

Rating Methodology for FILP Agencies

1. Basic Stance

JCR evaluates rating for FILP agencies based on both an individual stance (business infrastructure, financial conditions, etc.) as a stand-alone FILP agency and a credit enhancement effect by the central government in a comprehensive way. Incorporation of a credit enhancement into rating for a FILP agency reflects JCR's thought that it is possible that a FILP agency can expect support from the central government (local currency Long-term Issuer Rating "AAA"), which has already high creditworthiness, for redemption of principal and interest for its bond issue even if there is no express provision statement of guarantee, because of its strong relations with the central government as evidenced by the facts that a FILP agency as a bond issuing body is under control by the central government widely in areas such as capital contribution, appointment of executive directors and officers, and execution of business and that its bond issue itself and its budget including expenses for redemption of principal and interest require permission from the central government.

In the meantime, incorporation of the central government's credit enhancement into the rating for a FILP agency, however, does not mean that JCR determines across-the-board rating level for a FILP agency as supported by the central government without taking into consideration its individual circumstances as a stand-alone FILP agency. Namely, since debt service capacity of a bond issuing body is considered to be determined primarily in light of individual circumstances of the issuing body itself, gap among individual FILP agencies in their individual circumstance is reflected in rating for them.

In accordance with the point of view above, in rating for individual FILP agencies, JCR first sets a certain level of rating as the lower limit (floor) and then determines the rating levels for individual FILP agencies from a comprehensive point of view based on the individual circumstances of them. In the meanwhile, FILP agencies are roughly classified by their business outlines into "administrative agency type" FILP agencies with high public interest which provides the central government administrative services and "private firm similar type" FILP agencies whose services and the like are provided by also private sector companies. Concerning the rating floor for the private firm similar type FILP agencies, it is set below the floor for administrative agency type FILP agencies, because it is highly likely that a credit enhancement effect will not be able to be incorporated into the rating owing to privatization and other reasons in the future. As a result, individual circumstances as a stand-alone FILP agency count more in case of private firm similar type FILP agencies in terms of determination of rating.

2. Viewpoint on Credit Enhancement by the Central Government

(1) Basic Viewpoint

Credit enhancement provided by the central government should be determined based on "public

nature” of a business rendered by a FILP agency. Public nature of its business needs to be determined after examining its social meaning, political importance, necessity of the central government’s involvement, etc. in a comprehensive way. Since many of FILP agencies were established during the period of rapid economic growth after WWII to play roles in establishment of social capital, industrial promotion or aid, a FILP agency is examined in terms of whether or not it has already ended its purpose or whether or not it is important that the central government get involved with such agency in a situation where fields of government administration are now being reviewed increasingly. JCR considers it necessary to determine its public nature by the following items in addition to the above standpoints.

(2) Relations with the Central Government in Laws and Ordinances

As for the relations with the central government in laws and ordinances, JCR determines them by taking a look at primarily (i) regulations on appointment of executive directors and officers, execution of business, budget and settlement of accounts and (ii) capital ties with the central government. There are slight differences among FILP agencies in terms of the above relations as evidenced by the facts that there are some FILP agencies whose executive directors or officers are not required to be appointed by the responsible cabinet minister (limited to the permission) and that some FILP agencies need permission from the responsible cabinet minister for their bond issues, but some FILP agencies need only to report such issues. There are some variations among FILP agencies in terms of capital ties also that while many of FILP agencies are wholly government-owned entities, but there are several FILP agencies, for which the central government’s investment ratio is 50% – 60%. However, regulations under the Act of Incorporation and capital ties are almost the same among FILP agencies, and therefore there are few cases where differences among them in terms of “Relations with the Central Government in Laws and Ordinances” are seen.

(3) Measure on Source of Revenue

Presence of a measure on source of revenue, its content and study on need for such measure are important in determination of public nature of a business rendered by a FILP agency. Namely, a FILP agency, for which a measure on source of revenue is taken, lacks profitability generally, whereas, in contrast, public nature of business of such FILP agency is said to be high.

In taking a look at a measure on source of revenue taken by the central government, it should be kept in mind that although proportion of grants-in-aids, etc. (including subsidies, interest subsidies and the like) to ordinary revenue attracts attention generally, there are some FILP agencies, for which a measure on source of revenue is taken in the form of capital contribution or interest free loan, even if proportion of such grants-in-aids, etc. shown in income statement is not high.

(4) Presence of Similar Business in Private Sector

Whether or not there is any business in private sector which is similar to the business provided by a

FILP agency is an important criterion to determine public nature of its business. This is because if there is a market for such business already created in private sector, likelihood of privatization of such FILP agency is considered to be more likely.

3. Individual Circumstances as Stand-Alone FILP Agency

JCR performs analyses for individual circumstances facing a FILP agency that are similar to analyses for private-sector corporates or financial institutions. The evaluation points for a corporate type FILP agency (a FILP agency whose main business is not lending) are (i) business base, (ii) profitability and efficiency, (iii) risk of fluctuations in interest rates, (iv) financial stability, and (v) cost reduction and revision of business. On the other hand, the evaluation points for a financial institution type FILP agency (a FILP agency whose main business is lending) are (i) business base, (ii) content of assets, (iii) interest rate risk, (iv) adequacy of equity capital, and (v) profitability and efficiency.

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