002 onwards, the corporation began wholesale asset sales by pooling them together.

In addition, after the government recognized the true scale of the NPL problem within the financial system, the corporation began implementing corporate restructuring of troubled organizations, debt restructuring, and developing rehabilitation plans for borrowers to assist in business recovery.

### Methods of Asset Disposal by the RCC by Year



# V. Results of RCC's Activities: Recovery Indicators.

As of March 31, 2005, RCC acquired non-performing loans with a total book value of 4 trillion yen (~34.9 billion USD) from 192 solvent financial organizations for 353 billion yen (~3 billion USD). Thus, the average discount rate was 91%. For this category of loans, the corporation ensured a recovery of 642 billion yen (~5.6 billion USD).

For insolvent companies, the corporation acquired assets with a total book value of 29 trillion yen (~253 billion USD) for 6.4 trillion yen (~55.8 billion USD). The recovery from these loans amounted to 7.1 trillion yen (~61.9 billion USD). Thus, RCC not only ensured the recovery of invested funds but also generated a profit through the assets.

**Corporate Development Department of JSC "Problem Loan Fund"**

**Sources of Information:**

The Resolution and Collection Corporation of Japan, Mallory Dreyer, Yale University

Reports of BOJ, RCC, IMF

When converting currencies, average historical data for the relevant periods from the portal www.macrotrends.net were used.