

Maximising Value of Non-Performing Assets

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Japan

Inauguration and First Stage of the Industrial Revitalisation Corporation of Japan

by

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The Japanese economy has been in a slump for 13 years. To spur its economic recovery, Japan has enacted a series of legislation meant to rehabilitate struggling companies, such as the Financial Revitalisation Law, the Industrial Revitalisation Law, the Civil Rehabilitation Law, the Corporate Reorganisation Reform Law, the Special Law for Reorganisation of Financial Institutions and laws for the Recognition and Assistance of Foreign Insolvency Proceedings. In addition, the Guidelines for Multi-Creditors Out of Court Workout were established, referring to the International Federation of Insolvency Professionals' (INSOL) eight Principles. Now Japan boasts one of the most extensive legal systems for corporate rehabilitation in the world. Nevertheless, the country is still in a long and intractable recession. Under these circumstances, the Industrial Revitalisation Corporation of Japan (IRCJ) was established in May 2003 as one of the last resorts to recover Japanese economic prosperity.

1) Outline of the IRCJ as defined in the Basic Policy

The Comprehensive Measures to Accelerate Reforms proposed that the IRCJ be established as a key part of a plan to aggressively rehabilitate companies and industries, and accelerate non-performing loan (NPL) disposal with the aim of cutting NPLs by half within two years. The Basic Policy (BP) was adopted on this basis, and defines the IRCJ and its operational policies as follows:

- a) The IRCJ will act as a neutral intermediary in helping companies with excessive debt reorganise themselves when the company is viable but conflicts of interests prevent the company and creditors from agreeing on a rehabilitation plan.
- b) The IRCJ will intercede in matters that should be resolved by private entities. Therefore, the IRCJ should utilise private initiative as much as possible, promote the development and expansion of loan credit markets and securitisation, and foster a market for corporate recovery funds.
- c) The IRCJ shall not attempt to prolong a hopeless company's life. It will help regroup industries with overcapacity in co-operation with governing ministries and agencies and by using the amended Industrial Revitalisation Law if necessary.
- d) The IRCJ will be financed by government-guaranteed loans. It will be incorporated as a joint-stock company, allowing the government's involvement in setting criteria for financial support and choosing executive directors.
- e) The IRCJ will give support to companies classified as "borrowers requiring attention" (including "special attention" and "doubtful" debtors considered capable of rehabilitation). The IRCJ will purchase the loan obligations from the debtor's non-main banks and draw up a reorganisation plan in co-operation with the main bank and the debtor company if the IRCJ

¹ This report was written before the author's appointment as a chair of the IRC Commission in early May 2003. It reflects his personal views only, and is in no way intended as the official view of the IRCJ.

determines that more loans can be collected by reorganising the company than by liquidating it and the reorganisation plan agreed on by the main bank and the debtor company is considered feasible.

- f) In preparing a reorganisation plan, the IRCJ will ask for assistance from private sector experts in corporate restructuring. It will also use statutory procedures for corporate rehabilitation such as the Civil Rehabilitation Law and Corporate Reorganisation Law.
- g) Debt-to-equity swaps and DIP financing by government-affiliated financial institutions will be used. The IRCJ will be able to give additional loans, inject capital, form trusts and give guarantees to reorganising and reorganised corporations.
- h) The IRCJ will concentrate its purchase of NPLs in the first two years and sell the purchased NPLs and equities acquired via debt-to-equity swap within its five-year life span. In doing so, the IRCJ will strive to minimise the secondary losses taxpayers will ultimately bear.
- i) The IRCJ will set fair and transparent standards for the NPLs it purchases. NPLs will be purchased at a market value deemed fair, paying due consideration to the reorganisation plan. No NPLs should be purchased or sold without approval of the IRC Commission.
- j) A reorganisation plan must be completed within three years and include measures to improve the balance sheet and profitability of a debtor company so that the debtor company will be able to be re-financed by itself and the IRCJ will be able to sell the loans it purchased. In principle, a plan must set targets that meet the standards stipulated in the Industrial Revitalisation Law—standards of productivity enhancement and balance sheet restoration that are described below—for the debtor company to be approved for rehabilitation under the IRCJ scheme. The Industrial Revitalisation Law is to be amended concurrently with the adoption of the IRCJ Law. The IRCJ will apply criteria that are flexible, and be ready to make exceptions if the Commission believes there is good reason to do so.
- k) A reorganisation plan must include measures that enable a debtor company to achieve at least one of the following goals related to productivity improvement at the end of the planned three-year period or less:
 - 1. An increase in return on equity (ROE) of more than 2% (if a corporate recovery fund or other company buys the debtor company for the purpose of reorganising it, cash flow—adjusted return on assets (ROA)—must increase by more than 2%.)
 - 2. An increase in turnover ratio of tangible assets exceeding 5%.
 - 3. An increase in added value per employee exceeding 6%.
- l) Similarly, a reorganisation plan must include measures aimed at achieving all of the following targets of financial health by the end of the three-year period or less:
 - 1. Interest-bearing debt ten times less than the annual cash flow.
 - 2. Ordinary income that exceeds ordinary expenses.

2) *The IRCJ Law and the operations overview*

The IRCJ Law provides insight into the workings of the IRCJ. The main points can be summarised as follows:

- a) The IRCJ helps individual businesses with viable resources but excessive debt to reorganise by purchasing this debt from financial institutions, thereby ensuring that a healthy financial system is maintained through industrial revitalisation and bad-loan disposal.
- b) The IRCJ is a business corporation (K.K.) established by approval from the authorising ministers, which in this case are the prime minister, finance minister, and ministers of economy, trade and industry. These ministers must approve the IRCJ's executive appointments, budget plans, and financing (guaranteed by the government). They may use their supervisory positions to issue administrative orders requesting reports and inspections of the IRCJ's operations.
- c) The Industrial Revitalisation Commission (with a membership not to exceed seven and including three or more directors, two of whom must be a representative director and external director) determines whether to extend revitalisation support and makes decisions regarding the purchase and disposal of loans. Once a decision has been reached, the commission consults with the authorising ministers whereupon the ministers administering the relevant industries might make recommendations in light of the extent of the industry's overcapacity and relevant matters. The decision to extend support and purchase loans must meet the publicly disclosed criteria for support.
- d) Companies will apply for reorganisation support by submitting a business reorganisation plan to the IRCJ with their financial institutions (in general, the main bank or banks). Based on the Commission's conclusion, the IRCJ will move quickly to decide whether to support those plans deemed to have a high chance of success. Non-main banks and other financial institutions should decide whether to sell loan claims to the IRCJ (including loan trusts) or accede to the business reorganisation plan within the designated period of up to three months, and the IRCJ will generally request that these banks temporarily stay on debt collection during this period.
- e) The IRCJ will purchase the loans when these financial institutions request the purchase, or when the total sum of loans held by the financial institutions agreeing to the reorganisation plan meets the sum necessary for revitalisation (in the event that most financial institutions agreed to the purchase or agreed to the reorganisation plan). The purchase price will be the appropriate market value decided by the IRC Commission paying due consideration to the feasibility of the reorganisation plan. The decision to provide support will be retracted if revitalisation is not feasible due to the exclusion of financial institutions that do not apply for debt purchase or of financial institutions that hold large amounts of debt but do not agree to the reorganisation plan, thus preventing the plan from reaching the necessary debt sum.
- f) If financial institutions provide financing to the targeted company from the time the IRCJ decides to provide support to the time it decides to purchase debt, the super-priority claim of the DIP lender is noted in the reorganisation plan, and the financial institution can request that the IRCJ acknowledge the necessity and super-priority claim of this DIP financing. The company may start proceedings for civil rehabilitation or corporate reorganisation at a later point (before the IRCJ disposes of the purchased debt). Any unpaid DIP loans should be given priority in the reorganisation plans, which would be approved in the subsequent

rehabilitation or reorganisation proceeding. The courts may determine whether the authorisation would go against the equitable treatment of creditors, but the courts must keep in mind that: 1) the IRCJ has given their approval to the claim; and 2) financial institutions forgave loans according to the terms of the reorganisation plan formed in former IRCJ proceeding, so the super-priority claims of DIP lenders will not hurt other creditors. (This has set a precedent for the preferential treatment given to the claims of DIP lenders established before the debt transfer in subsequent statutory reorganisation procedures.)

- g) The IRCJ can support the revitalisation of a company whose debt it has purchased by providing financing, guarantees and capital. It can also review and adjust company operations, provide advice and conduct any other necessary task.
- h) The last date for debt purchase is 31 March 2005, and the IRCJ must attempt to transfer or dispose of all purchased debt and/or converted stocks within three years of the purchase decision date. The IRCJ can raise funds by borrowing through government guarantees, and the government will compensate for losses to be incurred by IRCJ's negative net worth at its liquidation.

3) *Practice of the IRCJ*

The sections of the IRCJ law pertaining to the IRCJ's administrative responsibilities could have been drafted in reference to part of the Guidelines for Multi-Creditors Out of Court Workout. Referring to these guidelines, the IRCJ's actual responsibilities can be summarised as follows:

- a) Companies that are struggling due to excessive debt can draft a reorganisation plan with their main bank(s). The company and bank staff will develop this plan with help or backing from certified public accountants and restructuring advisers. The reorganisation plan will encompass both financial and business reorganisation, the first achieved by using debt forgiveness and debt-equity swaps to cut interest-bearing debt and increase/decrease capital, and the latter by closing and cutting unprofitable businesses in peripheral divisions, strengthening profitable core divisions, and even splitting up the company, using mergers and affiliations and business transfers. Preparing the draft plan takes from two to three months, and more than 20 staff—including bank and company staff and external specialists—work on the plan. Financial advisers provide help, and the staff looks for candidates for sponsors and corporate recovery funds.
- b) The main bank and the company hold preliminary discussions with the IRCJ's professional office. The office uses external sources such as restructuring advisers, and follows the advice of members in the IRC Commission as necessary, in reviewing the accuracy of the financial data and the draft's validity, feasibility and economic rationale. Revisions are made as necessary, and the office calls on the advice of certified public accountants, tax accountants, and lawyers as necessary. The office also performs a due diligence process to set the appropriate market value for the debt purchase price. This process requires about 20 staff and a two-month period.
- c) Once a reorganisation plan with high feasibility is completed, the company and its main bank(s) officially apply to the IRCJ for aid. After consulting with the relevant ministers, the IRC Commission makes a decision without delay on whether to offer revitalisation support. Based on this decision, the IRCJ makes its own decision on support, and distributes the plan to the non-main banks, requesting a temporary stay on collections. The IRCJ also asks that the banks decide within a maximum of three months between two choices: whether to apply for debt purchase or to agree to the reorganisation plan. The detailed reports prepared by the

restructuring advisers and specialists will be used by the relevant ministers in their consultation, and by the commission in making their decision, regarding the prospects for the company's successful revitalisation. In other words, a great deal of preparatory work is done out of sight during the period from the prior consultations mentioned to the application for revitalisation support. Most plans that do not seem likely to be successful, despite revisions made at the review stage, probably never make it to the official application stage. The IRCJ does not publicly release information on plans that make it to the application stage and are not accepted.

- d) With the exception of a few creditors that can be excluded without impeding revitalisation, the IRCJ purchases the debt when the non-main banks apply for debt purchase or agree to the reorganisation plan. The IRCJ withdraws from the decision process if it does not gain the cooperation of the necessary financial institutions, and in this case, the companies are likely to go through statutory reorganisation procedures. The IRCJ sells the purchased debt within three years of purchase, and during this time, it monitors the progress of the plan with the main bank. Any breakdown in the revitalisation process will likely result in transfer to statutory reorganisation procedures.

4) *Impact of the IRCJ on revitalising businesses*

The IRCJ's objective is to help reorganise individual companies—a role normally left to the private sector to conduct on its own initiative. However, practical experience in establishing and administering the Guidelines for Multi-Creditors Out of Court Workout has shown the necessity of the semi-private, semi-governmental IRCJ's involvement in reducing the interest-bearing debt of companies with excessive debt and restoring these companies to health quickly, for private-sector efforts are often insufficient for full-fledged revitalisation.

In October 2001, the government's economic council issued its Programme to Accelerate Reform, which aims, among other things, to establish many corporate recovery funds and make DIP financings more popular in Japan at the initiative of the Development Bank of Japan (DBJ), after which the DBJ received an additional 100 billion yen in the fiscal year 2001 supplementary budget. In 2002, many corporate recovery funds were set up with or without involvement of the DBJ and DIP financing saw increasing use. This is similar to the IRCJ's scheme in that the public sector provides support for corporate and industrial reorganisation efforts. Reports state that IRCJ policy does not exclude small and medium-sized enterprises (SMEs) from this programme. The IRCJ was given the immense sum of 10 trillion yen to efficiently rehabilitate enterprises that cannot be left to the private sector, on the premise that the IRCJ was created to complement the Resolution & Collection Corporation (RCC).

The revisions in 2001 to the Financial Revitalisation Law enabled the RCC to help companies reorganise by buying up their loans, but this alone has not been sufficient, which explains the need for the IRCJ. The IRCJ and RCC should work together to clean up debt-ridden companies and efficiently rehabilitate as many companies as possible. Of course, it will take effective economic policy, and not just the revitalisation of individual companies, to resurrect the overall Japanese economy.

a) Limits to relying on private-sector initiative for revitalisation

As stated in the Basic Policy, ideally the private sector should be able to revitalise corporations through its own efforts, but factors such as the difficulty involved in balancing the interests of creditors require the presence of an institution that can consolidate debts and serve as a neutral

mediator to accelerate the revitalisation of companies with potential but which cannot be left to the private sector.

In 1999 and 2002, a number of major companies received large amounts of financial aid. Given the worsening asset deflation, and the banks' own compliance problems and restrictions posed by taxation, it was probably inevitable, but financial weakness prevented the main banks from extending sufficient support to these companies, as many analysts noted. This indicates the limits of the private sector's ability to rehabilitate companies.

According to the IRCJ Law, the IRCJ can provide aid to companies that are deemed likely to recover by following a reorganisation plan. Since a great deal of the taxpayer's money will be poured into these companies, the final decision on whether to proffer aid must rest on thorough asset evaluation founded on conservative estimates and a reliable business plan based on realistic projections—it is not enough to simply determine that the company would not necessarily collapse. If the financial profile and revenues improve more than the conservative assessments initially suggested, the IRCJ could realise gains on a rise in the price of stock obtained through a debt-equity swap.

Although many companies have gone through the statutory reorganisation procedures and continue to do so, these procedures inevitably lead to deterioration in corporate value. As such, ailing companies tend not to file for court protection until it is too late for them to be revitalised.

b) Difficulties with main banks in out of court workout procedures

The Guidelines for Multi-Creditors Out of Court Workout were established in September 2001 as a tool to facilitate the private sector's own efforts to revitalise corporations, but it was only used 12 times through the end of July of 2003.

The reorganisation plans made in out of court workout proceedings under the guidelines provided that companies limit their requests for loan forgiveness to their main and secondary main banks, and ask their tertiary banks only to maintain their credit balance. This was motivated by the fear that the tertiary banks would not agree to requests that losses be spread evenly among the creditor banks and that any attempt at out of court workout would be over before it had started.

In an equitable division, the main banks typically take on an amount equivalent to that forgiven by the tertiary banks. Next, the company would request aid from its secondary main banks, such as debt forgiveness equivalent to the amount of aid needed from all its creditor banks (including tertiary banks), but this would most likely result in a situation in which the main banks have to take on a larger share of the burden in order to decrease the secondary main banks' burden enough so that the debt forgiveness scheme is agreed on by all parties. For main banks, this disproportionate burden compared to other banks limits the merits of out of court workout resolution. The December 2002 reorganisation plan for Nippon Yakin Kogyo faced so many difficulties that some suspected it would be the last out of court workout case under the guidelines requiring support from secondary main banks.

Less than ten banks are involved in out of court workout cases under the Guidelines at the position of main banks. Although it is merely speculation, reasons why other banks did not use the workout proceeding under the Guidelines might be that there is no room to ask secondary and tertiary banks for their co-operation in the loss sharing because banks other than main banks withdrew their loans, or because the main banks were determined to maintain their policy of helping their group companies under their umbrella even in adversity.

Whatever the reason, main banks were required to shoulder almost the entire burden from October 2002, making it extremely difficult to work out reorganisation plans under the Guidelines. The only way to rehabilitate companies so that they regain profitability and a healthy financial profile—which is certainly beyond the ability of most banks to accomplish alone—is for the IRCJ to buy up debt from the secondary and tertiary banks and hold three-way discussions with the main bank and the company to establish a sound reorganisation plan.

At this point, it was essential for the IRCJ to be set up as soon as possible. Reorganisation plans for Seibu Department Store and Hazama Gumi launched in January 2003 have been worked out under the Guidelines. According to Hazama Gumi's plan, its tertiary banks will be asked for help with half of the financial losses allocated on a pro-rata basis. After the first reorganisation plan requiring secondary and tertiary banks to share losses had been worked out, the RCC bought up the non-performing loan assets from those banks as requested.

c) Incentives encouraging applications for loan purchases

In addition to 100 billion yen in capital, 10 trillion yen of funds will be available for the IRCJ for use in revitalising companies. This will enable the IRCJ to rehabilitate many major corporations, but this certainty is marred by fears that non-main banks might not respond to the IRCJ's call for offers to purchase debt. However, even in this case the goal will have been achieved if these non-main banks consent to the reorganisation plan and provide financial support in the form of debt forgiveness and debt-equity swaps.

The price for the loans will be set at a level commensurate with the business recovery plan, but there is some doubt as to what this will actually mean. Although market value is the usual alternative to book value, it will not be used in this case since the debt will not be traded in the market. The net book value prior to the reorganisation plan worked out in agreement with creditors is equivalent to the value of the loan less reserves, but the net book value employed when a reorganisation plan is worked out would be equivalent to the loan value less the amount of debt forgiven and the value of stocks gained in a debt-equity swap.

Neither of these methods will be used here. Rigid standards would not be appropriate even if referring to the market's valuation methods. The value used will likely be a sum discounted from the face amount depending on the reorganisation plan's feasibility, given the amount likely to be recovered in estimated future cash flow. However, the IRCJ will provide aid when it determines that a recovery plan has a high chance of saving the company, so setting a price for the loan purchase that sharply undercuts the loan's face value could shed doubt on the validity of its valuation of the company. Buying up loans at a high price increases the risk of secondary losses, but setting a low price could limit the number of buyers.

This is certainly a point of difficulty. Even if they are uncomfortable with the price, non-main banks can agree to reorganisation plans for companies they deem capable of recovery, and offer support through debt forgiveness and debt-equity swaps. This kind of participation is enough to efficiently resurrect struggling companies without the IRCJ having to use public money to buy up loans.

d) Possibility of increase in pre-packaged statutory reorganisations

Pre-packaged statutory reorganisation procedures involve the preparation of a reorganisation plan that is negotiated and consented to by interested parties including creditors before the company actually files for bankruptcy with the court that has jurisdiction over the case. Pre-packaged

procedures have certain advantages such as the availability of DIP financing, the approval of the rehabilitation plan by creditors' majority vote, avoiding power to cancel preferences and fraudulent transfers, and rejection of executory contracts.

Convincing creditors other than the company's main bank(s) to forgive debts, allocating losses to the secondary main banks as well as convincing tertiary banks to maintain a credit line for the reorganising company is an extremely difficult undertaking. Although the main bank and creditor companies may plead with the non-main banks for their co-operation, it takes about a year to gain the agreement necessary for reorganisation (a year-and-a-half if preparation time is included), and it is not unusual for the banks to force the reorganising company to increase the deposits serving as collateral as a condition for their consent. The procedures laid out in the Guidelines for Multi-Creditors Out of Court Workout shorten the period—including preparation—to six months (within two or three months of the notice of stand still), but it has not been unusual for some banks to resist co-operation to the last, requiring tremendous efforts to persuade them.

The involvement of the semi-governmental IRCJ will make financial reorganisation much easier compared to out of court workout, but even in this case it will be no simple matter to gain co-operation from the creditors accounting for the necessary portion of debt. When the total debt held by the banks agreeing to the plan is less than the total necessary debt, the company will have to give up on the IRCJ's scheme and instead follow procedures for civil rehabilitation or corporate reorganisation.

Previous cases have shown that out of court workout under the Guidelines involving only financial creditors result in much less damage to corporate value than is typically incurred in the statutory reorganisation procedures. This is likely because the news that only financial institution debt will be affected, relieves trade partners enough for them to continue transactions. The temporary suspension or standstill request made simultaneously with the IRCJ's decision to provide aid will also affect only financial institutions.

When there are worries that the necessary number of financial institutions will not agree, the necessary steps regarding trade receivables will be taken during the review period, making it possible to avoid involving general creditors in reorganisation plans. Once statutory reorganisation procedures start, the general creditors will be protected, as their receivables will be dealt with as minor debt. These measures also minimise the extent of the damage to corporate value, even if the company is forced to undergo statutory reorganisation procedures. In this procedure, the reorganisation process begins unless it is clear that the reorganisation plan will not be drafted, adopted, or approved, and definite decisions are not made regarding the feasibility of reorganisation in the early stages.

However, the IRCJ has a team of experts, including external restructuring advisers, who conduct an intensive review over a two to three month-period, whereupon the IRC Commission decides to help the debtor corporation only if the Commission is satisfied that the proposed reorganisation plan is highly feasible. This means that the civil rehabilitation and corporate reorganisation procedures, which accede to the IRCJ's decision, have a higher chance of success than other cases. Awareness of this further restricts the damage to the company's credit in the eyes of its trade partners, which could ensure that the civil rehabilitation and corporate reorganisation procedures run faster and more smoothly.

This suggests that conversion to statutory reorganisation procedures should not necessarily be avoided. Such a conversion may be made when some banks insist not to agree to the proposed plan, but a good track record of successful reorganisation under converted statutory procedures could make it easier to gain banks' co-operation in future IRCJ cases.

Flexible management by the courts has made it easier to use the civil rehabilitation procedures. In December 2002 the Corporate Reorganisation Reform Law was enacted, and became effective after April 2003. The extensive revisions include a partial DIP mechanism allowing the current executive officers to be appointed as trustees, more flexible majority criteria for accepting reorganisation plans, and the use of fair value in asset assessment and evaluation of collateral, all of which facilitate the application for corporate reorganisation procedures (similar to civil rehabilitation). Japan's bankruptcy laws are now among the most user-friendly in the world. The launch of the IRCJ will help to transform Japan's statutory reorganisation procedures into tools similar to Chapter 11 bankruptcy procedures in the US.

5) *The first stage of the IRCJ*

The Industrial Revitalisation Corporation of Japan (IRCJ) was established on 16 April 2003 and started its business operation on May 8 of the same year. After intensive due diligence of the debtors' assets and investigation of the feasibility of the draft reorganisation plans made by the professional staff of the IRCJ, the Industrial Revitalisation Commission (IRC Commission) decided to assist the reorganisation of four debtor corporations on August 28 and September 1.

They are Kyushu Industrial Transportation Corporation (Kyushu Sanko), DIA Construction, Usui Department Store and Mitsui Mine. Kyushu Sanko (KS) and its subsidiaries operate passenger and cargo transportation and other businesses including travel agencies and hotel operations. KS is an unlisted company with approximately 4 000 employees. Should KS go bankrupt, the adverse impact to the regional industrial society would be severe. DIA is a condominium developer doing business throughout Japan and is listed on the Tokyo Stock Market. Usui Department is a local department store in Koriyama, Fukushima whose closing would cause a serious decline in the shopping arcade in Koriyama-City, which is the biggest city in Fukushima Prefecture. Mitsui Mine (MM) started its coal mining business in 1911 and was the biggest coal mining company in Japan until terminating its coal mining business several years ago. MM and its subsidiaries engage in many kinds of business, including trading of coal, production of coke, manufacturing machinery, cement plants, cargo transportation and land development. MM is a listed company with more than 3 000 employees.

Journalists have criticised that the targeted debtor corporations are smaller than expected in size and wondered if the IRCJ could carry out its task to recover Japan's economical prosperity through reorganising many influential distressed corporations with excessive debts. Professional staff members of the IRCJ are working hard, often through the night, on weekends and holidays to investigate the financial status, evaluate assets, draft restructuring plans and other related matters of many candidate debtor corporations. Regrettably, most of these candidate debtor corporations are small to medium-sized companies.

It cannot be denied that to-date banks are hesitant to bring cases to the IRCJ. Minister Takenaka of the Financial Service Agency sent letters to banks encouraging more use of the IRCJ as advised by Minister Taniguchi who is in charge of the IRCJ. Nevertheless, it is not easy to change the banks' cautious attitude toward the IRCJ. The IRCJ is able to deal with cases only when banks bring cases to it. Without the positive support of banks, the IRCJ cannot play its role. Why do banks not bring a sufficient number of substantial cases to the IRCJ?

In order to explain the reasons, one must mention the "main bank" system, which is unique in Japanese business society. A main bank used to maintain a special close relationship with a particular business corporation and supply funds to the corporation, which may be needed for business operations and additional investments. In addition to the funds, main banks often send managers to the borrower corporations to assist in the debtors' operation. Although the main bank system was

pervasive for a long time in Japan, the financial environment is changing now. Corporations with a good financial reputation are able to raise funds in the capital markets and are not relying on main banks. Corporations, who cannot raise money by themselves from the market, have continued to rely upon the main banks. Banks other than main banks, fearing additional non- or poorly-performing loans, tend to refuse to consent to rolling over loans which become due so main banks have to fill the gap continuously. Japanese mega banks, losing their power during the prolonged economic recession, have little room to help corporations with huge debts. However, mega banks, that may have indirectly controlled the debtor corporations for years, find it difficult to persuade other banks to share losses on a pro rata basis in an out of court workout process.

In order to accelerate the wiping out of NPLs and encouraging business revitalisation at the same time, the IRCJ was established. The IRCJ will purchase loans from non-main banks at the request of debtor corporations with excessive debts and their main banks, when the IRC Commission is satisfied that their reorganisation plans are feasible and equitable. Experienced and talented professional staff of the IRCJ, evaluate assets including the goodwill of debtor corporations on a discounted cash flow basis using the purchase method, and may request that debtor corporations and their main banks amend the draft reorganisation plans to increase the amount of debts forgiveness to avoid a possible second failure. This is done before the IRC Commission examination regarding the feasibility of the plans.

Mega banks, who are concerned about losing control of the valuation process, are reluctant to bring large influential cases to the IRCJ. Mizuho Holdings, UFJ Holdings, Sumitomo Mitsui Banking Corporations and Bank of Tokyo-Mitsubishi have now established subsidiaries or divisions specialised to assist borrower corporations' efforts to rehabilitate. Many regional banks have created similar specialised divisions. Inauguration of the IRCJ played a significant role in stimulating these actions by the banks. A concern, however, is that these measures may, in some cases, hinder the recognition of appropriate losses in wiping out NPLs and delay Japan's economic recovery. It is important that the banks not take half measures to reduce their NPLs.

The Japanese government infused 2 trillion yen into Resona Bank in July 2003 and Resona is eager to reduce its NPLs by recognising their actual value. This may be a good example. IRCJ is ready and hopes to use 10 trillion Japanese yen to purchase NPLs, if the banks bring cases to it before the end of March 2005, which is the designated deadline for buying loans. As of the end of September 2003, six companies have done so.