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## The Resolution and Collection Corporation of Japan

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# The Resolution and Collection Corporation of Japan<sup>1</sup>

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Yale Program on Financial Stability Case Study  
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## **Abstract**

Though the Japanese real estate and stock market bubble burst in the early 1990s, the ensuing financial crisis in Japan did not reach a systemic level until 1997, when four large financial institutions failed in a single month. Because of their heavy exposure to real estate and equity markets, Japanese banks had a nonperforming loan (NPL) problem, which was prolonged, and private sector estimates of the scale of the NPL problem differed significantly from the official estimates. In response, the Japanese government created multiple asset management companies; the Resolution and Collection Corporation (RCC) was the result of the merger of two narrowly focused, semi-governmental agencies. The RCC, which began operating in 1999, was tasked with purchasing NPLs from both solvent and insolvent financial institutions. In 2001, its scope was expanded to include corporate restructuring and revitalization. Though there was no specified sunset date for insolvent institutions, the purchase window for solvent financial institutions ended on March 31, 2005. The RCC purchased ¥4,004 billion (approximately \$37 billion) in bad debt (book value) at a purchase price of ¥353 billion from solvent institutions by March 2005, and it collected ¥642 billion by March 2008. The RCC purchased ¥6,366 billion in assets (estimated ¥29,000 billion book value) from failed financial institutions and recovered ¥7,143 billion by the end of March 2008. Though the RCC is operational as of today, its operations are no longer focused on resolving the 1990s crisis.

**Keywords:** asset management company, nonperforming loans, Japan, RCC

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# The Resolution and Collection Corporation of Japan

## At a Glance

The Japanese financial crisis of the 1990s was prolonged as banks and the government were slow to acknowledge and respond to a massive nonperforming loan (NPL) problem. In 1998, two asset management agencies merged to create the Resolution and Collection Corporation (RCC), which was tasked with the purchase and disposal of NPLs from solvent and insolvent financial institutions. The RCC began operations in 1999, but its operations were limited, as the full scale of the NPL problem was still not recognized.

The government took more aggressive action to address the NPL problem in 2001 by adding corporate restructuring and revitalization to the RCC's scope. In 2002, the RCC was allowed to purchase NPLs from solvent institutions at market value. The deadline to purchase assets from solvent institutions was March 31, 2005, but no deadline was set for failed institutions. By March 2005, the RCC had purchased ¥4,004 billion of loans (book value), approximately \$37 billion, at a purchase price of ¥353 billion from solvent institutions, and it had recovered ¥642 billion by March 2008. The RCC recovered ¥7,143 billion on total purchases of ¥6,366 billion (estimated ¥29,000 billion book value) from failed financial institutions by March 31, 2008. The RCC assisted with corporate restructuring of 569 borrowers between 2001 and 2008.

### Summary of Key Terms

Purpose:	"[A]ccelerate the recovery and collection of non-performing loans transferred from failed [and solvent] financial institutions through a fair and transparent process in order to minimize public costs" (DIC) 2005a, i).
Launch Dates	Announcement (merger): October 1998 Operational: April 1, 1999
Wind-Down Dates	Expiration date for transfers: N/A for insolvent; March 31, 2005, for solvent
Size and Type of NPL Problem	Official estimate of 17% of banking system loans in 1998 (Lincoln 1998) Corporate, equities, and real estate
Program Size	Not specified at outset
Eligible Institutions	All Japanese financial institutions Both open and closed banks
Usage	Solvent: ¥353 billion (purchase price) for ¥4,004 billion (book value, approximately \$37 billion) Insolvent: ¥6,366 billion (purchase price) for an estimated ¥29,000 billion (book value)
Outcomes	Solvent: Recovered ¥642 billion on ¥353 billion Insolvent: Recovered ¥7,143 billion on ¥6,366 billion
Ownership Structure	Government-owned
Notable Features	Special investigative powers to take on difficult cases such as those tied to organized crime; purchased loans at a steep discount; created from merger of prior asset management agencies

## Summary Evaluation

Many observers believe that Japan's banking problems were prolonged in the 1990s and 2000s due to the unwillingness of the government and financial sector to recognize the

extent of the NPL problem. The RCC, which the government created to address the NPL problem, has been criticized due to its relatively limited scope: it ultimately purchased a total of ¥33 trillion in loans (book value); private economists at the time estimated the NPL problem at ¥100 trillion to ¥250 trillion. Others argue that the RCC was limited in effectiveness as the purchase price offered to solvent financial institutions was often steeply discounted because the RCC sought to minimize the risk of transferring losses to taxpayers. Others have stated that corporate restructuring was outside the RCC's value-adding capabilities. However, it has been recognized that the RCC recovered in excess of its purchase price in its disposal of assets from failed and solvent institutions.

<b>Resolution and Collection Corporation of Japan: Japan Context</b>	
<b>GDP (SAAR, nominal GDP in LCU converted to USD)</b>	\$4,523 billion in 1998 \$5,062 billion in 1999
<b>GDP per capita (SAAR, nominal GDP in LCU converted to USD)</b>	\$31,903 in 1998 \$36,027 in 1999
<b>Sovereign credit rating (5-year senior debt)</b>	Data for Q4 1998: Fitch: AAA Moody's: Aa1 S&P: AAA  Data for Q4 1999: Fitch: AAA Moody's: Aa1 S&P: AAA
<b>Size of banking system</b>	\$9,727 billion in 1998 \$11,331 billion in 1999
<b>Size of banking system as a percentage of GDP</b>	215.1% in 1998 223.9% in 1999
<b>Size of banking system as a percentage of financial system</b>	79.2% in 1998 78.5% in 1999
<b>5-bank concentration of banking system</b>	43.6% in 1998 42.1% in 1999
<b>Foreign involvement in banking system</b>	Data not available for 1998–1999
<b>Government ownership of banking system</b>	Data not available for 1998–1999
<b>Existence of deposit insurance</b>	Yes in 1998 Yes in 1999
<i>Sources: Bloomberg, World Bank Global Financial Development Database, World Bank Deposit Insurance Dataset</i>	

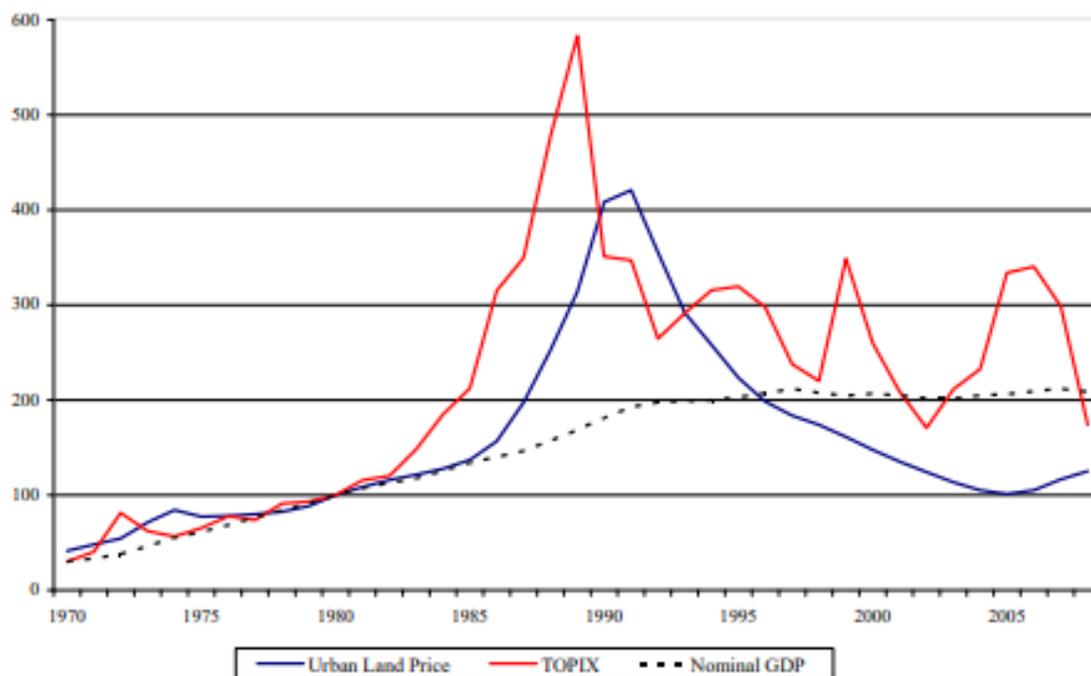
## I. Overview

### Background

#### *Asset Bubble Burst and Establishment of CCPC (1990–1994)*

Japanese real estate and stock market prices tripled in the latter half of the 1980s (Lincoln 2002). The asset price bubble burst in the early 1990s, triggered by interest rate hikes by the Bank of Japan (BOJ), leading to “[a] rapid downturn in speculative investments” that “weakened both demand and asset prices, creating a downward spiral” (Tandon 2005). Within three years, the stock market had lost 60% of its peak 1989 value, and land prices decreased by more than half in the following decade, as depicted in Figure 1 below (Caballero, Hoshi, and Kashyap 2006). The decline in stock and real estate prices had the potential to create large mark-to-market losses for banks and other financial institutions, given their volume of equity holdings and real estate loans (Kanaya and Woo 2000).

**Figure 1: Tokyo Stock Exchange Index (TOPIX), Urban Land Price, and Nominal GDP (1980=100) from 1970–2008**



Source: Fujii and Kawai 2010.

In the initial years following the collapse of the bubble, financial institution failures were sporadic and limited to smaller institutions (Nakaso 2001). Larger banks and the government delayed recognizing the extent of the nonperforming loan (NPL) problem in the hope that asset prices would return to pre-1990 levels (Fujii and Kawai 2010; Kanaya and Woo 2000). Banks were also slow to write off loans with a low probability of recovery due

to the strict tax guidelines for loan loss write-offs, as write-offs were permitted “only after the loan loss amount had been ascertained in bankruptcy or foreclosure proceedings” (Kanaya and Woo 2000).

Japanese banks established the Cooperative Credit Purchasing Company (CCPC) in 1993 to assist with the disposal of NPLs, but “the apparent purpose behind its creation was to allow banks to take advantage of tax deductibility for loan write off” (Kanaya and Woo 2000). The CCPC dealt only with loans with real estate as collateral. It was established as a private entity with 162 member institutions that provided the initial ¥7.9 billion (approximately \$74 million)<sup>3</sup> in capital as well as financing for the purchase of bad loans (Packer 1994). Banks could sell loans to the CCPC, which “generated tax benefits for the banks because upon the transfer to the CCPC, the selling banks could recognize losses immediately that reduced their taxes” (Hoshi and Kashyap 2010). The CCPC had recourse to the selling institutions. Institutions selling a loan to the CCPC had a contingent liability; if there was a significant difference between the purchase price and collections, the difference was charged to the institution. The first round of purchases in 1993 included 229 loans with a face value of ¥682 billion at a discount of 33.7% (Packer 1994). The major banks accounted for the majority of the loans sold to the CCPC. In the first years of operations, the CCPC was slow to dispose of loans, as it sold only 88 properties by March 1994 (Packer 2000). However, loan disposal accelerated after 1998, and the CCPC was liquidated in 2004. In total, the CCPC purchased NPLs worth ¥15.4 trillion in face value with ¥5.8 trillion in appraised value (Hoshi and Kashyap 2010).<sup>4</sup>

#### *Credit Cooperative Failures and the RCB (1994–1998)*

Despite the establishment of the CCPC, two significant credit unions—Tokyo Kyowa Credit Union and Anzen Credit Union—failed in December 1994 (Nakaso 2001). In 1995, the Bank of Japan created the Tokyo Kyodo Bank (TKB), an asset management company, to assume the assets of the two failed credit unions (Hoshi and Kashyap 2004). In August 1995, the TKB assumed the assets of additional failing credit cooperatives and a failed bank. Private financial institutions provided ¥20 billion in capital, and the BOJ provided ¥20 billion in capital for the TKB. In September 1996, the TKB was reorganized into the Resolution and Collection Bank (RCB) (Nakaso 2001). After the restructuring, the RCB was a 75% subsidiary of the Deposit Insurance Corporation of Japan (DICJ), as the DICJ provided ¥120 billion in capital (DICJ 2002b). Ultimately, the RCB took over the operations of 45 failed banks and credit unions and worked to collect, recover, or sell the nonperforming loans extended by the failed institutions (DICJ 1999; *Japan Times* 1999a).

#### *The ‘Jusen’ Companies and the HLAC (1992–1998)*

Concurrent with the credit cooperative failures, there was a high level of uncertainty about the quality of lending by the *jusen*, the nonbank housing loan corporations established by banks in the 1970s. The *jusen* moved into higher-risk lending in the 1980s following deregulation and increased competition in the home mortgage market (Hoshi and Kashyap

<sup>3</sup> Conversion based on the average yearly exchange rate as of December 31, 2000 (\$1 = 107.80 yen).

<sup>4</sup> For more information on the structure of the CCPC, see: Packer (1994) and Packer (2000).

2010). The *jusen* received capital injections in 1993 and committed to rehabilitation plans; however, real estate prices continued to fall, and the Ministry of Finance (MOF), creditors, and investors agreed to dissolve seven *jusen* in 1996. The MOF commissioned a special examination of the *jusen* and determined that 74% of their outstanding loans were nonperforming (Kanaya and Woo 2000).

In 1996, the Japanese Diet (the legislature) established the Housing Loan Administration Corporation (HLAC) (Koo and Sasaki 2010). The HLAC was an asset management company for the *jusen*, and the assets of seven *jusen* companies were transferred to the HLAC in October 1996 (*Japan Times* 1996). The HLAC was established as a 100% subsidiary of the DICJ with ¥200 billion in capital (DICJ 2002b). The HLAC was created to dispose of the estimated ¥4.7 trillion of NPLs from the *jusen* companies that it assumed, and the government estimated that the activities would take up to 15 years to complete (DICJ 1999; *Japan Times* 1996). The initial estimate of the number of NPLs of the *jusen* companies was approximately 200,000, and there was concern “that as much as ¥1.2 trillion of the loans [would] be unrecoverable” (*Japan Times* 1996). In addition to assuming the assets of the *jusen*, the HLAC sought civil damages from banks that acted in a criminal manner (*Japan Times* 1999a).<sup>5</sup>

#### *Increases in NPL Volume during the 1990s*

During the 1990s, an array of factors led to the NPL problem and its continued acceleration. NPLs were distributed across all types of financial institutions, though the problem was concentrated in real estate, construction, and wholesale and retail trading (Cabinet Office 2001b). Banks in Japan were reluctant to recognize losses on NPLs during the mid-1990s, as there were strict tax guidelines on write-offs; banks also feared that borrowers would view the write-off as “a signal that the banks had given up on loan recovery” (Kanaya and Woo 2000). The main bank system of lending further contributed to the NPL problem. A borrowing firm’s main bank was its primary lender; the main bank was the “quasi-insider monitor” that identified problems before the borrowing firm became insolvent and assisted with business restructuring. However, many main banks continued to provide loans to firms, even if there was uncertainty surrounding their long-term viability (Tandon 2005). The continued financing of failing firms, known as “evergreening,” is considered a contributing factor to the crisis (Caballero, Hoshi, and Kashyap 2006). Other macroeconomic trends, such as “the bursting of the asset price bubble, continued weakness of the domestic economy, chronic price deflation and the rising number of business failures and bankruptcies help [to] explain the rise in NPLs” (Fung et al. 2004).

During the 1990s, the government enacted increasingly stringent guidelines to standardize loan classification and disclosure requirements. At the onset of the crisis in the early 1990s, loan classification standards were considered inadequate compared to international standards. The government began to pass legislation to enforce classification standards and progressively strengthened loan disclosure requirements. The new provisioning policy was based on a bank’s self-assessment of its portfolio, which enabled more flexible provisioning

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<sup>5</sup> For more information on the *jusen* crisis, see: Milhaupt and West 2004.

based on the quality of borrowers and their histories of default. In 1999, comprehensive requirements for disclosure were introduced, which were considered “among the most far-reaching in the world” (Nakaso 2001). The government also sought to further strengthen loan loss provisioning and standardize borrower and asset classification in 2002 (IMF 2003). The progressive strengthening of standards to increase transparency and consistency in reporting is one factor that contributed to the increasing volume of NPLs beginning in 1992.

Though banks were required to provide more transparency about loans and increase loss provisioning, uncertainty regarding the total volume of NPLs persisted. In mid-1995, the official estimate of NPLs was approximately ¥40 trillion. However, there were different sources of estimates for the total NPL volume: private estimates, estimates based on bank disclosures and financial statements, and official estimates. As reflected by the fact that “[p]rivate estimates of actual bad loans [were] substantially greater than amounts announced by the banks and the MOF,” there was not a clear understanding of the true scope of the problem, despite the write-offs and reclassification of NPLs (Tandon 2005). Private estimates for bad loans ranged from ¥100 trillion to ¥250 trillion, while the official estimate was ¥36.8 trillion as of 2001 (Lincoln 1998).

#### *Other Responses to the Escalating Crisis*

The severity of the crisis became clear with the failure of four large financial institutions in November 1997. On November 3, 1997, Sanyo Securities, a firm with ¥2.7 trillion in assets, filed an application to begin reorganization proceedings, and the government immediately suspended its operations. Sanyo’s failure “paralysed the entire interbank market,” and Yamaichi Securities failed three weeks later. In the case of Yamaichi, the government proceeded with an “orderly wind-down” rather than suspending its operations (Nakaso 2001). Hokkaido Takushoku Bank had failed on November 17; an assuming bank was found, and the BOJ provided liquidity support. On November 26, Tokuyo City Bank failed; the government released a statement that day reaffirming its commitment to financial stability and ensuring deposit protection, as the Deposit Insurance Act of Japan had been amended in 1996 to include a temporary suspension of deposit insurance limits (Fujii and Kawai 2010; Nakaso 2001). In 1998, the prime minister announced the nationalization of the Long-Term Credit Bank of Japan and the Nippon Credit Bank; the banks were placed under special public management by the DICJ (DICJ 2000; Hoshi and Kashyap 1999).

With the crisis reaching an acute phase, the Diet passed the Financial Function Stabilization Act, which allowed the government to use ¥30 trillion of public funds, ¥17 trillion of which went to protection for depositors of failed banks and ¥13 trillion of which went to bank recapitalization (Fujii and Kawai 2010; Nakaso 2001). The first publicly funded recapitalization program, which used ¥1.8 trillion, took place in March 1998. However, the injection was “unsuccessful in stabilizing the situation,” and there was a high level of public dissatisfaction in the government’s response to the crisis (Hoshi and Kashyap 2010). The dissatisfaction prompted leadership changes, as the Hashimoto government resigned and a new government led by Keizo Obuchi assumed power (Hoshi and Kashyap 2010). The new government passed the Prompt Recapitalization Act (also referred to as the Early Strengthening Law or the Financial Function Early Strengthening Law) and approved

another capital injection worth ¥7.5 trillion (Nakaso 2001), which seemed to calm the market, though the NPL problem remained and capital shortfalls reemerged soon after (Hoshi and Kashyap 2010).<sup>6</sup>

Over the course of the financial crisis in Japan, crisis management and oversight authority changed, and new governmental bodies were established. The Financial Supervisory Agency was established in June 1998, and it took over supervisory powers from the MOF (Kanaya and Woo 2000). The Financial Reconstruction Commission (FRC) was also established in 1998 and given the authority to inspect and supervise the banks; it was established as an independent administrative body under the prime minister to administer the new laws related to bank failures and capital injections (Nakaso 2001). In 2001, the Financial Supervisory Agency and the FRC were reorganized into the Financial Services Agency (FSA), and the FSA became an external part of the Cabinet Office (Fujii and Kawai 2010). The FSA had “integral responsibility over supervision, inspection, and planning of the financial system” (Hayashi 2015).

There was a strong public outcry against using taxpayer money to resolve the crisis. In response to the *jusen* problem, the government used ¥685 billion of taxpayer money, which led to “public outrage over the repudiation of the promise” not to rely on taxpayer assistance to resolve the crisis (Hoshi and Kashyap 2010). After this, “any reference to the use of public funds [became] almost a political taboo” (Nakaso 2001), and “[t]he legacy of this experience was long lasting because it made the government very reluctant to ask for the much larger sums that would be needed once the troubles of the commercial banks became evident” (Hoshi and Kashyap 2010).

### **Program Description**

The Resolution and Collection Corporation (RCC) was established via the merger of the HLAC and the RCB through an amendment to the Deposit Insurance Act and the Financial Revitalization Act (also referred to as the Financial Function Reconstruction Law). In 1998, the merger agreement was announced, and the RCC began operations on April 1, 1999 (RCC 2018). The RCC was created to “accelerate the recovery and collection of non-performing loans transferred from failed financial institutions through a fair and transparent process in order to minimize public costs”; beyond the acquisition of assets from failed institutions, the RCC could also purchase NPLs from solvent financial institutions (DICJ 2005a). The RCC assumed the responsibilities of the HLAC and the RCB for managing and collecting the NPLs from the *jusen* and the failed credit cooperatives. The RCC continued to pursue legal action against former executives and debtors of failed institutions (Kang 2003). The RCC purchased preferred shares and subordinated debt from the institutions receiving capital injections, in accordance with the Prompt Recapitalization Act, though the FRC—and later the FSA—oversaw the capital injections and determined the underwriting terms of the capital (Nakaso 2001).

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<sup>6</sup> For more information about the capital injections in Japan at this time, see cases by Unnava, forthcoming in the *Journal of Financial Crises*.

The RCC was established as a wholly owned subsidiary of the Deposit Insurance Corporation of Japan (RCC 2018). The government of Japan provided the funding for the RCC, as the DICJ issued government-guaranteed DICJ bonds and injected the proceeds into the RCC. When the RCC began operations, it had ¥212 billion in capital (Kang 2003,). Kohei Nakabo, who served as president of the HLAC from its founding in July 1996, became the president of the RCC (Otake 1999a). The RCC was staffed by the previous HLAC and RCB employees, and the RCC had approximately 1,900 employees in April 1999 (Nakaso 2001; Otake 1999a).

#### *Process for Solvent Institutions*

The Financial Revitalization Act granted the RCC the ability to purchase NPLs from solvent banks in addition to failed institutions, though sales were not mandatory for solvent financial institutions (DICJ 2001; Hoshi and Kashyap 2010). On June 22, 1999, the RCC began accepting applications from the healthy banks willing to sell assets. These banks were required to file their provisional applications between June 22 and July 9, and the RCC and DICJ reviewed the applications, exchanged opinions with the banks, and provided offer prices for the loans (*Japan Times* 1999c). Banks interested in an offer then filed formal applications to proceed with the purchase. The RCC announced additional application windows over the course of its operations. When the Financial Revitalization Act was enacted in 1998, it granted the RCC the authority to purchase assets from solvent financial institutions through March 31, 2001, but the government later amended the law to extend the deadline to March 31, 2004. In April 2003, the deadline was again extended, and the final deadline was set to March 31, 2005 (DICJ 2008).

#### *Process for Insolvent Institutions*

In the case of a failed financial institution, the DICJ, FSA, and the courts worked together through the resolution process to ensure a smooth transfer of business and operations to an acquiring institution. The failing institution submitted an application to the DICJ for assistance, and the DICJ determined the method of financial assistance, which took “the form of a monetary grant, loan or deposit of funds, purchase of assets, guarantee of liabilities, assumption of financial obligations, subscription for preferred shares and other capital raising instruments, or loss sharing” (DICJ 2008). The purchase of assets was agreed upon by the failed institution, the assuming financial institution(s) or bridge bank, the RCC, the DICJ, and the FSA.

#### *Purchase Price*

The RCC does not appear to have disclosed the methodology for determining the purchase price offered for NPLs, though it established a multistage process to determine the price. For real estate-backed loans, the process began with the submission of a real estate appraisal to the RCC with the property valuation; the RCC then reviewed the appraisal. Because the RCC did not have recourse to the originator bank, it sought to determine an appropriate value for the purchase price (Packer 2000). The RCC, with guidance from the DICJ and the Purchase Price Examination Board (an advisory board of the DICJ governor), determined the purchase price for assets from solvent institutions on a case-by-case basis (DICJ 2008; Nanto 2009).

The RCC also sought guidance from supervisory bodies, such as the MOF and the FSA (*Japan Times* 1999b).

When the RCC was established, it purchased assets at a steep discount to prevent the recognition of losses on its portfolio; this decision was driven by the heightened political climate and the government's hesitancy to use taxpayer funding for bank bailouts. By October 2001, the RCC had paid an average of 3.8% of the original book value for the assets it purchased. In certain cases, the RCC would pay ¥1 "when purchasing virtually valueless collateral taken on soured loans," which discouraged banks from asking the RCC to buy their NPLs (*Japan Times* 2001b). Given the discount that the RCC was paying to purchase loans, concerns were raised that banks were not incentivized to sell their NPLs to the RCC. Thus, on January 11, 2002, an amendment to the Financial Revitalization Act was enacted that enabled the RCC to purchase NPLs from "sound financial institutions at 'market value'" (DICJ 2002a). Some critics advocated that the RCC be able to purchase NPLs at book value, but this was ultimately unsuccessful, as the RCC sought to avoid recognizing losses that would ultimately be imposed on taxpayers (*Japan Times* 2002c).

### *Recovery and Disposal*

When the RCC was established, some worried that it would compete with private firms in the debt collection business and crowd them out of the market. However, the president of the RCC stated that the organization would "try to avoid this scenario by specializing in the recovery of loans that 'nobody wants to take,'" such as those connected to organized crime or deemed more difficult to recover (*Japan Times* 1999a). Because of the DICJ's special investigative powers, the RCC was considered to have an edge over the private sector in cases where the loans were considered difficult to recover (Otake 1999b).

During the first years of operations, the RCC had limited disposal options, as its objective was to "solely recover all of its loans, mainly through repayment or collateral selloff" (Otake 1999a). In 2001, the government actively pursued the expansion of the RCC's scope to accelerate the disposal and resolution of NPLs. The RCC received its trust services license in September 2001, which provided "supplementary measures to dispose of NPLs, which private financial institutions cannot handle" (Yanagisawa 2001). The license allowed the RCC to be "entrusted with a portion of the banks' nonperforming loan assets and use them to securitize loans and sell them to investors" (*Japan Times* 2001a). The minister for financial services stated that the "approach is expected to expedite an intensive reduction of NPLs still remaining on banks' balance sheets" (Yanagisawa 2001). In addition, the RCC adopted bulk sales as a disposal method in 2002 (DICJ 2008).

Political and economic pressure to address the NPL problem escalated as its scope was recognized. The prime minister, Junichiro Koizumi, convened a panel to prepare a reform program aimed at fixing the NPL problem. In a speech to the Diet on September 27, 2001, the prime minister announced that "in order to expand the functions of the Resolution and Collection Corporation (RCC), we will introduce more flexibility into the pricing system for nonperforming loan purchase and promote the establishment of a fund for further corporate reconstruction" (Koizumi 2001). The cabinet called for the RCC to establish a headquarters

for corporate restructuring in 2001 “in order to facilitate the rehabilitation of failed companies” (Cabinet Office 2001a). Thus, the RCC’s activities expanded to include corporate restructuring and rehabilitation, which included debt restructuring and rehabilitation planning, as another method to dispose of and manage NPLs. Legal revitalization cases were those where the RCC would utilize legal proceedings to enforce civil rehabilitation and corporate reorganization. With the consent of financial creditors, the RCC worked “to maintain the livelihood of debtors and rebuild/sustain their business by modifying loan terms.” The RCC also used “its trust business functions to support the revitalization of business operators when revitalization cases [were] brought to the RCC by other financial institutions” (RCC 2018).

The minister of the FSA, Heizo Takenaka, also emphasized the importance of resolving the NPL problem. In October 2002, he announced the three-pillared Program for Financial Revival and announced the work schedule in November 2002 (Takenaka 2002). One pillar, the “New Framework for Corporate Revival,” promoted the use of the RCC to dispose of NPLs and encouraged the RCC to engage in corporate restructuring. The Program for Financial Revival reiterated the government’s goal to “normalize the NPLs problem in FY 2004 by reducing major banks’ NPL ratio to about half.” The Program for Financial Revival further encouraged the RCC to develop a market for loans by accelerating loan sales and strengthening its securitization function (FSA 2002).

### Outcomes

By March 31, 2005, the RCC purchased a total of ¥4,004 billion (book value) of NPLs from 192 solvent financial institutions at a purchase price of ¥353 billion, an approximate 91% discount on the book value (DICJ 2005b). (See Figure 2.) As of March 2008, the RCC collected a cumulative ¥642 billion on the recovery of these loans (DICJ 2008).

**Figure 2: Cumulative Total of Assets Purchased from Sound Financial Institutions, as of March 31, 2005**

Institution Type	Number of financial institutions	Principal of claims (¥ billion)	Purchase price (¥ billion)
City banks, long-term credit banks and trust banks	20	2,831.6	287.3
Regional banks	59	572.8	40.4
Regional Banks II	41	434.0	13.7
Shinkin banks and credit cooperatives	72	165.7	11.9
<b>Total</b>	<b>192</b>	<b>4,004.1</b>	<b>353.3</b>

Source: DICJ 2005b.

For the purchase of assets from failed financial institutions, the RCC acquired a total of ¥6,366 billion (purchase price) of NPLs and recovered ¥7,143 billion as of March 31, 2008. The estimated book value of the NPLs purchased from insolvent institutions was ¥29,000

billion.<sup>7</sup> Of the ¥6,366 billion in purchases from failed institutions, the RCC purchased ¥4,576 billion from banks, ¥550 billion from Shinkin banks (regional cooperative institutions), and ¥1,241 billion from credit cooperatives (DICJ 2008). (See Figure 3.)

**Figure 3: Purchase of Assets from Failed Financial Institutions, as of March 31, 2008**

Category	Amount of purchase (¥ billion)	Cumulative amount of recoveries (¥ billion)
Purchase of assets from failed financial institutions	5,186.5	5,496.4
Purchase of assets from banks placed under special public management (the former Long-Term Credit Bank of Japan and the former Nippon Credit Bank)	1,179.8	1,646.4
<b>Total</b>	<b>6,366.3</b>	<b>7,142.8</b>

Source: DICJ 2008.

During the first asset purchase window for solvent banks, the RCC received applications from 39 financial institutions for a total asset purchase of ¥220 billion (Otake 1999b). The DICJ reported that the RCC purchased assets from solvent financial institutions on September 29, 1999 (DICJ 2003). After the first window closed, the president of the RCC announced that he hoped the RCC would eventually buy ¥10 trillion worth of loans and that he was confident more offers would come in the next window (Otake 1999b).

According to the International Monetary Fund (IMF), the RCC had “a minor role in reducing bank NPLs” between its establishment in 1999 and 2002 (IMF 2002). However, with the government’s emphasis on utilizing the RCC as a tool to dispose of NPLs, the RCC began to more aggressively purchase assets. In addition, a 2002 amendment enabled the RCC to purchase NPLs from solvent institutions at market value, making it more attractive for the institutions to sell to the RCC (DICJ 2002a). The minister for financial services in 2002 remarked that “as for [the] selling off of loan assets to the RCC, the sales prices have considerably increased to the fair value. The amount of sales has also begun to demonstrate a sign of increase” (Yanagisawa 2002).

In 2001 and 2002, the methods available to the RCC for the disposal and collection of NPLs expanded. The RCC obtained a trust license to securitize NPLs and began to engage in corporate revitalization in 2001. Bulk sales were adopted as a disposal method in 2002 (DICJ 2008). Soon after receiving its trust license, the RCC issued ¥107.4 billion in securities (Kang 2003). According to the DICJ, the liquidation of receivables (book value) by the RCC totaled ¥8,403 billion by the end of March 2008. The RCC disposed of ¥1,562 billion of assets

<sup>7</sup> It does not appear that the DICJ has disclosed the total book value of assets purchased from failed institutions. Koo and Sasaki (2010) estimate that the average discount was 78% of book value for purchases from failed institutions. Koo and Sasaki use ¥4,885 billion as the total purchase price and estimate that the total book value of acquired assets from failed institutions was ¥22,427 billion. The authors recognize that ¥4,885 billion differs substantially from the ¥6,366 billion reported by the DICJ. In order to arrive at the ¥29,000 billion estimate, we use the estimated discount of 78% on the total purchase of ¥6,366 billion. Therefore, the estimated book value for assets purchased by the RCC from failed institutions was ¥29,000 billion.

through individual sales, ¥617 billion through securitization, and ¥6,224 billion through bulk sales between 1999 and 2007. The securitization function was utilized between 2001 and 2005, and the bulk sales method was adopted in 2002 and became the primary tool for asset disposal (DICJ 2008).

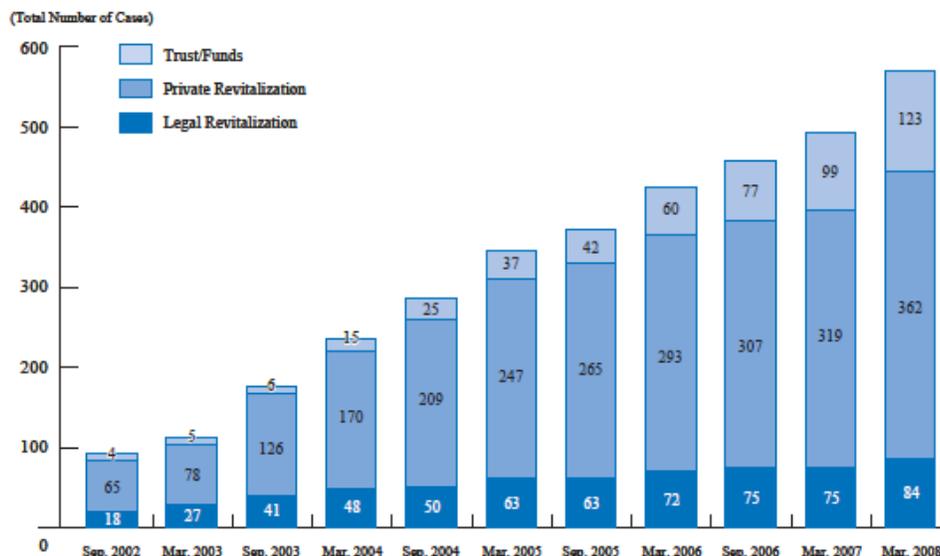
**Figure 4: Liquidation of Receivables (Original Book Value of Claims) by the RCC (in ¥ billion)**

<b>Fiscal Year</b>	<b>1999-2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>Total</b>
Individual Sales	95.5	133.9	220.4	359.2	327.4	167.6	122.8	135.5	1,562.3
Securitization	—	32.3	109.6	341.2	56.4	77.4	—	—	616.7
Bulk Sales	—	—	263.8	361.8	1,322.7	2,445.1	769.6	1,060.9	6,223.9
<b>Total</b>	95.5	166.2	593.8	1,062.2	1,706.4	2,690.1	892.4	1,196.4	8,402.9

*Source: DICJ 2008.*

The RCC utilized its corporate restructuring function to reorganize borrowers behind nonperforming loans. Between November 2001 and March 31, 2008, the RCC was involved in 569 cases of corporate revitalization, which included cases of legal revitalization, private revitalization, and privately funded revitalization (DICJ 2008). (See Figure 5.)

**Figure 5: Accumulated Total Number of Cases of Corporate Revitalization by the RCC between 2002 and 2008**



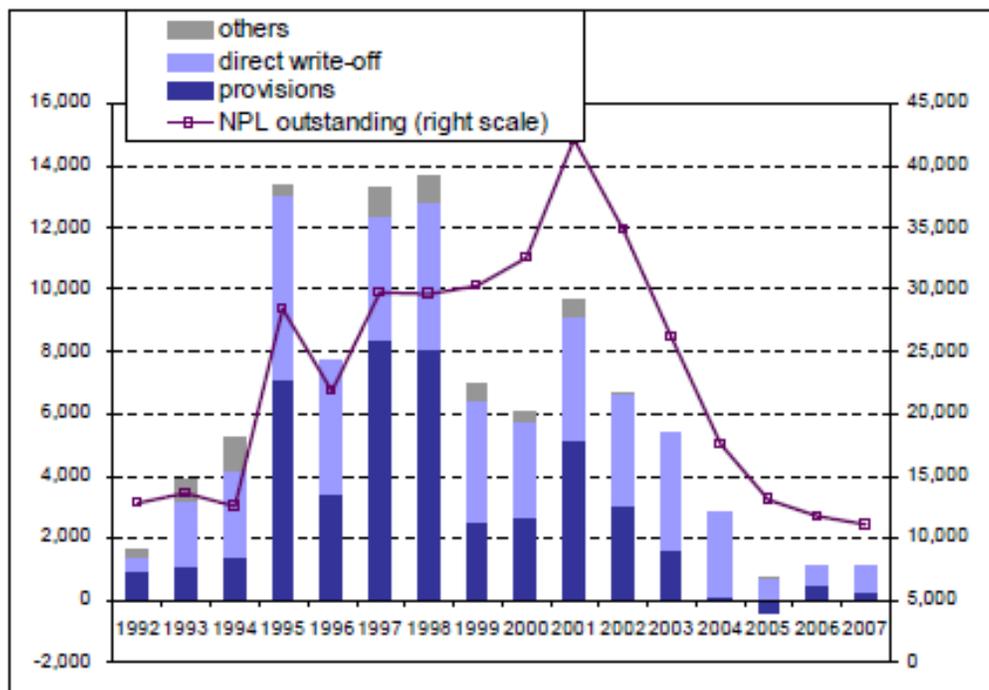
*Note: Trust/funds refers to privately funded recapitalization/restructuring.*

*Source: DICJ 2008.*

By 2012, the RCC had completed the closure of *jusen* accounts (RCC 2018). The residual assets of the *jusen* account, worth ¥11.9 billion, were transferred to the national treasury (DICJ 2013).

In addition, the RCC investigated complaints related to borrowers and lenders. From 1996 to 2008, the RCC investigated 311 cases surrounding auction interference, fraud, extortion, and other misbehaviors. The RCC pursued 124 cases of civil liability by March 31, 2008, for a total amount claimed of ¥125.3 billion (DICJ 2008).

During the first years of the RCC's operations, the full scope of the NPL problem was not fully understood, and the NPL problem accelerated. In 2001, the Cabinet Office noted that the NPL stock continued to increase for two reasons: the NPL definition had been gradually expanded, and the pace at which banks disposed of loans was slower than the pace at which they provisioned new NPLs (Cabinet Office 2001b). Because "[t]he government required the banks that received public capital to increase lending" to businesses exposed to the real estate industry, "a new set of nonperforming loans" was created (Hoshi and Kashyap 2010). The ratio of NPLs to total credit exposure at the major banks peaked in 2001 at 8.7%, after which, outstanding NPLs declined. (See Figure 6.) The peak ratio for regional banks was 8.1% in 2001 (BOJ 2006). The FSA began to conduct inspections of banks and reported the gap between the banks' disclosures and its own assessment; in the first assessment, which evaluated 2000–2001, the FSA found that the gap between the amounts reported by 15 major banks and the FSA's inspection was ¥12.4 trillion (FSA 2003).

**Figure 6: Outstanding NPLs and Losses on Disposal of NPLs (in ¥ billion)**

*Note: Data are for the end of fiscal year. NPLs are “risk management loans” of all banks, whose definition is slightly different from NPLs based on the Financial Revitalization Law. The numbers referred to in the text are based on the Financial Revitalization Law, which became available from March 1999.*

*Source: Fujii and Kawai 2010.*

There were additional policy measures enacted to address the NPL ratio in Japan, such as the continued strengthening of classification and provisioning standards. Capital injections were another key component of the government’s response (Hoshi and Kashyap 2010). The BOJ reported in 2006 that “the ratio of NPLs to total credit exposure of the major banks (12 large nationwide commercial and trust banks) declined significantly to 2.9 percent at the end of fiscal 2004, after they achieved the target set by the government of halving the ratio as of the end of fiscal 2001 within three years. It continued to decline to 1.8 percent at the end of fiscal 2005.” The BOJ reported that the progress made by the regional banks was not as fast as that made by the major banks. The BOJ attributed the slower decline in the ratio of NPLs at regional banks to the “moderate pace of recovery of the local economies in which the regional banks operate, compared with the recovery of the metropolitan areas.” Additionally, the disposal approach taken by regional banks may have been stifled by the “fact that the regional banks tend[ed] to put more focus on maintaining long-term business relationships with borrower firms” (BOJ 2006).

### *Establishment of the IRCJ*

Though the scope of the RCC was expanded in 2001 to include corporate revitalization and restructuring, the Japanese government created another body, the Industrial Revitalization Corporation of Japan (IRCJ), in April 2003, in accordance with the Industrial Revitalization Corporation Law, as a subsidiary of the DICJ (DICJ 2008). The IRCJ was established on “the premise that [it would] complement the RCC.” According to Shinjiro Takagi, the chairman of the IRCJ, the amendment that expanded the RCC’s scope to include corporate restructuring was insufficient, explaining the need for the IRCJ. He framed the two bodies as working in parallel and not in conflict: “the IRCJ and RCC should work together to clean up debt-ridden companies and efficiently rehabilitate as many companies as possible” (Takagi n.d.).

The IRCJ was established to purchase NPLs from non-main bank lenders; the IRCJ then used its status as a creditor to work with the borrower’s main bank to restructure debt or assist with corporate revitalization (Hoshi and Kashyap 2010). The IRCJ was financed by government-guaranteed loans with ¥10 trillion in purchasing power and ¥50 billion in capital (Pohl 2005). The asset purchase window for the IRCJ ended on March 31, 2005, and the IRCJ was given guidance to dispose of or manage assets within three years of the purchase date (Takagi n.d.). The IRCJ could purchase loans at market value while taking the feasibility of the rehabilitation plan into account (IMF 2003). Over its lifespan, the IRCJ spent ¥530 billion to purchase ¥970 billion of debt; at the time of its closure in May 2007 (a year earlier than planned), the IRCJ had restructured 41 borrowers with ¥4 trillion in total debt (Hoshi and Kashyap 2010). The borrowers came from various sectors and industries, and the IRCJ “played a role in bridging the gap between private and legal corporate reorganization under a scheme combined with civil rehabilitation procedures to minimize impairment of business value” (DICJ 2008).

## **II. Key Design Decisions**

### **1. Part of a Package (1): At the time of the RCC’s establishment, the Japanese government also announced a series of reforms and interventions to address the escalating financial crisis, including bank recapitalization.**

Over the course of 1998, the Japanese government passed several laws to address the systemic financial crisis. The Financial Function Stabilization Act, passed in February 1998, made ¥30 trillion available to the government for capital injections and deposit protection (Hoshi and Kashyap 2010). In October 1998, the Diet, the Japanese legislative body, passed the Financial Revitalization Act and replaced the Financial Function Stabilization Act with the Prompt Recapitalization Act (DICJ 2008). The Prompt Recapitalization Act “stipulate[d] a temporary emergency measure regarding capital injection to financial institutions” (DICJ 1999). The Financial Reconstruction Committee was established in 1998 to oversee the bank restructuring process (Kanaya and Woo 2000).

The government approved two rounds of capital injections: the first, under the Financial Function Stabilization Act, in March 1998 (¥1.8 trillion) and the second, under the Prompt

Recapitalization Act, in March 1999 (¥7.5 trillion) (Hoshi and Kashyap 2010). The RCC could purchase preferred shares and subordinated debt from financial institutions as a part of the Prompt Recapitalization Act, though the capital injections were overseen by the Financial Reconstruction Committee.<sup>8</sup>

The Financial Revitalization Act included the principles for the resolution of failed financial institutions (DICJ 1999). As a part of the Financial Revitalization Act, the HLAC and the RCB were merged to create the RCC, which commenced operations on April 1, 1999 (Kanaya and Woo 2000). Concurrently, the government was in the process of nationalizing the Long-Term Credit Bank of Japan and the Nippon Credit Bank (Hoshi and Kashyap 2010).

**2. Part of a Package (2): The government expanded the scope of the RCC to include corporate debt restructuring and corporate revitalization in 2001. The government ultimately established a separate asset management company, the IRCJ, with a similar function in 2003.**

The scope of the RCC was expanded in 2001 to include corporate debt restructuring and revitalization. Prime Minister Koizumi, in a policy speech to the Diet in 2001, stated that the function of the RCC would be expanded and that a fund for further corporate revitalization would be established (Koizumi 2001). The Front-Loaded Reform Program included a measure to reinforce the disposal of NPLs and stated that the RCC would “establish a headquarters for corporate restructuring in order to facilitate rehabilitation of companies” in November 2001 (Cabinet Office 2001a). In 2003, the government established another agency, the Industrial Revitalization Corporation of Japan, which was intended to work with the RCC to address the NPL problem in Japan. The IRCJ was given the purpose of restructuring the bad loans it purchased and assisting with the corporate revitalization of borrowers. The IRCJ had a purchase window of two years and focused on purchasing bad debt from distressed debtor companies that were viable and likely to be successfully rehabilitated (Takagi n.d.).

**3. Legal Authority: The RCC was established via a merger of two semiprivate asset management companies. As a fully owned subsidiary of the Deposit Insurance Corporation, it received its authority in amendments to the Deposit Insurance Act and the Financial Revitalization Act.**

The RCC was a fully owned subsidiary of the Deposit Insurance Corporation of Japan. The function to manage, collect, and dispose of assets from bankrupt institutions was designated to the DICJ in the Deposit Insurance Act; the DICJ was also designated the authority to take action on specified difficult collection claims, including claims tied to organized crime (DICJ 2008; Otake 1999b). The Deposit Insurance Act was amended in 1996 to allow the DICJ to purchase assets from failed institutions as a method to provide funds to failed financial institutions (Koo and Sasaki 2010). The Financial Revitalization Act was enacted in 1998 and established the RCC, from the merger of the RCB and the HLAC, as a subsidiary of the DICJ (DICJ 2008). Before the RCC began operations, the scope of its authority was expanded to

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<sup>8</sup> For more information on the 1998 and 1999 capital injections, see the forthcoming cases on the broad-based capital injections in Japan in the *Journal of Financial Crises*.

include the purchase, management, collection, and disposal of assets from sound financial institutions, which was delegated in the Financial Revitalization Act (Koo and Sasaki 2010). The DICJ designated debt recovery and real estate management and disposal work to the RCC, which performed these activities “on behalf of the DICJ” (DICJ 2003).

Additional legal authority was delegated to the RCC in a variety of measures in the years after its establishment. In 2001, Prime Minister Junichiro Koizumi established a set of structural reform policies, which included corporate restructuring (Koizumi 2001), and the Front-Loaded Reform Program of 2001 stated that the RCC was to establish a corporate revitalization headquarters (Cabinet Office 2001a). The ability to purchase assets from solvent institutions at market value was delegated in an amendment to the Financial Revitalization Act in 2002 (DICJ 2008). Additionally, the RCC was granted a trust services license to engage in securitization and was given the authority to participate in auctions. The Program for Financial Revival, established by the Financial Services Agency and introduced in 2002, further reiterated that the scope of the RCC included corporate restructuring (FSA 2002). Furthermore, amendments to the Financial Revitalization Act in 2001 and 2003 ultimately prolonged the window for asset purchases from solvent institutions to March 31, 2005 (DICJ 2008).

**Figure 7: Timeline of Changes to the Legal Authority for the RCC**

Year	Legal Authority Granted or Extended
1996	<ul style="list-style-type: none"> <li>Revision to the Deposit Insurance Act designating authority to the DICJ to purchase assets from failed institutions</li> </ul>
1998	<ul style="list-style-type: none"> <li>Financial Revitalization Act included the merger of the HLAC and the RCB into RCC</li> <li>Authority granted to investigate difficult claims</li> </ul>
1999	<ul style="list-style-type: none"> <li>RCC began operations and was able to purchase assets from solvent institutions</li> </ul>
2001	<ul style="list-style-type: none"> <li>Front-Loaded Reform Program and amendment to Financial Revitalization Act designated corporate restructuring and revitalization functions to the RCC</li> <li>Extension of deadline for purchase from solvent institutions to March 31, 2004</li> <li>RCC granted trust services license</li> </ul>
2002	<ul style="list-style-type: none"> <li>Amendment to Financial Revitalization Law allowed RCC to purchase assets of solvent institutions at market prices</li> </ul>
2003	<ul style="list-style-type: none"> <li>Extension of deadline for purchase from solvent institutions to March 31, 2005</li> </ul>

*Sources: Compiled from Cabinet Office 2001a and DICJ 2008.*

#### **4. Special Powers: The RCC had special investigative authority for cases considered difficult to recover, specifically those related to organized crime.**

The DICJ supported the RCC in the collection and recovery of assets from “malicious debtors and others” including “obstructed recovery cases involving antisocial forces” (DICJ 2008). Some considered the “antisocial forces,” also known as organized crime or the yakuza, to be a key factor contributing to the size of the NPL problem as well as the slow recovery and disposal of NPLs in Japan. Estimates for the number of loans related to the yakuza varied significantly, with one estimate at 80% and others at 10% or 30% (Holley 1996). Banks and financial institutions made loans to yakuza borrowers, some of which became

nonperforming after the collapse of the real estate asset price bubble. In some cases, the yakuza prevented banks from foreclosing on property and prevented auctions, as the yakuza squatted in empty units and buildings (Sugawara 1995). By 2002, 18% of the loans the RCC had purchased were yakuza-related (Bremner 2002). The National Police Agency backed the RCC to aid with the seizure of property, and the DICJ established Special Investigation Divisions to enhance the recovery of assets. The DICJ “reinforced support for the fair handling of collections in obstructed recovery cases by providing meticulous guidance and advice to the RCC concerning the monitoring and analysis of behaviors of debts in the process of subsequent negotiation on recovery” (DICJ 2008).

**5. Mandate: The Japanese government mandated that the RCC minimize the losses and maximize recovery on acquired NPLs.**

The RCC had the mandate to “accelerate the recovery and collection of non-performing loans transferred from failed [and solvent] financial institutions through a fair and transparent process in order to minimize public costs” (DICJ 2005a). The government later expanded the RCC’s scope and mandate to include corporate restructuring, a trust services license, and the ability to purchase NPLs at market value from solvent financial institutions.

**6. Communication: The Japanese government framed the RCC as a strong lever to resolve the NPL problem, though there was public uncertainty and speculation regarding whether it would be effective.**

With the establishment of the RCC, the government projected confidence in its ability to resolve the NPL problem. The president of the RCC was frequently quoted in press releases and articles in the *Japan Times*. He was seen as a strong leader of the organization (Otake 1999b). When he began to lead the RCC, he stated, “This new job is an urgent and important task since the banks’ blood vessels are clogged with bad loans” (*Japan Times* 1999a). Upon its establishment, the RCC was deemed to “[signal] the birth of a powerful state-backed organ to collect bad loans” (Otake 1999a). During the first purchase window for solvent financial institutions, the president of the RCC recognized that the total was less than anticipated but was confident that future windows would be more fruitful (Otake 1999b).

However, there was a “divergence between the government’s characterization of the condition of the banking industry and that of outsiders” (Hoshi and Kashyap 2010). There were conflicting messages regarding the scope of the NPL problem in Japan, with private estimates, bank estimates, and official estimates varying in the estimated scale of the problem; in fact, the “official estimates of bad loans were regarded as a ‘lower bound’” of the scope of the NPL problem (Tandon 2005). In a further example of the lack of consensus, IMF directors and government officials were not aligned on the urgency of the crisis. IMF analysts urged the government to take decisive and aggressive action given the scale of the crisis (*Japan Times* 1999d). However, the statements released by the government contradicted the IMF—in February 1999, an MOF official stated that the financial crisis would be over within a matter of weeks (Hoshi and Kashyap 2010).

In addition, there was public uncertainty and distrust of the government's reforms and interventions, following the use of taxpayer funding of ¥685 billion for the *jusen* problem in 1996. This assistance was viewed unfavorably by the public, as it reflected the government reneging on its promise not to rely on taxpayer funds to resolve the crisis. After this experience, it became politically unpopular to advocate for programs that would utilize taxpayer funds for bank assistance (Nakaso 2001).

When the government began to expand the scope of the RCC to include corporate restructuring, a trust services license, and the ability to purchase NPLs at market value from solvent financial institutions, the government was presenting a message of confidence in the abilities of the RCC to work toward the objective of resolving the NPL crisis (Yanagisawa 2001). There was public speculation surrounding the RCC's added functionalities, including hope that the RCC would "have the teeth to promote disposal of the banks' huge bad loans, following in the footsteps of the Resolution Trust Corp" (Kishima 2001).

Furthermore, the government began to more aggressively combat the NPL problem in the early 2000s, with leaders making public statements about the need to address the crisis. Prime Minister Junichiro Koizumi actively spoke about the need to resolve the NPL problem, specifically stating that the RCC would be an important lever to do so (Koizumi 2001). Another key figure in addressing the NPL problem was the FSA minister, Heizo Takenaka, who developed the Program for Financial Revival, which set the goal to resolve the NPL problem by FY2004 (FSA 2002). Both Koizumi and Takenaka supported the proactive utilization of the RCC to mitigate the NPL crisis.

The IMF recognized that the FSA, BOJ, DICJ, and RCC all demonstrated "a high degree of transparency" in their operations (IMF 2003). The activities of the RCC were reported by the DICJ. The DICJ explicitly published the names of the failed firms receiving financial assistance in press releases and public statements, but it does not appear to have published the solvent financial institution participants. Press releases regarding failed firms outlined the financial assistance scheme, the book value of the assets transferred to the RCC, and the purchase price for the assets.<sup>9</sup>

## **7. Ownership Structure: The RCC was a fully owned subsidiary of the Deposit Insurance Corporation of Japan.**

The RCC was established via the merger of the Housing Loan Administration Corporation and the Resolution and Collection Bank, both of which were established in the years prior to 1998 to resolve bad debt from specific financial institutions or types of financial institutions. The HLAC was a 100% subsidiary of the DICJ, while the RCB was a 75% subsidiary of the DICJ. An amendment to the Deposit Insurance Act and the Financial Revitalization Act (also referred to as the Financial Function Reconstruction Law), enabled the merger of the two to create the RCC.

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<sup>9</sup> See DICJ n.d. for examples of the financial assistance schemes for failed institutions.

**8. Governance/Administration: The DICJ provided governance and oversight of the operations of the RCC.**

The former president of the HLAC, Kohei Nakabo, became the president of the RCC. The RCC was staffed by the previous HLAC and RCB employees (Otake 1999a). When the RCC was established in April 1999, it had approximately 1,900 employees (Nakaso 2001). According to an analysis of asset management companies published by the Bank for International Settlements, the RCC had “limited” independence in the legal environment and was not granted special legal protection for staff (Fung et al. 2004).

The DICJ oversaw and provided guidance to the RCC, while the FSA and BOJ provided external governance and oversight (Fung et al. 2004). The DICJ provided the RCC “with the guidance and advice necessary to execute its recovery activities; such as uncovering hidden assets by exercising the right to inspect properties” (DICJ 2005a).

**9. Size: The RCC had neither a specified size nor constraints on the amount of NPLs it could purchase.**

There were no restrictions placed on the RCC regarding the total sum of NPLs it could purchase (Fung et al. 2004).

**10. Funding Source: The RCC was fully publicly funded, and it purchased NPLs at a steep discount, making it unlikely that it would recognize losses.**

The government of Japan provided the funding for the RCC. The DICJ issued government-guaranteed bonds and injected the proceeds into the RCC. At the time of its initial operations, the RCC had ¥212 billion in capital (Kang 2003). There was no loss-sharing arrangement for the RCC and selling institutions, as the RCC did not have recourse to the originator banks for the losses incurred when it sold collateral associated with a loan (Hoshi and Kashyap 2004). Because there was strong public sentiment to avoid incurring losses, the RCC purchased assets at a steep discount from book value—on average a 78% discount from failed institutions and a 91% discount from healthy institutions—making it unlikely that the RCC would recognize losses on the sale or collection of assets (Koo and Sasaki 2010; Nakaso 2001).

**11. Eligible Institutions: The RCC was able to purchase assets from both solvent and insolvent banks and certain nonbank financial institutions.**

According to Article 53 of the Financial Revitalization Act, the eligible institutions included: managed financial institutions, agreement successor banks, and special public management banks (Law No. 132 1998). The definition of “financial institution,” as presented in the Deposit Insurance Act, included major, regional, and city banks as well as credit unions and credit cooperatives (DIA 1971). Other eligible financial institutions included bridge banks, the Federation of Agricultural Cooperative Associations, and the Federation of Fisheries Cooperative Associations (DICJ 1998). Special public management banks refer to banks such as the Long-Term Credit Bank and Nippon Credit Bank, which were temporarily nationalized banks (Law No. 132 1998).

**12. Eligible Assets: The RCC could purchase nonperforming loans from eligible institutions.**

The types of assets that the RCC could purchase from solvent institutions included loans, suspense payments, interest receivables, and accounts receivables for borrowers classified as “bankrupt, de facto bankrupt or in danger of bankruptcy” (DICJ 2002a). Loans that were ineligible included loans to public welfare corporations, loans with disputed claims, loans to borrowers undergoing reorganization, loans to nonresidents, and loans for overseas real estate (DICJ 1999).

For the transfer of assets in the case of a failed institution, the assets eligible for purchase were the assets considered unsuitable for the bridge bank or banks under special management to hold (DICJ 1999).

**13. Acquisition – Mechanics (1): The RCC acquired NPLs from insolvent financial institutions under the scope of the DICJ’s financial assistance operations.**

The RCC was engaged as needed for insolvent financial institutions, as the DICJ was involved in overseeing the financial assistance process. In the case of a failed financial institution, the DICJ, FSA, and courts were involved in overseeing and managing the resolution process. The FSA appointed a financial administrator; if no assuming institution was found, the FSA found a bridge bank. The failed institution and assuming institution(s) submitted an application to the DICJ for assistance, and the DICJ determined whether to provide assistance. The financial assistance could take “the form of a monetary grant, loan or deposit of funds, purchase of assets, guarantee of liabilities, assumption of financial obligations, subscription of preferred shares, etc. or loss sharing.” If there was an assuming financial institution, the assets that the assuming bank did not want were transferred to the RCC. The purchase of assets would be agreed upon by the failed institution, the assuming financial institution(s) or bridge bank, the RCC, the DICJ, and the FSA (DICJ 2008).

**14. Acquisition – Mechanics (2): The RCC purchased NPLs from solvent financial institutions after the interested banks submitted applications during the purchase window.**

For the purchase of assets from solvent financial institutions, the RCC announced the first application window when it began its operations; the application window was from June 22 to July 9, 1999 (*Japan Times* 1999c). The application window for solvent institutions “as a rule [took] place four times a year,” but the RCC was also able to consult with individual financial institutions on the purchase window if requested (DICJ 2003). After receiving applications, the RCC evaluated the applications from interested banks and offered a price to the banks; the DICJ provided guidance on the offer price. If interested, the banks then submitted a formal application to initiate the sale and would work with the RCC to coordinate the purchase (*Japan Times* 1999c). The window for sales was initially set to expire in 2001 but was ultimately extended to March 31, 2005 (DICJ 2008).

**15. Acquisition – Pricing: It was not clear how the RCC determined transfer price during its first years of operations; an amendment in 2002 enabled the RCC to purchase assets at market value.**

The RCC determined the purchase price for NPLs on a case-by-case basis with guidance from the DICJ and the Purchase Price Examination Board (an advisory body) (Nanto 2009). The Purchase Price Examination Board was an advisory body of the DICJ governor (DICJ 2008). The Purchase Price Examination Board originally had three members, but it was expanded in 2002 to have five members (DICJ 2003). The RCC did not have recourse to the financial institutions selling the loans; thus, the RCC established a process to ensure the price “reflected fair value” (Packer 2000). The determination of the purchase price was to “[take] into consideration the risk of assets becoming uncollectable and the administrative expenses required for purchase and collection of the assets in question” (DICJ 1999). The RCC established a multistage process for pricing the NPLs in which a real estate appraiser submitted a valuation of the property, and the RCC, FRC, and DICJ reviewed and approved the valuation (Packer 2000). In addition, the RCC sought guidance from the MOF and FSA in determining purchase price (*Japan Times* 1999b). The purchase price also required approval from the prime minister, though the Financial Reconstruction Commission granted approval until January 2001 (DICJ 2008). In the first years of operations, the RCC purchased loans at a steep discount, paying an average of 3.8% of the original book value (*Japan Times* 2001b).

The steep discount the RCC paid for loans was considered to be a deterrent to healthy banks interested in selling their NPLs. In a Cabinet Report in 2001, the government recognized that the NPL problem was worsening and stated that “[t]he government will also make the price-setting formula more flexible in order to facilitate purchases of nonperforming loans by the Deposit Insurance Corporation of Japan and the RCC” (Cabinet Office 2001b). Given the increasing pressure to resolve the NPL problem, the government passed an amendment to the Financial Revitalization Act, effective January 2002, which allowed the RCC to purchase NPLs from “sound financial institutions at ‘market value’” (DICJ 2002a). However, some critics believed that this was not enough and advocated that the RCC should purchase loans at book value (*Japan Times* 2002a; 2002b). A cross-party coalition was established to study the proposal, and after analysis, the RCC president announced that he did not support the plan, as the RCC sought to avoid recognizing losses that would ultimately be transferred to taxpayers (*Japan Times* 2002c). As another measure to promote flexibility in purchase price, the RCC was given the ability to bid in NPL auctions in 2001 (IMF 2002). Between 1999 and 2005, the RCC’s purchase price of NPLs from solvent institutions was an average of 9% of book value (DICJ 2005b). According to an estimate, the RCC purchased assets from insolvent institutions at an average of 22% of book value (Koo and Sasaki 2010).

**16. Management and Disposal (1): The RCC initially disposed of loans through sales and collections of NPLs. The tools available to the RCC for asset recovery and disposal were diversified in 2001 and 2002.**

The RCC ultimately utilized the following methods for disposal of NPLs: collection, sales, securitization, and/or operational and financial restructuring. In its first years of operations, the RCC was limited in disposal methods, and the RCC was slow to dispose of assets (IMF

2002). The RCC received its trust license to securitize nonperforming assets in 2001, after which it began issuing asset-backed securities (Kang 2003). The Program for Financial Revival called for the RCC to accelerate the sales and collections of loans, which led the RCC announce its “Basic Policy Concerning the Liquidation and Securitization of Assets Held by the RCC,” under which the RCC would “more actively” consider sales and securitization when the methods were economically rational and advantageous. “The RCC adopted a method to sell multiple claims in bulk (bulk sales) through bidding at the end of FY2002” (DICJ 2008). Due to the expanded disposal options, the RCC was more aggressive in its disposal of NPLs between 2001 and 2008; its total balance of debt decreased from ¥5.8 trillion to ¥1.1 trillion (Hoshi and Kashyap 2010).

**17. Management and Disposal (2): As another method to resolve and recover bad debt, the RCC was entrusted with a corporate revitalization and restructuring function in 2001.**

The corporate restructuring function was delegated to the RCC in 2001 through an amendment to the Financial Revitalization Act and the Cabinet Office’s Front-Loaded Reform Program. The Front-Loaded Reform Program called for the RCC to establish a headquarters for financial revival (Cabinet Office 2001a). The RCC began operations related to corporate restructuring in November 2001. The RCC established the Corporate Revitalization Study Committee as an advisory body with the purpose of evaluating the feasibility of each revitalization case (DICJ 2008). The corporate restructuring function was strongly encouraged in the FSA’s Program for Financial Revival in 2002 as well (FSA 2002). Corporate revitalization could take multiple forms: the RCC was involved in legal revitalization in which it utilized legal proceedings to enforce rehabilitation, and it was involved in cases of private revitalization that involved debt or business restructuring with the consent of other creditors (DICJ 2008). The RCC used its trust license to support the revitalization of firms for which a revitalization case was submitted to the RCC by a different financial institution. The RCC evaluated cases based on the following criteria: the continuation value of the business, the willingness of the firm to make repayments, disclosure transparency, and the economic rationality for the creditor (RCC 2018). Between November 2001 and March 31, 2008, the RCC assisted with 569 cases of revitalization (DICJ 2008). Overall, the RCC assisted with the restructuring of ¥6.2 trillion in debt (Hoshi and Kashyap 2010).

**18. Timeframe: The RCC did not have a sunset date for purchases from failed institutions. The deadline to purchase from solvent institutions was initially March 31, 2001, but it was ultimately extended to March 31, 2005; the RCC continues to operate as of the writing of this case study.**

There was no official sunset date for the RCC, as the RCC continues to operate (with new capabilities and authority) to the present date (Fung et al. 2004; RCC 2018). The deadline for the purchase of NPLs from solvent institutions was initially set for March 31, 2001, and was later extended to March 31, 2005 (DICJ 2008).

### III. Evaluation

The definition of nonperforming loans in Japan was initially inadequate, and provisioning standards were lax. Both of these factors contributed to a slow recovery and a difficult environment to resolve NPLs. The authorities gradually revised the regulatory frameworks, but the “lack of adequate provisioning and public disclosure obscured the actual status of the NPLs problem in the financial system and delayed the introduction of much needed comprehensive action” (Nakaso 2001).

In postcrisis analysis, some scholars have argued that the purchase price for NPLs from the solvent banks was too low, which disincentivized these banks from selling to the RCC. Proponents of this argument state that the usage of the RCC was limited as it “[offered] unattractive pricing to banks for the acquisition of NPLs ... owing to political reluctance to recognize financial loss” (Fung et al. 2004). The move to allow the RCC to purchase NPLs at market value was seen as a step in the right direction to accelerate the disposal of bad loans. Takeo Hoshi and Anil Kashyap argue that the RCC case illustrates that asset purchase programs are not sufficient to address bank solvency problems (Hoshi and Kashyap 2010). According to an estimate from Richard Koo and Masaya Sasaki, the RCC was able to buy bad assets at a 78% discount to book value from failed institutions and a 91% discount to book value from healthy institutions. In addition, their analysis shows that the “total value of assets purchased by the [RCC from solvent institutions] was an order of magnitude lower than that of assets purchased from failed institutions” which is “a reminder of how difficult it is to remove assets on which large losses must be booked from the balance sheets of healthy institutions” (Koo and Sasaki 2010).

Others have argued that the RCC was not aggressive enough in its purchase and disposal of NPLs and that the RCC should have set performance and time-bound targets for disposal of assets (Kang 2003). Hoshi and Kashyap argue that the RCC was slow in selling off the loans it purchased and essentially operated as a warehouse for bad loans in the initial years of operations (Hoshi and Kashyap 2010). By 2002, the RCC had “played only a minor role in reducing bank NPLs, having so far purchased only ¥1.3 trillion in distressed assets (face value) at an average discount of 96 percent” (IMF 2002). Before 2001, the RCC could only collect or sell individual loans; after 2001, the RCC was able to securitize NPLs, assist with debt restructuring, and utilize bulk sales to dispose of loans. Due to the expanded disposal options, the RCC was more aggressive in its disposal of NPLs between 2001 and 2008; the total balance of debt decreased from ¥5.8 trillion to ¥1.1 trillion, and the RCC disposed of many assets for more than the purchase price (Hoshi and Kashyap 2010).

Other scholars argue that the RCC was valuable as it provided the opportunity for banks to remove NPLs from their portfolios in the absence of demand in the market (Fujii and Kawai 2010). By March 2005, the RCC had purchased ¥4,004 billion of NPLs (book value) from solvent institutions for a purchase price of ¥353 billion, and the cumulative amount of recoveries as of 2008 was ¥642 billion, with no additional purchases made (DICJ 2005b; 2008). The RCC purchased a total of ¥6,366 billion in NPLs from failed institutions and had collected ¥7,143 billion by March 2008 (DICJ 2008).

When the RCC was enabled to engage in corporate restructuring, there was criticism that the RCC lacked the expertise, bandwidth, and resources necessary to effectively restructure corporate debt. Some argued that the RCC “should focus on asset disposal and leave the lead role in corporate restructuring to the private sector” (Kang 2003). With the establishment of the IRCJ, some were concerned that there was no “clear-cut” delineation between the functions of the two bodies; Nicole Pohl argues that there were elements of “competition” between the two (Pohl 2005). Hoshi and Kashyap argue that “the division of labor between the RCC and IRCJ [was] not as clear as it is often discussed. However, the RCC was “ultimately involved” in restructuring ¥6.2 trillion in bad debts for 577 borrowers. The authors recognize that by assisting with corporate rehabilitation, the RCC began to address the underlying cause of the NPL problem in Japan (Hoshi and Kashyap 2010).

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## V. Key Program Documents

### Summary of Program

#### Assets Purchased from Sound Financial Institutions (DICJ 2005b)

*A summary of the RCC’s operations and purchases of assets from solvent institutions.*

<https://ypfs.som.yale.edu/library/document/assets-purchased-sound-financial-institutions>.

#### Program for Financial Revival—Revival of the Japanese Economy through Resolving Non-Performing Loans Problems of Major Banks (FSA 2002)

*A summary of the government’s financial sector reform program targeting the resolution of NPLs in 2002.*

<https://ypfs.som.yale.edu/library/document/program-financial-revival>.

#### Summary of the ‘Front-Loaded Reform Program’ (Cabinet Office 2001a)

*A summary of the government’s financial sector reform program in 2001.*

<https://ypfs.som.yale.edu/library/document/summary-front-loaded-reform-program>.

### Implementation Documents

#### Purchase Price of Sound Institutions’ Assets under Article 53 of the Financial Revitalization Law (DICJ 2002a)

*A document outlining the RCC’s purchase price methodology for assets from solvent financial institutions.*

<https://ypfs.som.yale.edu/library/document/purchase-price-sound-institutions-assets-under-article-53-financial-revitalization>.

### Legal/Regulatory Guidance

#### Deposit Insurance Act of Japan (DIA 1971)

*The law establishing the deposit insurance system in Japan that outlines the DICJ’s authority.*

<https://ypfs.som.yale.edu/library/document/deposit-insurance-act-japan>.

#### Law No. 132: Act on the Emergency Measures for Rehabilitation of Financial Functions (Law No. 132 1998)

*The statute passed in Japan in response to the escalating financial crisis.*

<https://ypfs.som.yale.edu/library/document/law-no-132-act-emergency-measures-rehabilitation-financial-functions>

### **Press Releases/Announcements**

[Foundation of the Industrial Revitalization Corporation in Japan \(Takagi n.d.\)](#)

*A document outlining the IRCJ in Japan from the leader of the agency.*

<https://ypfs.som.yale.edu/library/document/foundation-industrial-revitalization-corporation-japan>.

[Japanese Financial Sector: Progress and Prospect \(Yanagisawa 2002\)](#)

*A speech on the progress of the financial sector restructuring from an official in the FSA.*

<https://ypfs.som.yale.edu/library/document/japanese-financial-sector-progress-and>.

[Japan's Financial Sector Reform: Progress and Challenges \(Yanagisawa 2001\)](#)

*A speech on the progress of the financial sector restructuring from an official in the FSA.*

<https://ypfs.som.yale.edu/library/document/japans-financial-sector-reform-progress-and-challenges>.

[Policy Speech by Prime Minister Junichiro Koizumi to the 153rd Session of the Diet \(Koizumi 2001\)](#)

*A speech from the prime minister that covers financial sector restructuring and support.*

<https://ypfs.som.yale.edu/library/document/policy-speech-prime-minister-junichiro-koizumi-153rd-session-diet-provisional>.

[Statement by Heizo Takenaka, Minister for Financial Services \(Takenaka 2002\)](#)

*A speech from the minister for financial services outlining the government's financial system restructuring.*

<https://ypfs.som.yale.edu/library/document/statement-heizo-takenaka-minister-financial-services>.

[The Gap between Major Banks' Self-Assessment and the Result of FSA's Inspections \(FSA 2003\)](#)

*A press release announcing the discrepancies between banks' self-assessments and the FSA's assessments.*

<https://ypfs.som.yale.edu/library/document/gap-between-major-banks-self-assessment-and-result-fsas-inspections>.

### **Media Stories**

[Bank Restructuring Falls Short: IMF \(Japan Times 1999d\)](#)

*An article in the Japan Times summarizing an IMF report on the insufficiency of the financial system restructuring to date.*

<https://ypfs.som.yale.edu/library/document/bank-restructuring-falls-short-imf>.

[Coalition Finalized Bill Adding to RCC's Powers to Clear Loans \(Japan Times 2001b\)](#)

*An article in the Japan Times describing legal progress in expanding the RCC's abilities.*

<https://ypfs.som.yale.edu/library/document/coalition-finalized-bill-adding-rccs-powers-clear-loans>.

Coalition to Study Book-Value Buys by RCC (Japan Times 2002b)

*An article in the Japan Times describing the proposal to allow the RCC to buy assets at book value.*

<https://ypfs.som.yale.edu/library/document/coalition-study-book-value-buys-rcc>.

Debt Collector Handed License to Speed Up Bad-Loan Disposal (Japan Times 2001a)

*An article in the Japan Times outlining the RCC's additional legal authority.*

<https://ypfs.som.yale.edu/library/document/debt-collector-handed-license-speed-bad-loan-disposal>.

Debt Collector Starts Operation (Japan Times 1999a)

*An article in the Japan Times announcing the RCC's operational launch.*

<https://ypfs.som.yale.edu/library/document/debt-collector-starts-operation>.

Gangsters Aggravating Japanese Banking Crisis (Sugawara 1995)

*An article in the Washington Post describing the impact of organized crime on the bad loan and banking problems.*

<https://ypfs.som.yale.edu/library/document/gangsters-aggravating-japanese-banking-crisis>.

HLAC, RCB merger Creates New Collection Agency (Otake 1999a)

*An article in the Japan Times announcing the merger of the RCB and HLAC into the RCC.*

<https://ypfs.som.yale.edu/library/document/hlac-rcb-merger-creates-new-collection-agency>.

Japan Mob Muddies Real Estate Loan Crisis (Holley 1996)

*An article in the Los Angeles Times that describes the influence of organized crime on the NPL problem, specifically the real estate loan crisis.*

<https://ypfs.som.yale.edu/library/document/japan-mob-muddies-real-estate-loan-crisis>.

'Jusen' Loan-Recovery Body Established (Japan Times 1996)

*An article in the Japan Times announcing the establishment of the HLAC and its objective to resolve and manage debt from the 'jusen' companies.*

<https://ypfs.som.yale.edu/library/document/jusen-loan-recovery-body-established>.

Pile of Bad, Yakuza-Tied Debts Awaits New President of RCC (Otake 1999b)

*An article from the Japan Times describing the challenges facing the RCC upon its launch.*

<https://ypfs.som.yale.edu/library/document/pile-bad-yakuza-tied-debts-awaits-new-president-rcc>.

RCC Chief Airs Concern over 'Secondary Losses' (Japan Times 2002c)

*An article in the Japan Times describing concerns about losses on assets and pricing.*

<https://ypfs.som.yale.edu/library/document/rcc-chief-air-concern-over-secondary-losses>.

RCC Plans Bad Loan Buys from June (Japan Times 1999b)

*An article describing the RCC's expected launch.*

<https://ypfs.som.yale.edu/library/document/rcc-plans-bad-loan-buys-june>.

RCC Should Buy Bad Loans at Book Value: Yamasaki (Japan Times 2002a)

*An article describing an argument that the RCC should be able to buy assets at book value.*

<https://ypfs.som.yale.edu/library/document/rcc-should-buy-bad-loans-book-value-yamasaki>.

RCC to Buy Risky Loans (Japan Times 1999c)

*An article announcing the RCC's launch and purchase of bad loans.*

<https://ypfs.som.yale.edu/library/document/rcc-buy-risky-loans>.

RCC's Revamp Offers Hope against NPLs (Kishima 2001)

*An article in the Japan Times describing the RCC's new legal authority and activities and the expectations around its expanded capabilities.*

<https://ypfs.som.yale.edu/library/document/rccs-revamp-offers-hope-against-npls>.

The Yakuza: Bad Debts, Bad Men (Bremner 2002)

*An article in Bloomberg outlining the challenges posed by organized crime in resolving bad debt in Japan.*

<https://ypfs.som.yale.edu/library/document/yakuza-bad-debts-bad-men>.

## **Key Academic Papers**

Industrial Revitalization in Japan: The Role of the Government vs the Market (Pohl 2005)

*A paper describing the IRJC's operations and its impact on corporate restructuring in Japan.*

<https://ypfs.som.yale.edu/library/document/industrial-revitalization-japan-role-government-vs-market>.

Japan: Regulatory Development of the Banking Resolution Regime (Hayashi 2015)

*An overview of the evolution of Japan's bank and financial system restructuring authority.*

<https://ypfs.som.yale.edu/library/chapter-21-japan-regulatory-development-banking-resolution-regime>.

Japan's Disposal of Bad Loans: Failure or Success? (Koo and Sasaki 2010)

*An analysis of Japan's response to the financial crisis and NPL problem.*

<https://ypfs.som.yale.edu/library/document/japans-disposal-bad-loans-failure-or-success>.

Japan's Financial Problems (Lincoln 1998)

*A paper describing the origin and escalation of financial sector problems in Japan.*

<https://ypfs.som.yale.edu/library/document/japans-financial-problems>.

Lessons from Japan's Banking Crisis, 1991–2005 (Fujii and Kawai 2010)

*An academic paper outlining key lessons learned from the Japanese response to the financial*

*crisis of the 1990s.*

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