II-4.

Direction in which Private Housing Finance be Reformed

4. Direction in which Private Housing Finance be Reformed

4.1. Basic Viewpoint

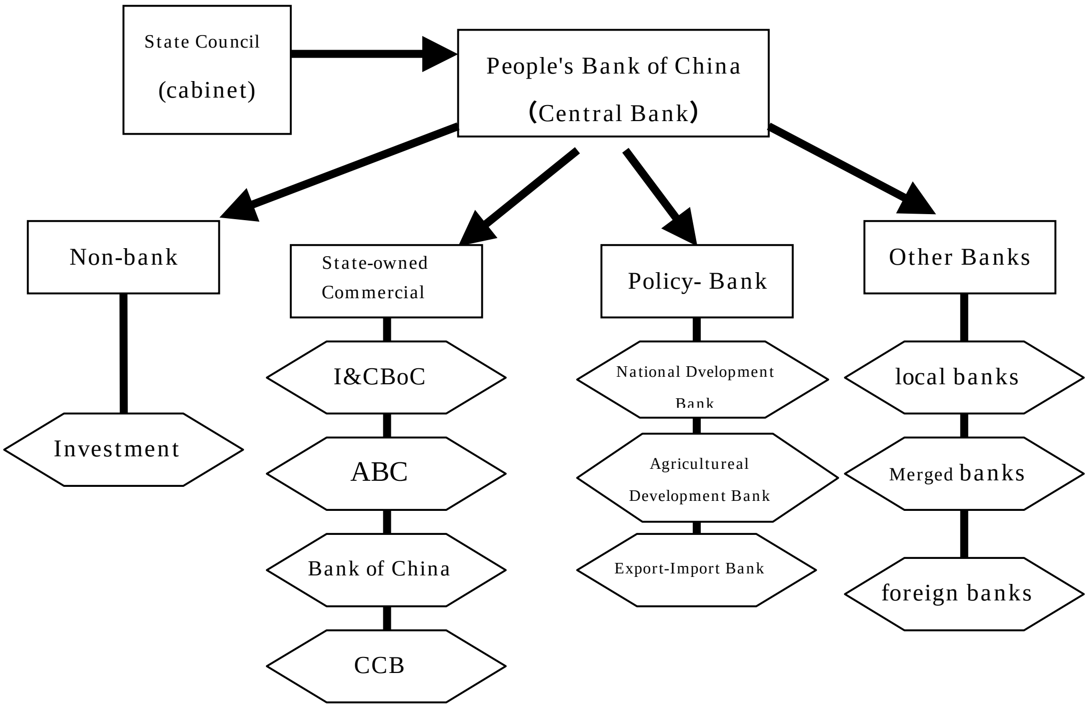
4.1.1. Indirect Finance and Direct Finance

The finance system should be studied in its unique circumstances, such as its effects on entrepreneurial management, financial expenditure, resource distribution and stability of the macro economy.

Since as China's economy is beginning to transform from a planned to a market economy system. The finance-institutional challenging issues require China to institutionalize the financing system and built up a security market. Likewise, to make effective use of the direct finance market typically represented by stock/debenture market, fund-raising enterprises should react sensibly against any changes in various market factors, such as the interest rate, etc. Therefore, it is necessary to establish the market order in which accurate information and transparent transactions are available for such enterprises.

In China, enterprises, especially those owned by the Government, have not been able to respond to the factorial changes in the financial market. Moreven, the capital market continues to be highly speculative because the information available has remained asymmetrical. Judging from these circumstances, the Banking System must play a significant role in providing indirect financing by leading the financial system and housing financial field as well.

Figure 4-1 Banking system in China



I&CBoC = Industrial and Commercial Bank of China

ABoC = Agricultural Bank of China

CCB = China Construction Bank

Source: JICA Study Team

4.1.2. Qualities of Banking Business

A bank can earn revenues if it can minimize the "risk that arises while brokering needed funds". Banking is a "risk business." The pursuit for returns while ignoring risks would result to bankruptcy. Safe investment in fear of risks, in the contrary, would result to a failure to make any profit.

Banking is based on the risk business that yield profit by operating the funds raised from depositors, and managing interest/foreign exchange risks and/or the credit risks arising from personal defaults (non-fulfillment of their obligations). The essence of a bank business, therefore, is risk management. A bank, therefore, could never collect personal savings without having a risk management ability through brokerage of the risks between fund suppliers and fund demanders while making investments in enterprises.

In Japan, every bank is now placing emphasis on personal loans under the assumption that "Individuals will play the leading part from now on." More recently, however, an increasing number of personal bankruptcies have taken place, leading to an increase in the percentage of bank loans. It is likely, moreover, that the fluidity risk may be higher than ever because savers try to draw their deposits from banks, being terrified with a rumor that bad debts are increasing.

In China, housing-related loans have been showing a rapid growth at present. Their balances have not reached so big an amount with a relatively small number of bad debts. It will be more and more important for a bank in the future to manage risks and returns properly. It is safe to say that an ideal bank should secure profits by taking the minimum possible risks, aiming to be in good financial condition with risks minimized at a feasible level.

4.1.3. Credit Risk Management

The typical risks that a bank takes include a credit risk and a market risk.

- The term, credit risk, means the possible failure to recover loans because of loanees' insolvencies, business slumps, or personal bankruptcies.
- The term, market risk, means the revenue fluctuations, coupled with a change in interest rate/exchange rate, including an asset-liability management (ALM) mismatch arising from a difference between deposit maturity and loan term.

It is said that banks generally have credit risks composed of 50 to 60% of all the risks, and market risks at 20 to 30%.

A comparative review of the revenue structure for banking institutions in the USA before and after the financial liberalization in 1980s tells us that the gentle completion prior to the financial liberalization permitted an American bank to obtain a profit margin of about 2% from an enterprise. In addition, there were a lot of loans to good-standing enterprises so that banks could have a lower rate of bad debts. As a result, an American bank on those days was able to secure a sufficient revenue without the necessity of being too sensitive to credit risks and expending cost. A ratio of the bad debt loss to the final profit, therefore, remained around 20% only.

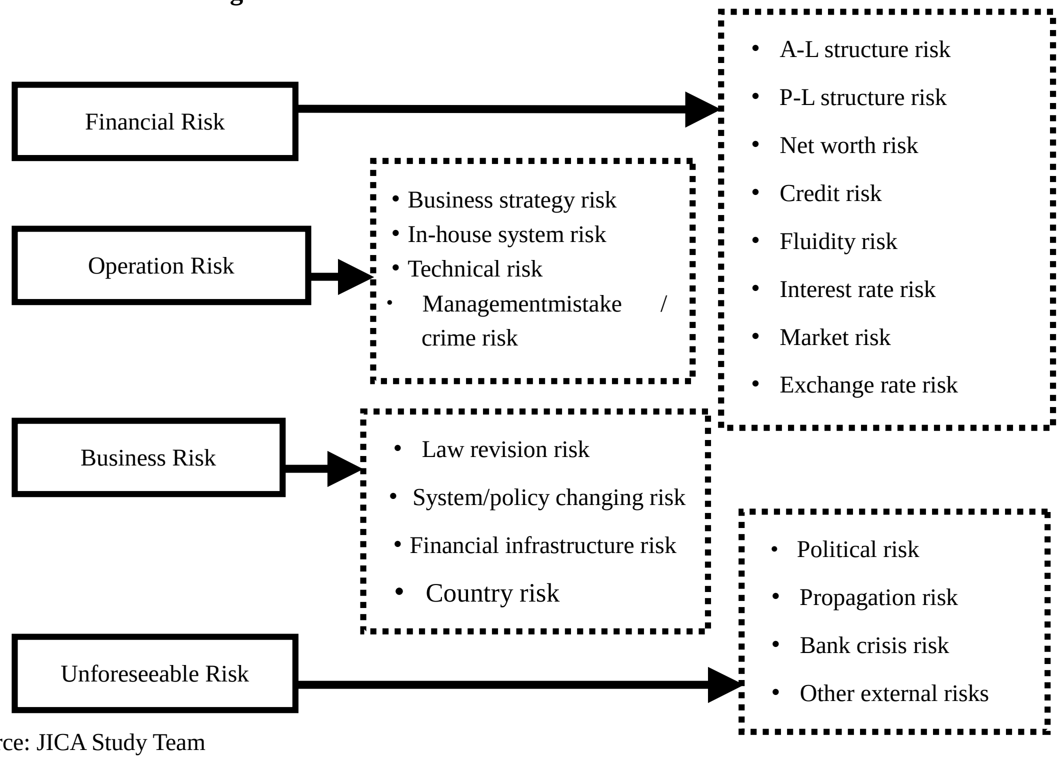
Since the financial liberalization, however, the finance has been progressively changing over to securities while starting a substantial competition among banks. Consequently, the profit margin has become smaller and smaller. Coupled with a simultaneous startup of the industrial structure conversion, and with an increase in personal consumption, American banks have gradually changed their loanees from big and leading companies to successful sectors, such as medium-/small-sized business, and personal loanees. Consequently, the profit margin has contracted to approximately 1.2% while their bad debt loss has increased up to 0.4 thru 0.6%. The bad debt to the final profit/loss ratio reach approximately 30% thru as high as 50%. As a result, a high revenue are earned by banks who are able to efficiently manage credit risks. Now, enterprises have had their fund raising means diversified more and more. With favorable saving interest rates selectively contracted, furthermore, banks have tended to have a smaller spread between deposits and loans. Under such circumstances, credit risk and cost management will turn out to be a greater and critical issue for banks to manage their business.

Banks encounter a lot of risks other than credit and market ones. These risks are collectively called bank risks, which could be classified as follows:

- Financial risk: asset-liability structure risk, profit-loss structure risk, net worth risk, credit risk, fluidity risk, interest risk, market risk, and exchange risk
- Operation risks: business strategy risk, in-house system risk, technology risk, and management mistake/crime risk
- Business risks: law revision risk, system/policy changing risk, financial infrastructure risk and country risk
- Unforeseeable risk: political risk, propagation risk, bank crisis risk and other externally occurring risk.

Thus, there are a variety of the risks for a bank to take. The financial risks, among others, take place with highest probability in daily bank operations.

Figure 4-2 A Classification of Bank Risks



Source: JICA Study Team

4.2. Present Situations of Housing Finance in China

4.2.1. Private Housing Finance with Lead Taken by Indirect Financing

During the days of a planned economy, the Chinese Government guaranteed the safety of deposits in banks. And it could not be imaged that they might turn bankrupt. Consequently, personal depositors “trusted” in banks. However, individuals could not borrow money from a bank. There is a tendency for enterprises to take a bank for one of the governmental organizations. If a borrowing enterprise had failed to repay the borrowed fund at a contracted due date, it would have “solicited” the competent governmental division for an extension of the borrowing term or for a release from the obligation (a waiver of the credit from a bank’s point of view).

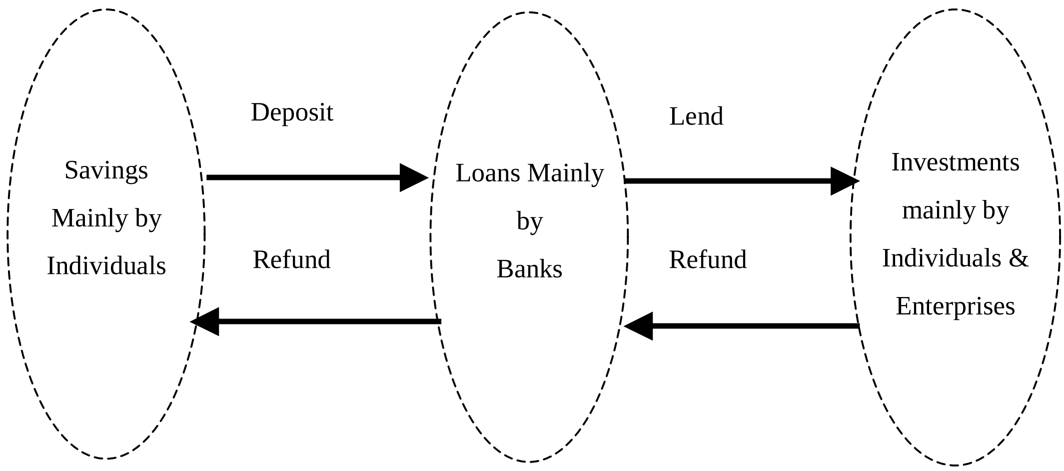
The socialistic economy had a policy to emphasize the duty for an enterprise to redeem the fund that it had borrowed from a bank. And the Government requested every bank to enhance the control of bad debts for their reduction.

Unless the loan granted to an enterprise is refunded at a due date, the bank will accumulate a bad debt in the bank’s assets/liabilities. The accumulation of bad debts would decrease the bank’s assets, and the revenues as well. Finally, the market would refuse the bank to raise its funds, resulting to bankruptcy. To whatever extent each bank in China may have recognized this risk, the fact that such risk does really exits in China is a significant change in environments for every Chinese bank.

Under such changing environments, the People’s Bank of China, (China’s Central Bank) main objective is stabilizing the macro-economics. And the same time, it has come to undertake a higher level of responsibilities than ever for the management of ordinary banks, including their credit risk management and asset-liability management. In other words, it may be deemed as an increase in responsibility for the central bank to inspect and audit ordinary banks. In this sense, the same applies in the housing finance field, too.

Private housing finance in China is composed of savings mainly by individuals, loans mainly by banks, and investments by individuals and enterprises, while they are obligated to refund their borrowings to that end.

Figure 4-3 Private Housing Finance, Savings and Investment Structure



Source: JICA Study Team

Since 1998, the private housing finance in China has been showing a rapid growth on a housing-related lending balance basis. As a result, private housing loans have come to exceed the Provident Fund loans, governmental finance. In developed countries, it is generally said that private financing plays the leading part in offering housing loans. Judging from the current status, it is safe to say that China is about to enter such stage.

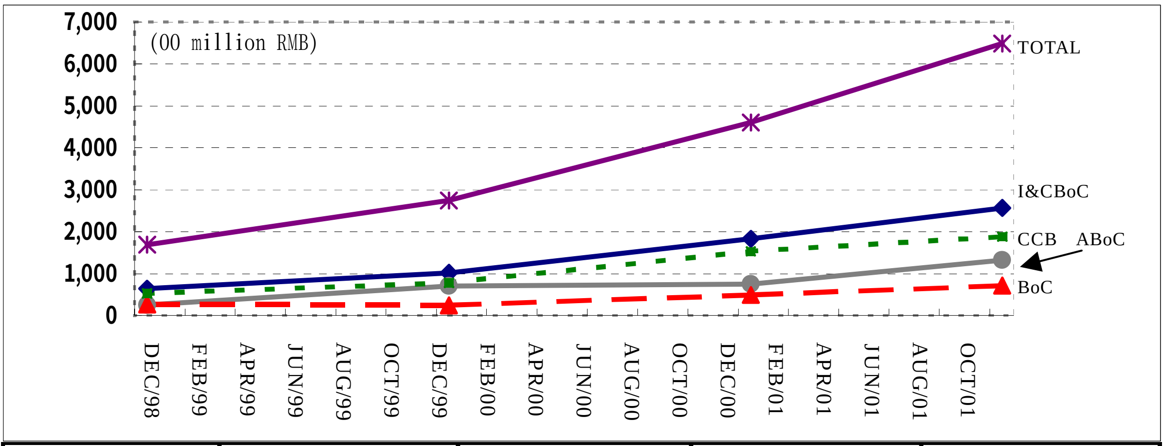
4.2.2. Housing-related Lendings Rapidly Extended

From a statistical point of view, state-owned commercial banks have rapidly increased housing related lendings since 1998. At the end of October in 2001, the housing-related lending balance compared with the end of December in 1998, grew by 4.02 times in Industrial and Commercial Bank of China (I&CBoC), by 5.16 times in Agricultural Bank of China (ABoC), by 2.67 times in Bank of China (BoC), and by 3.57 times in China Construction Bank (CCB), reaching a total increase by 3.84 times.

According to the representatives of the central bank, People's Bank of China, and other banks, the housing-related lendings have rapidly increased mainly because:

1) The housing system reform has resulted in a growth of the needs for personal housing purchases and has led to a rapid increase in demand for financing them.
2) Banks have had an unbalancedly small amount of personal lending assets while showing a relatively good standing of personal housing loans. Consequently, banks have been positively tackling personal housing loan services.

Figure 4-4 A Time-Series of Changes in Housing-related Lending Balances by Commercial Bank（in 00 million RMB, with table in 0 thousand RMB）



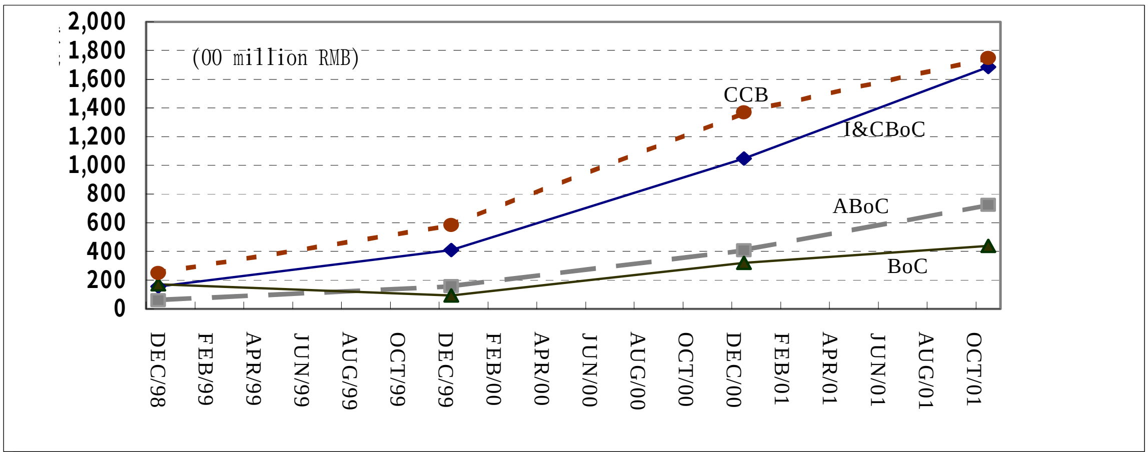
DATE	1998/12/31	1999/12/31	2000/12/31	2001/10/31
I&CBoC	6,384,708	10,157,696	18,297,341	25,666,129
ABoC	2,562,244	7,039,707	7,479,146	13,228,156
Boc	2,663,277	2,439,524	4,945,417	7,120,522
CCB	5,277,098	7,783,197	15,309,469	18,834,601
TOTAL	16,887,327	27,420,124	46,031,373	64,849,408

Source: JICA Study Team, based on the materials available from People's Bank of China

4.2.3. Present Situations of Personal Housing Loans

The housing-related lending increase referred to above shows a particularly high rate of increase in value of personal housing loans. Personal housing loan growth multiples by commercial bank (a comparison between OCT/01 and DEC/98) in China were 10.84 for Industrial and Commercial Bank of China (I&CBoC), 11.97 for Agricultural Bank of China (ABoC), 2.57 for Bank of China (BoC) and 6.98 for China Construction Bank. As explained by the representatives, the reasons why such high growth rates were achieved, in addition to those referred to above, are: a) Every bank has enhanced their personal housing loan services. b) Since the profit performance is relatively high, every bank has been positively tackling these services at a branch level.

Figure 4-5 A Time-Series of Changes in Balance of Personal Housing Loan Balances by Commercial Bank（in 00 million RMB, with table in 0 thousand RMB）



DATE	1998/12/31	1999/12/31	2000/12/31	2001/10/31
I&CBoC	1,554,607	4,102,915	10,476,862	16,853,461
AboC	604,400	1,560,546	4,082,438	7,234,445
BoC	1,705,988	921,212	3,191,988	4,390,198
CCB	2,504,200	5,841,231	13,684,719	17,477,650
TOTAL	6,369,195	12,425,904	31,436,007	45,955,754

Source: JICA Study Team, based on the materials available from People's Bank of China

China Construction Bank (CCB) , among others, is ranked at the top on a personal housing loan balance basis. Since 1999, however, Industrial and Commercial Bank of China has achieved the highest rate of grown in personal housing loan balance. There are possibilities, therefore, that the personal housing loan balance in Industrial and Commercial Bank of China may exceed that of China Construction Bank in the near future.

Table 4-1 Growth Rates of Personal Housing Loans by Commercial Bank

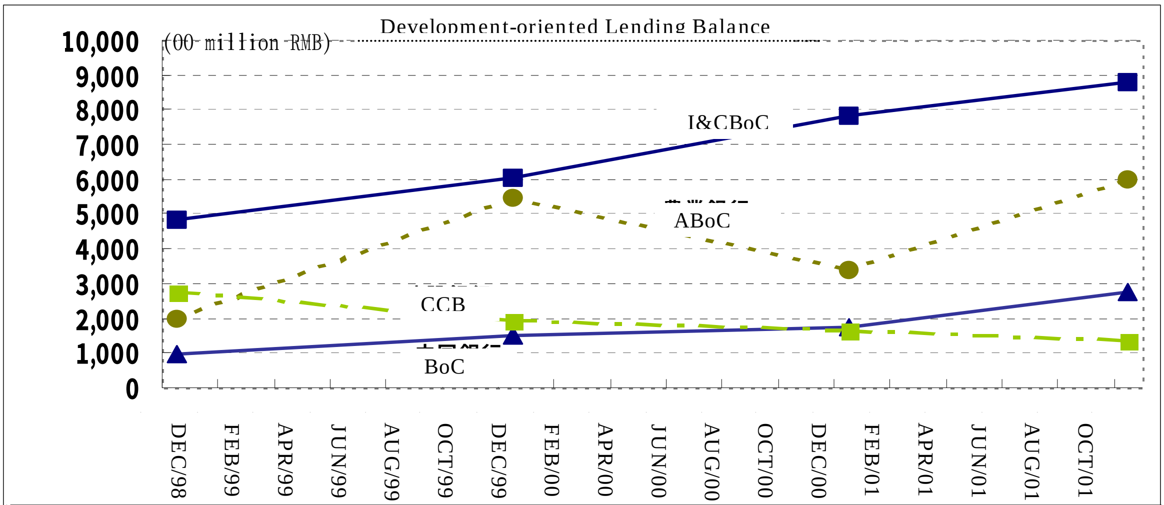
GROWTH RATE (as compared with a year earlier)	1999	2000	2001＊
Industrial and Commercial Bank of China	164%	155%	61%
Agricultural Bank of China	158	162%	77%
Bank of China	-46%	246%	38%
China Construction Bank	133%	134%	28%
TOTAL	95%	153%	46%

Source: JICA Study Team, based on the materials available from People's Bank of China

4.2.4. Status Quo of Development-oriented Lendings

As far as development-oriented lendings are concerned in the housing-related loans, it appears that the result varies from bank to bank. Industrial and Commercial Bank of China has been consistently increasing the lendings while Agricultural Bank of China has had an increasing then decreasing trend. Bank of China has had their development-oriented lendings stabilized or slightly increased. And China Construction Bank has been showing a decline rather than increasing the lendings.

Figure 4-6 A Time-Series of Changes in Balance of s by Commercial Bank（in 00 million RMB, with table in 0 thousand RMB）

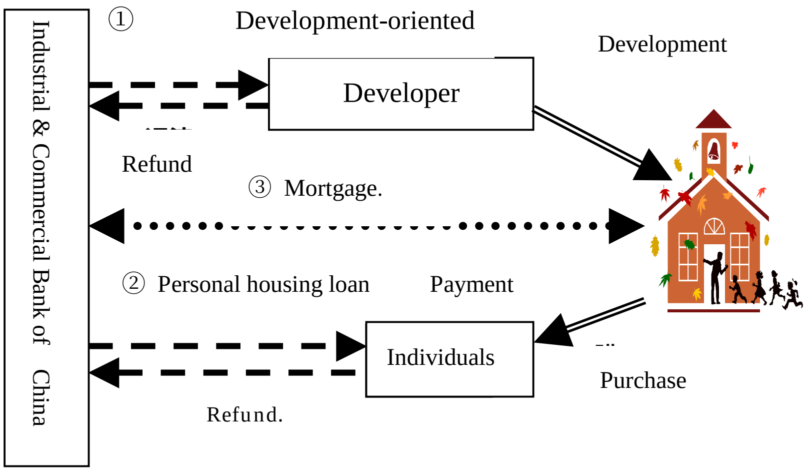


DATE	1998/12/31	1999/12/31	2000/12/31	2001/10/31
I&CBoC	4,830,101	6,054,781	7,820,479	8,812,668
ABoC	1,957,844	5,479,161	3,396,708	5,993,711
BoC	957,289	1,518,312	1,753,429	2,730,324
CCB	2,772,898	1,941,966	1,624,750	1,356,951

Source: JICA Study Team, based on the materials available from People's Bank of China

Development-oriented lendings are available in a variety of loan patterns. The development-oriented lendings increase of Industrial and Commercial Bank of China was due to the unique financing system employed so that a loan will stop gap for an individual person as final loanee through the support for developers, with a development property selected beforehand. In other words, a positive discovery of the property to develop has allowed the bank to materialize a favorable lending.

Figure 4-7 Stopgap Finance System in Industrial and Commercial Bank of China



Source: JICA Study Team, based on the materials available from People's Bank of China

Table 4-2 Statistics on Housing-related Lendings by Commercial Bank（in 000 RMB）

①	DATE	1998/12/31	1999/12/31	2000/12/31	2001/10/31
Housing-related Lendings	I&CBOC	3,137,904	4,444,334	5,258,949	5,641,991
	ABOC	1,274,103	2,722,501	1,026,788	3,369,711
	BOC	674,523	1,179,351	1,416,719	1,791,390
	CCB	2,772,898	1,941,966	1,624,750	1,356,951
	TOTAL	7,859,428	10,288,152	9,327,206	12,160,043
②	DATE	1998/12/31	1999/12/31	2000/12/31	2001/10/31
Commercial Real Estate Development Lendings	I&CBOC	475,952	490,426	470,122	337,050
	ABOC	411,757	1,243,534	1,184,960	1,173,175
	BOC	282,766	338,961	326,649	331,825
	CCB				
	TOTAL	1,170,475	2,072,921	1,981,731	1,842,050
③	DATE	1998/12/31	1999/12/31	2000/12/31	2001/10/31
Miscellaneous Real Estate Development Lendings	I&CBOC	1,216,245	1,120,021	2,091,408	2,833,627
	ABOC	271,984	1,513,126	1,184,960	1,450,825
	BOC			10,061	607,109
	CCB				
	TOTAL	1,488,229	2,633,147	3,286,429	4,891,561
④	DATE	1998/12/31	1999/12/31	2000/12/31	2001/10/31
Total Development Lendings (①+②+③)	I&CBOC	4,830,101	6,054,781	7,820,479	8,812,668
	ABOC	1,957,844	5,479,161	3,396,708	5,993,711
	BOC	957,289	1,518,312	1,753,429	2,730,324
	CCB	2,772,898	1,941,966	1,624,750	1,356,951
	TOTAL	10,518,132	14,994,220	14,595,366	18,893,654
⑤	DATE	1998/12/31	1999/12/31	2000/12/31	2001/10/31
Personal Housing Loans (self-employees)	I&CBOC	1,554,607	4,102,915	10,476,862	16,853,461
	ABOC	604,400	1,560,546	4,082,438	7,234,445
	BOC	1,705,988	921,212	3,191,988	4,390,198
	CCB	2,504,200	5,841,231	13,684,719	17,477,650
	TOTAL	6,369,195	12,425,904	31,436,007	45,955,754
⑥	DATE	1998/12/31	1999/12/31	2000/12/31	2001/10/31
Grand Total (④+⑤)	I&CBOC	6,384,708	10,157,696	18,297,341	25,666,129
	ABOC	2,562,244	7,039,707	7,479,146	13,228,156
	BOC	2,663,277	2,439,524	4,945,417	7,120,522
	CCB	5,277,098	7,783,197	15,309,469	18,834,601
	TOTAL	16,887,327	27,420,124	46,031,373	64,849,408

Source: JICA Study Team, based on the materials available from People's Bank of China

4.3. Status Quo of Control over Private Housing Finance

4.3.1. Status Quo of control over Loans by Commerscial bank

(1) Definition of borrowers and classification of loan

Private housing loan by commercial banks should be extended in compliance with the provisions of the People's Bank of China in respect of qualification of borrowers, classification of loan and hypothecation, as follows.

1) Qualified borrowers

a) Housing constructors
b) Real estate developer
c) Real estate agent
d) Reform service and intermediaries
e) Constructor
f) Interior services
g) Common housing purchase companies
h) Organization of apartment housing constructors
i) Individuals to purchase housing

2) Classification of housing loans

Borrowers	- Housing loan (government agencies, enterprises and organizations)	
	- Loan for housing construction by joint housing constructors	
	- Individual housing loan	
	- Loans to property developers	
Use	- Loan for housing development	
	- Loan for development of commercial properties	
	- Personal housing loan	
	- Other real estate loans	
Term	- Short-term real estate loan	
	- Medium-term real estate loan	
	- Long-term real estate loan	
Hypothecation	- Unsecured loan	
	- Secured loan	- Guaranteed loan
		- Mortgaged loan
Definition	-Commercial loan	
	-Consigned loan (policy-led loan)	

(2) Screening standards

Loan screening is classified as corporate loan and personal loan, as prescribed by the People's Bank of China. Corporate loan is subject to financial analysis among others. More careful screening is made of corporate loan since it involves a large sum of money, and the loan extended over a long period.

The People's Bank of China sets relatively rigid regulations for loans, lending money for housing services in accordance with the following criteria.

1) Screening standards for corporate loans

Table 4-3 Major check-points of loans to corporations

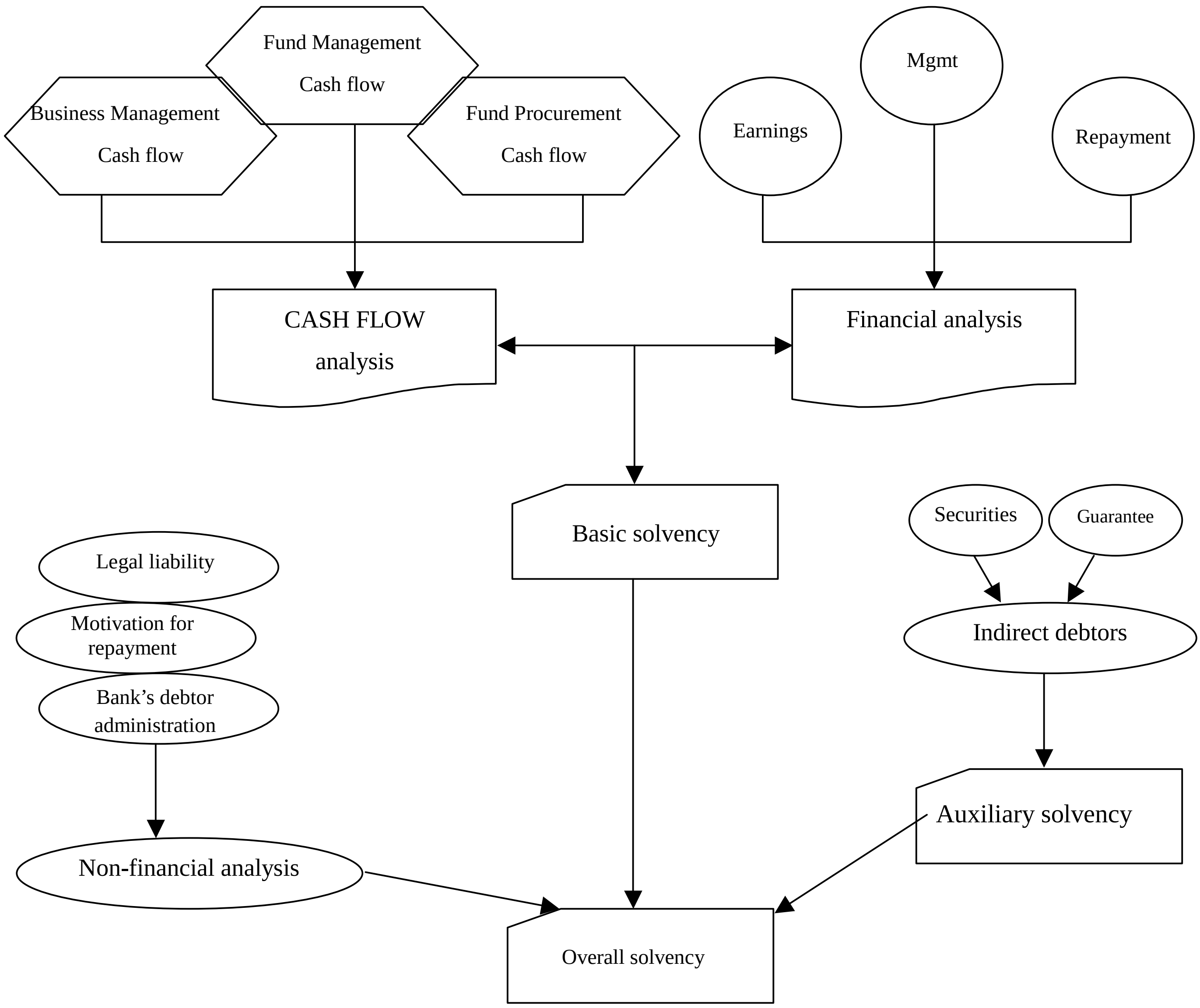
Major check points	People's Bank of China's standards
Profit Indicators	
⇒ Gross margin	
⇒ Operating profit margin	
⇒ Net profit rate	
⇒ Cost and expense ratios	
Efficiency indicators	
⇒ Sales to assets	
⇒ Sales to fixed assets	
⇒ Accounts receivable days on hand	
⇒ Inventory days on hand	
⇒ Return on assets	The greater the better
⇒ Return on equity	The greater the better
Leverage	
⇒ Debt to assets	50% or less
⇒ Debt to net worth	The smaller the better
⇒ Debt to tangible net worth	
⇒ Interest coverage	
Cash flow indicator	
⇒ Current ratio	170% or more
⇒ Quick ratio	100% or more
⇒ Cash ratio	

Source: Prepared by the author based on data released by the People's Bank of China

2) Analysis of solvency of corporations

Banks determine corporate solvency through financial analysis based on the above criteria. Concurrently, banks extend loans against mortgage guarantee and investigate operating conditions and financial position of corporate borrowers to determine their overall solvency.

Figure 4-8 Flowchart of borrowers' overall solvency



Source: Prepared by the author based on data released by the People's Bank of China

3) Loans to individuals

In principle, housing loan is extended to any individuals on application, but it should be noted that bank loan is a commercial loan which involves repayment of principals and payment of interests by borrowers. Accordingly, both borrowers and banks should take cautious stance toward these transactions.

a) Characteristics of screening for loans to individuals

Personal loan involves a relatively smaller amount of money and assessment of personal creditworthiness is difficult. Another problem is that some individuals have a large part of "gray income" though their nominal income is relatively low.

b) Various "gray income" for individuals

- 1. Side business income
- 2. Various remuneration's, such as advisory fees, lecture fees, traveling fares,
- 3. Return on investments by name of a family member,
- 4. Donations not reported on tax return and the like

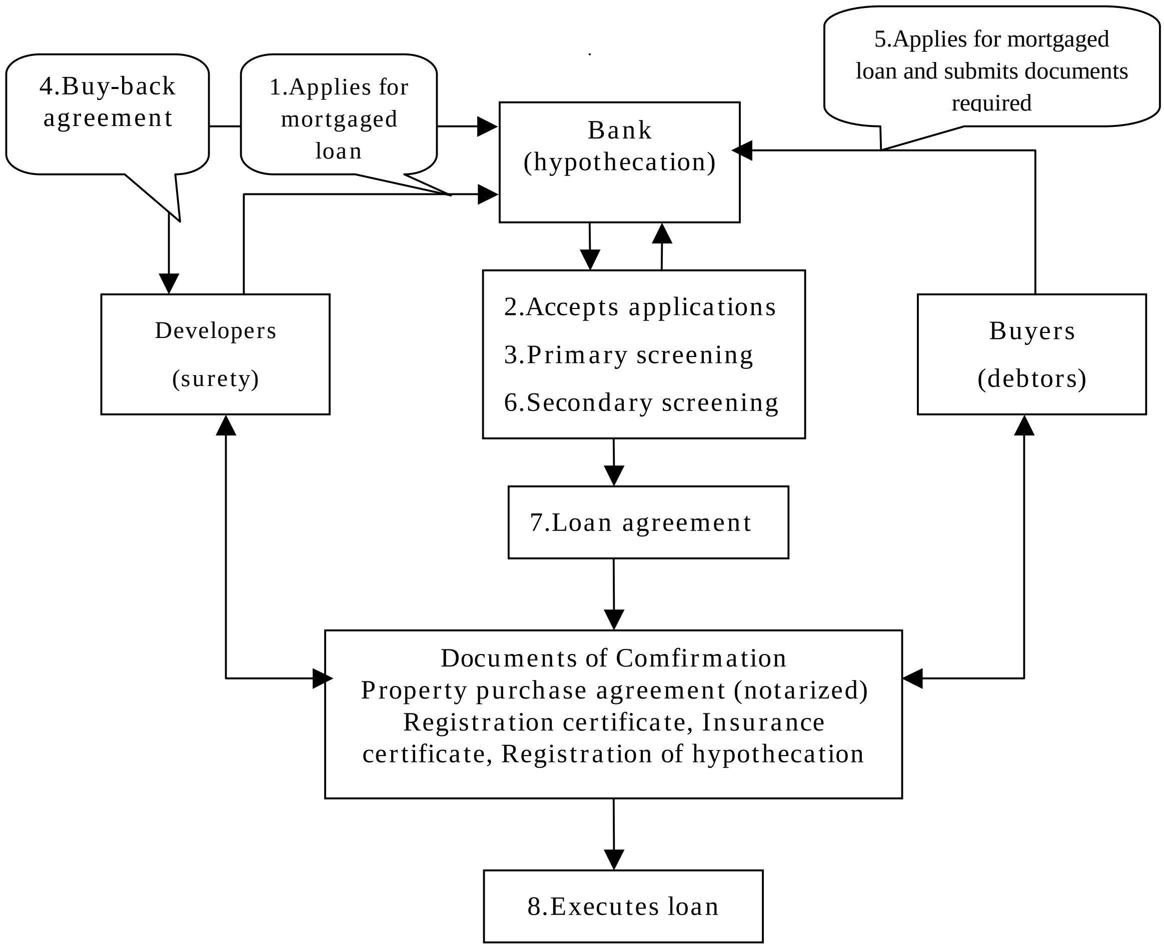
c) Grasping actual income

Banks often request "individuals with high gray income" to increase down payment or deposits against applications for housing loan. To estimate the actual income of applicants, banks check their monthly billings on utilities (lighting, heating, tap water, etc.). For instance, some banks in Shanghai classify people paying 700 RMB or more in a month for utilities as "qualified" applicants for personal housing loan.

d) Procedures for mortgaged loan to individuals

Primary screening of mortgaged loan is focused on developers' capabilities, performance and financial position, and properties to be developed. Secondary screening is focused on creditworthiness of individuals and contract documentation.

Figure 4-9 Flow chart of procedures for mortgaged loans to individuals



Source: Prepared by the author based on data released by the People's Bank of China

4) Screening standards of personal loan

Table 4-4 Screening of housing loans to individuals

Terms and condition of loan	People's Bank of China's standard
Qualifications for application: - Registered as urban citizen - Has stable source of income - Has assets to be mortgaged - 30% down payment for purchase (Subsidies is countable as part of down payments.)	20% down payment, acceptable
Loans in Foreign Currencies: - High income earners (employees of foreign-owned companies, overseas Chinese, etc.) - Dependable securities and guarantee Value: - Less than securities assessment value - Ceilings prescribed by each bank - No more than twice the PF fund (adding up slated deposits till retirement and unpaid deposits) Interest Rate: - People's Bank of China's statutory interest rate minus one rank (Example: Half-year loan interest rate (statutory) is applied to one-year loan) - Five-year loan interest rate + α is applied to 10-year loan - Fixed interest rate is applied to one year (or less) loan (contract interest rate) - For one-year (or longer) loan, new interest rate is applied from the beginning of a year following the year in which statutory interest rates were chanted (re-contract). Documents to Submit: - Bank application documents - Application documents in the case of PF consignment or mixed consignment - Resident certificate (ID card) - Income certificate, tax payment certificate and asset certificate (deposit certificate, etc.))o. Housing purchase contract and relevant documents - Secured property assessment certificate, hypothecation agreement, guarantor certificate, insurance certificate - Other documents required by the bank Repayment Conditions: - Opens account with the bank and repays by transfer - Lump-sum repayment upon maturity in the case of one year (or less) loan - In the case of a year (or longer) loan, principal with interest are repayable in equal monthly installment (normally on 15th and 20th) Progressive repayment is acceptable.: Repays more in year A and less in year B : Maximum minus minimum amount = α - Accelerated repayment: acceptable on lapse of a year after initial repayment, subject to prior application and payment of special fees	α ≦ 5% α ≦ minimum

Terms and condition of loan	People's Bank of China's standard
Loans in Arrears: - In the case of three-month consecutive arrears or six-month cumulative arrears, secured properties are subject to disposition. - Penalty: Outstanding loans x 0.12% x number of days in arrears	0.12% (daily interest rate)

Source: "Housing Loans in Commercial Banks." Chinese Finance Publishing Co., May 1999

4.3.2. Personal Credit Assessment

(1) Common practice

Local banks except those in Shanghai (mentioned below) have no credit inquiry system based on individual credit database. These banks investigate personal credit standing through field survey.

Table 4-5 Personal credit investigation

Contents	Means	Reliability
Debtors' social status	Public office inquiry	High
Submitted document reliability	Public office inquiry	Relatively high
Intended use of loans	Field investigation	Relatively low
Debtors' solvency	Collection of personal information	Low
Confirmation of securities and guarantee	Field survey/office inquiry	Relatively high

Source: Prepared by the author based on hearings from local banks

(2) Shanghai model

In 1999, Shanghai Credit Inquiry Corporation (hereafter referred to as the "Corporation") was established as the first organization to operate individual credit inquiry system under the guidance of the People's Bank of China.

1) View of Peoples' Bank of China

The Corporation was established based on People's Bank of China's " View on Expansion of Personal Consumption Loan" in May 1999 in order to reduce the credit risk against banks' personal loan.

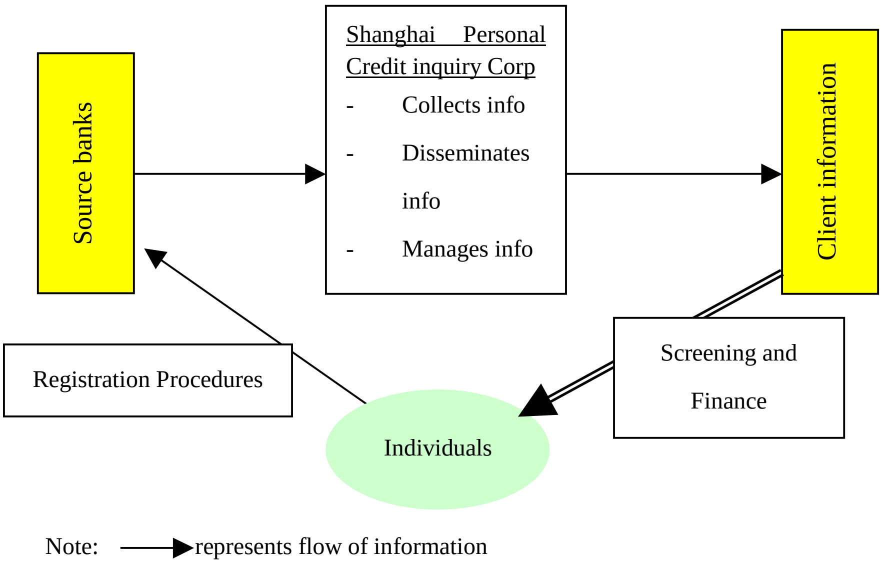
2) Management of Shanghai Credit Inquiry Corporation

The Corporation eyes to start operation of inter-bank personal credit inquiry system for banks in and around Shanghai in June 2000, and complete a comprehensive personal credit evaluation system within 2001. The system will store about 1.8 million personal credit inquiry data by the time Corporation kicks off the system in June. Data sources are 680,000 personal consumer accounts and 1.18 million credit card accounts with banks.

The Corporation pays data source banks 0.2 RMB per data and collects 10 RMB per data from client banks. As of June 2000, personal loan users in Shanghai total 680,000 debit card (automatically accommodating bank loans from deposit accounts) users total 1.18

million. Since these users use the personal credit inquiry system, the Corporation projects that the number of total inquiries will run up to 4.2 million in the future, followed by a revenue of 42 million from data inquiry service.

Figure 4-10 Shanghai Personal Credit inquiry System



Source: Prepared by the author based on data from Shanghai Personal Credit Inquiry Corporation

(3) Contents of Shanghai Personal Credit Inquiry System

- Status information: ID No., name, data of birth, sex, marital status, family register information, employment sources, educational background, etc.
- Credit information: Outstanding debts, creditor banks, loan term/amount, guarantors' information, records of repayment, records of arrears, re-contract (re-schedule) information, etc.
- Credit card information: Number of accounts, name of banks, use data, repayment data, credit balance, records of abuse, history of card transactions, etc.
- Social information: Legal implications (lawsuit, crimes, imprisonment, record of punishment, etc.)
- Special records: History of frauds in financial and/or credit card transactions, if any
- Record of same inquiries: Frequency of inquiry within six months, reason and contents of inquiries, etc.

Table 4-6 Example of Personal Credit Inquiry Report

File Number：1587861212	Date of Reference: 2001/05/12
Status Information ID No. (Personal identification): 1234567890 Name: Zhang San Date of birth: August 16, 1996 Sex: Male, married Registered address: Room 200-33-213, Shanghai City Employment: Accountant, Finance & Accounting Dept. the First Department Store, Shanghai City Education: Graduated from Shanghai Caizheng University (faculty of Accounting)	Social information: Lawsuit: filed against incumbent on August 7, 1994 over money trouble Rulings: Incumbent (defendant) is liable for compensation. Record of crime: November 12, 1992 Contents: Disruption of public order Punishment: Detained for three days
Credit information Date loan was extended: June 30, 1999 Borrowings: Borrowed 240,000 RMB from one bank Outstanding loan in the current month: 86,000 RMB Contractual monthly installment: 5,000 RMB Guarantee: A car was hypothecated, with a mortgage value of 84,000 RMB Record of repayment: Monthly, 3.500 RMB to be withdrawn from bank account, 1,500 RMB from PF account Arrears: 3,500 RMB (cumulative) Re-contract (re-schedule) Loan repaid by: End of July 2000	Special records Fraud on finance: May 10, 1998 Contents : Forgery of official documents Damages: 25,000 RMB Disposition: Lawsuit filed against incumbent Fraud on credit cards: September 23, 1999 Fraud committed: False notification on victim to theft Damages: 6,000 RMB Disposition: Ordered to suspend use of credit card
Credit card information First account opened: May 16, 1995 Number of cards used: Three (one of them under official order to suspend use) Name of banks: Industrial and Commercial Bank of China, China Construction Bank and Bank of China (card under official order to suspend use) Credit limits: 6,000 RMB per card Record of use:	Record of same inquiries Frequency of inquiry within six months: 5 times Inquiry organization Date Purpose of inquiry Banks, October 25, 1999, Loan screening Banks, October 24, 1999, Loan screening Banks, October 22, 1999, Loan screening Court, September 1, 1999, Submission of evidence to court Banks, June 27, 1999, Credit check

File Number：1587861212	Date of Reference: 2001/05/12
Industrial and Commercial Bank of China: 35 times China Construction Bank: 63 times Bank of China: 47 times Repayment information: Abused credit card issued by Bank of China (card under official order to suspend use), other issues uncovered. Credit balance: Record of illegal use: August 15, 1998 (credit card issued by Bank of China)	

Source: Prepared by the author based on data from Shanghai Credit Inquiry Corporation

4.3.3. Bad Debts in Housing-related Lendings

For recent years, banks' bad debts have been drawing significant attention in China. The main reasons why bad debts have increased include the failure to recover the lendings concentrated on state-owned enterprises because their standings have had an unfavorable turn. A collapse of the bubble economy has caused real estate lendings to change over to a bad debt. In addition, it may be also pointed out that the bad debt increase in banks has arisen from those risky lendings which have increased in a severe inter-bank competition.

(1) Bad Debts in Real Estate Mortgage Loans

Housing loans are a new business for Chinese banks, which seem to encounter with a lot of new risks. How the experience may be summed up to eliminate mistakes and reduce risks would turn out to be their challenge.

Table 4-7 Examples of Lendings in Arrears (unrecoverable) - Real Estate Mortgage Loans

CAUSE	MORTGAGE/ SURETY IN REALITY	MISTAKE MADE BY BANK	DESCRIPTION
Insolvency due to Bankruptcy	Developer mortgage property really transferred that property without obtaining approval from transferee.	Ownership to mortgage property was not ensured fully.	In August 1995, Developer K borrowed 6.6 million Hong Kong dollars from Bank G, with 15-storied building under construction mortgaged. Even with borrowing term expired, however, developer was insolvent for shortage of fund. Bank G applied for disposal of mortgage. Company B, however, claimed its ownership. In reality, that property had been already transferred before mortgaged. And ownership had transferred to Company B when property was mortgaged.
Fraud	Misrepresentation of mortgage property	Mortgage was not checked out fully.	In April 1994, Real Estate Company J borrowed 5.5 million RMB from Bank C, with "Building" mortgaged. Later, Company J was investigated on a separate charge by competent justice authorities and bank implemented recovery. Mortgage, however, was found to be land only without building.
Arrears	Mistake in establishing mortgage right	Missing mortgage right registration proceedings	In April 1994, Hotel R borrowed 6 million RMB from Bank F, with Factory A offering its owned land as mortgage. Before Land Bureau, bank tried to go through registration proceedings, which, however, were delayed because factory had not paid land rent. After completion of lending later, registration proceedings were not gone through. With refund in arrears, bank appealed to court, which, however, judged that such land mortgage had been invalid for want of registration proceedings.

CAUSE	MORTGAGE/ SURETY IN REALITY	MISTAKE MADE BY BANK	DESCRIPTION
Arrears	Discrepancy in interpreting Mortgage Time Limit Law	Mortgage time limit extension proceedings not fully gone through	In November 1993, Company H borrowed 900 thousand RMB from Bank L. With refund in long-term arrears repeated, bank brought it to court. In the meantime, however, mortgage was transferred to third party. Bank claimed that mortgage term had been prescribed during period in arrears. This appeal, however, was rejected by court. Law was so interpreted to the effect that bank was obligated to register extension of mortgage in arrears.

Source: *Case Study on Risk Management of Commercial Banks*, Haitian Publishing Company, November 1997

(2) Bad Debts in Personal Housing Loans

As far as the bad debts in personal housing loans are concerned, the arrears still showed a low rate since banks have just begun to render personal housing loan services.

Table 4-8 Rate in Arrears of Personal Housing Loans by Bank

As of the end of June 2000

	OVERALL	SHANGHAI BRANCH	WUHAN BRANCH	CHENGDU BRANCH
China Construction Bank	less than 1%	approx. 4%	less than 1%	less than 1%
Industrial and Commercial Bank of China	less than 1%	less than 1%	less than 1%	less than 1%

Source: Answers in hearings at head offices and branches in each bank arranged

China Construction Bank has had a relatively high rate of arrears in its Shanghai Branch. This has been accounted for to the effect that the branch has had a longer history in rending personal housing loan services while handling a large number of loans. Shanghai China Construction Bank branch, therefore, has organized an arrears disposal division (work-out) where a staff of approximately 20 persons are working.

Recovery of refund in arrears for lendings consigned and disposal of properties have been entrusted to a lending agency bank. The Provident Fund Management Center has a title to the disposal of mortgage properties. In the case of a sorted loan, the Provident Fund Management Center and a bank share the title to the mortgage on the basis of pro rata of the actual value of the loan.

4.4. Loan Examination Enhancement - Risk Management in Advance

A bank must tackle with the risk management under the recognition that their function as a financing broker is nothing but accurately grasping and analyzing the location and size of every risk so as to perform an appropriate risk management and operations.

4.4.1. Risk Management Scheme

(1) General Risk Operation

It is fundamental to a "general risk operation" that a wide diversity of risks are comprehensively grasped and operated in accordance with the standardized rules as far as practicable.

The "general risk operation," has an objective of stably reckoning a risk-worthy revenue and properly distributing resources, with all risks identified, measured, controlled and monitored while inspecting and auditing their processes.

A comprehensive risk management section should be established as an organization to undertake the functions of integrally grasping and controlling the various risks taking place in every service beyond the boundaries of goods, services, and organs. The credit risk management should be put under the control of a finance planning section while an audit section should control the law observance management.

Based on the risk-related information intensified by such organs, the corporate management should organize various committees to hold their meetings so that the risk information-based service operation pollicies can be deliberated.

1）Introducing Capital Quota Scheme

The term, capital quota scheme, means the system where an amount allowed to take risks is established on a section by section basis to manage and operate the risks, so that they will fall within a range of the amount so allowed. The risks to be covered by a capital quota includes a credit risk, a market risk, a stock investment risk, an operational risk and a variety of miscellaneous risks, that is, every risk. A value of the risks taken section by section should be made to fall within a range of the bank's integral net worth for the purpose of maximizing the after capital cost income and risk adjusted performance measurement (RAPM) through an optimum distribution of capital while properly managing risks.

2）Operational Risk Management

Operational risks are defined as “all the risks, other than credit and market ones, which may cause losses to arise either directly or indirectly due to the inappropriateness and/or malfunctioning in internal process, manpower, engineering and other external events.”

To measure an operational risk, a self-assessment system should be implemented section by section. In the self-assessment, operational risks are classified into several tens of items to identify those scenarios which may be considered significantly influential over the corporate management. Thus, lost money, occurrence frequency, and control scheme should be assessed respectively. To make a self-assessment under the operational risk management system, each section should assess and should plan to promote the risk management scheme. Inspection and Audit Sections should inspect and audit the self-assessment results in each section, including how risks are being managed. And General Risk Management Section should map out policies and self-assessment standards.

A volume of the operational risks all over a bank should be arithmetically obtained according to a ratio of the risk scores, based on the results of self-assessment made in each section. The operational risk measurement method should be advanced more and more from now on.

(2) Credit Risk Management

1) Credit Risk Counting

An appropriate risk management would begin with confirming where a risk is existing and determining its form and size. Under this basic rule, credit risk counting is to be promoted. As part of establishing the infrastructure to that end, an integral rating system standardized all over the internal and external bases should be introduced to rate the creditability of individual customers and rank them by credit rating.

To quantitatively measure a credit risk, it is necessary to provide three factors, creditable value, default rate, and recovery rate. In the departmental capital quota system, a departmental credit risk capital quote plan should be mapped out, based on the field-proven departamental credit risk level, while taking into account a change in balance ofthe credit in the future, a forecast of default rates by credit rating, a prediction of recovery rates by security, stress test results and so on.

To measure a credit risk, an In-house model is used to make a simulation, with an inter-obligee correlation taken into account. And findings in such simulation are effectively utilized to control an intensive status of credit ratings.

2) Credit Risk Management Scheme

To assure that the business fits the characteristics of operations, it should be made as a general rule to promote the distribution of credits to the operation department as far as practicable. To make an individual examination and to control a credit rating, any intra-departmental matter should be likewise decided and controlled by a department in charge of examination organized within the department. Each department should try to separate operational promotion from examination so that they can perform a mutual check and balance. Under such a system, the department in charge of examination should be able to strictly examine independently the department in charge of operational promotion.

3) Market Risk Management

a) Risk Management System

For market risk management, its basic framework is of three-layer construction.” In other words, it should be sectionalized into three layers: management level, operational control/base management level, and trader level at which the market is manipulated in reality so as to secure the operations of an organization in which authorities and duties are separately defined. And it is the comprehensive risk management section that should perform a role of organically coupling them.

b) Risk Management Process

In a corporate management meeting, it is necessary to comprensively take into account the net worth and profitability, and to predetermine the total amount of market risks that could be taken, and to distribute it to each operation, such as exchange rates and derivatives. And each officer in charge of such operations should transfer its authorities to each department manager-in-charge, with the officer’s own authorities taken for upper limits. And the department manager in charge of each operation should have responsibilities and authorities within a range of the market risks transferred so as to conduct such operations.

For the purpose of suppressing the negative effects of market operations on the income of the bank as a whole, the socalled loss-cut rules are established to determine a limit of losses beforehand. The comprehensive risk control section should use a “market risk information system” as nucleic system to total and measure a volume of market risks in the entirely of a bank daily by risk category, such as interest rate, exchange rate, by operation, by operation control department and by region. And the findings involved, including profit/loss and authority observance status, should be reported directly to the corporate management.

(3) Action against Various Risks

1) Fluid Risk Management

Fluid risks are managed on a daily basis, which likewise involves configuration management from various viewpoints, a fluidity gap management, and fluid supply management, (such as commitment line or the like), and buffer asset (reversed asset) management to maintain fluidity. Moreover, a "contingency plan" is mapped out so that a bank can quickly respond to rapid changes in the market, political, and economic environments and changes outside the market.

2) Settlement Risk Management

The settlement business is one of those operations which permit Tokyo Mitsubishi to make effective use of its creditability, fund-raising ability, and network. We have been tackling more and more intensively with the settlement business from a strategic point of view in addition to the risk management aspects. Out of the settlement risks, the foreign exchange settlement is intended to enhance the management scheme on a credit rating. At the same time, we have a policy to carry out the reduction of settlement risk value itself, with netting promoted.

3) Clerical Risk Management

The term, clerical risks, means those risks, which may cause a bank to suffer from any loss if a clerk should neglect doing the paperwork accurately, or when accidental errors occur, or commit illegal action. Procedures and authorities should be applied more strictly, the procedures are mechanized and systematized to reduce the manual paperwork processing. And the cash/goods-in-kind management system should be enhanced while securing a check function by internal inspection or the like. And clerks should be trained more fully. Thus, efforts should be made to improve reliability for customers' benefit while striving to take action for a reduction of clerical risks.

4) System Risk Management

The term, system risks, means those risks which may cause a bank to suffer from any loss, either tangible or intangible, because a computer system shutdown, and/or malfunctioning may have resulted in a certain impediment to the performance of banking operations, and to rendering services to customers. It is necessary to take such essential countermeasures to provide a disaster-proof system, such as installing a variety of backing-up infrastructure and to implement fault training. To cover an information security-related risk, moreover, it is necessary to organize an information security section.

5) Judicial Affair Risk Management

Those laws and regulations which should be complied with to carry out operations have been implemented in the in-house procedures. At the same time, a system has been established to listen to the opinions of legal expertise as required. Judicial Affairs Section is to support the in-house judicial affairs risk management.

4.4.2. Personal Housing Loan Management by Commercial Banks in Japan

For more reference, an explanation will be given about how housing loans are handled by four Japanese banks, namely: Tokyo Mitsubishi, Sakura, Sanwa and Daiichi Kangyo.

(1) Borrower's age

BANKS	OPERATIONS
Tokyo Mitsubishi	20 or more years old but not older than 65 years, with the final installment refundable at 70 or less years
Sakura	20 or more years old but not older than 70 or less
Sanwa	= ditto =
Daiichi Kangyo	20 or more years old but not older than 60 years or less, with the final installment refundable at 71 or less years

(2) Insurance and guarantee

BANKS	OPERATIONS
Tokyo Mitsubishi	Those able to contract collective credit life insurance
Sakura	Those able to contract collective credit life insurance and eligible for receive guarantee from guarantee agency
Sanwa	= ditto =
Daiichi Kangyo	Those able to contract collective credit life insurance

(3) Fund applications

BANKS	OPERATIONS
Tokyo Mitsubishi	- To newly build, extend and/or modify housing and to purchase built housing for sale (including rooms in collective housing) - To purchase existing hosing (including rooms in collective housing) - To purchase land for dwelling (in case housing should be built within 2 years to come)
Sakura	- Funds required for personal use or family use to live as follows: - To newly build or purchase housing (including existing housing) and to extend or modify housing - To purchase a room or rooms in collective housing (including existing collective housing) - To purchase land for housing

BANKS	OPERATIONS
Sanwa	- To newly build. purchase, extend and/or modify housing where the borrower should live, including the funds required to cover a re-loan of the existing housing loan and various expenses involved in re-loaning - There are some restrictions, depending upon whether the building is of wooden construction and/or to the area of a property to purchase, etc. The real estate is required to comply with the Building Standards Acts and with the provisions in any other laws and/or regulations.
Daiichi Kangyo	- To purchase land and/or newly build, extend, modify and/or rework housing for the borrower to live - No loan is allowed if the property to be purchase violates the provisions set forth in the Building Standards Act, etc., such as capacity ratio (ratio of building floor area to building lot area), area ratio (ratio of construction lot area to building area) or the like.

(4) Amount

BANKS	OPERATIONS
Tokyo Mitsubishi	300 thousand yen or more but within 50 million (every 100 thousand yen)
Sakura	100 thousand yen or more but within 100 million (every 100 thousand yen)
Sanwa	500 thousand yen or more but within 50 million (every 100 thousand yen)
Daiichi Kangyo	200 thousand yen or more but within 50 million (every 100 thousand yen)

(5) Term

BANKS	OPERATIONS
Tokyo Mitsubishi	2 or more years but within 35 years (monthly)
Sakura	1 year or more but within 35 years (monthly)
Sanwa	1 year or more but within 35 years (yearly)
Daiichi Kangyo	1 year or more but within 35 years (yearly)

(6) Interest rate selection

BANKS	OPERATIONS
Tokyo Mitsubishi	Throughout the term of the loan, “fixed interest rate,” “variable interest rate (with upper limit)” and “variable interest rate” are repetitively reselectable. A changeover of the “fixed interest rate” to the “variable interest rate” or “variable interest rate (with upper limit)” is limited after the expiry of the “fixed interest rate” application term. A changeover of the “variable interest rate (with upper limit)” to the “variable interest rate “ or “fixed interest rate” is limited after the expiry of the “variable interest rate (with upper limit)” application term. A changeover of the “variable interest rate” to the “fixed interest rate” or “fixed interest rate (with upper limit)” is allowed on any repayment due dates.
Sakura	A desired interest rate is selected from the three types: variable interest rate, specific fixed interest rate, and specific variable/fixed interest. The interest rate system is allowed to be reviewed at any time for a changeover of the “variable interest type” to the specific fixed interest type. After completion of the fixed interest application term, the interest rate will automatically changed-over to the variable interest rate type. Nevertheless, a specific interest rate system irrespective of either identical or different loan term is allowed to continue, provided, however, that the lender agrees prior to the expiration of the fixed interest rate application term. (In either case where the variable interest rate system is newly adopted or the specific interest rate type continues to apply, the interest rate should be newly calculated all over again while reviewing the amount to repay thereafter.) In case of the variable/fixed mix interest type, it is possible to review the fixed interest rate and the fixed one, respectively. (A breakdown of the amount that was set when applying for is not allowed to alter.) (An interest rate system should be reviewed in accordance with the standards established by Sakura Bank.)

BANKS	OPERATIONS
Sanwa	A desired interest rate can be selected out of the four types: variable interest, selective fixed interest rate, variable interest rate with upper limit special clause) and mixed interest rate. A variable interest rate is alterable at any time to a selective fixed interest rate or to a variable interest rate with upper limit special clause. Once the special clause period for a selective fixed interest rate has expired, it is possible to select either special clause set type (selective interest rate or variable interest rate with upper limit special clause) or variable interest all over again. For the mix type, interest rate types can be combined freely with a loan divided into two or more portions. For example, a selective fixed interest type and a variable interest type may be combined. (Contractual documents are required to be prepared on each of the interest rate types combined. The registration expenses will be a little higher, accordingly.
Daiichi Kangyo	A desired interest rate is selectable out of the three types: variable interest rate, upper limit setting interest rate and selective interest rate. A variable interest rate may be changed over to a upper-limit setting interest rate or selective fixed interest rate on the day next to a subsequent contracted repayment date. The upper limit setting type interest rate permits either upper limit setting time to be selected all over again at the end of the upper-limit setting period while allowing for a selection of either variable interest or fixed interest type as well.

(7) Terms to which fixed interest type and upper-limited variable interest types apply

BANKS	OPERATIONS
Tokyo Mitsubishi	A fixed interest rate has a term of 3, 5 or 10 years selectable. A variable interest rate (with upper limit) has a term of either 5 or 10 years selectable.
Sakura	A fixed interest rate has a term of 2, 3, 5 or 10 years selectable. A variable/specific fixed mix interest rate has a term of 2, 3, 5 or 10 years selectable.
Sanwa	A selective fixed interest rate has a term of 3, 5 or 10 years selectable. A variable interest rate with upper limit special clause has a term of either 5 or 10 years selectable.

BANKS	OPERATIONS
Daiichi Kangyo	A selective fixed interest rate has a term of 2, 3, 5, 7 or 10 years selectable. An upper limit setting interest rate has a term of either 5 or 10 years selectable.

(8) Repayment

BANKS	OPERATIONS
Tokyo Mitsubishi	Repay in monthly equal installments with principal and interest. A repayment with extra bonus months available is also selectable (but within 50% of the loaned amount). If an applied interest rate should vary during the application term, it remains unaltered before passing the fifth October 1 following the date at which such interest rate was selected. Throughout the application period, an amount of the repayment should be reviewed every five years to determine the subsequent repayment amount. Even if an amount of the repayment should increase during the application period, such increase shall not exceed 25%.
Sakura	Either one of the following methods can be selected: - Repay in monthly equal installments with principal and interest - Jointly apply an interest - An extra repayment on receipt of bonus applies jointly. (An amount of the bonus-related repayment should fall within 50% of the loaned amount.) - A variable interest rate should be reviewed twice a year. The repayment in monthly equal installments should remain unchanged for a period of five years even if the interest rate fluctuates. In line with every five years' review, an amount to repay should be reviewed. If the amount to repay should increase, however, such increase should be limited to 1.25 times the amount previously repaid. - For the repayment in monthly equal installments, an amount to repay should be reviewed and recalculated in line with a review of the interest rate.

BANKS	OPERATIONS
Sanwa	Repay in monthly equal installments. An extra repayment twice a year or in months with bonuses received is jointly applicable. A repayment of the principal, moreover, may be deferred (in months within one year, with interest payable monthly). An amount to be repaid should be altered every five years, coupled with a fluctuation of interest rates. A new amount to be repaid should be determined as recalculated every five years. Nevertheless, any new amount to be repaid should not exceed 125% of the preceding amount repaid. To make a changeover to the "selective fixed interest" or "variable interest with upper limit special clause," the amount to repay should be recalculated on the spot. Whatever interest rate type of loan may be selected at the end of a special clause term, the amount to repay should be calculated on the spot
Daiichi Kangyo	Repayment in monthly equal installments. An extra repayment twice a year or in months with bonuses received is jointly applicable. (An amount of the bonus-related repayment should fall within 50% of the loaned value.) A deferred repayment of the principal for a period of 6 months or 1 year. For a loan of variable interest rate type, the interest rate should be reviewed twice a year after receipt of the loan. On October of every year, the interest rate is recalculated to obtain a new repayment amount. The new repayment amount is limited to a maximum of up to 1.25 times the preceding repayment amount. If the new repayment amount should be smaller, it will apply as unchanged.

(9) Accelerated repayment

BANKS	OPERATIONS
Tokyo Mitsubishi	Accelerating the repayment would incur in the following charges: - 5,250 yen for a repaid amount of less than 1 million yen - 31,500 yen for a repaid amount of less than 10 million yen - 52,500 yen for a repaid amount of 10 million yen A variable interest rate, however, should have an accelerated repayment charged at 3,150 to accelerate the final time limit and at 5,250 yen to recalculate the amount to repay.

BANKS	OPERATIONS
Sanwa	- 5,000 yen to make a partial repayment accelerated for a variable interest rate type loan, and 20,000 yen for any other interest types. In addition, a guarantee agency commission of 3,000 yen is charged. - 5,000 yen to make a blanket repayment accelerated for a variable interest type loan and 30,000 yen for any other interest types. In addition, a guarantee agency commission of 8,000 yen is charged.
Daiichi Kangyo	Variable interest rate type loan: An accelerated repayment is charged at 5,250 yen. Nevertheless, an amount of 50 thousand yen or more should be repayable so that it will leave a repayable balance in ten thousand yen or more. An accelerated repayment in full amount is charged at 3,150 yen within a loan term of 3 years. at 2100 within 5 years, at 1,050 yen within 7 years and free of charge for more than 7 years. Upper limit interest rate setting loan: A repayment accelerated during the upper limit interest rate type loan is charged at 21,000 yen for repayment partially accelerated and 31,500 yen for repayment in full amount. Separately, another charge of 10,500 yen is incurred as specified by Daiichi Kangin Credit Development, Ltd. Selective fixed interest rate type: A repayment accelerated during the selective fixed interest rate type loan is charged at 21,000 yen for repayment partially accelerated and 31,500 yen for repayment in full amount. Separately, another charge of 10,500 yen is incurred as specified by Daiichi Kangin Credit Development, Ltd.

(10) Ratio of annual repayment amount to annual income (with repayment of other borrowings included in repayment amount)

BANKS	OPERATIONS
Sakura	The amount to be loaned should be based on the previous year annual income tax and it should fall within 1. and 2. below. 1. The amount of all borrowings, including any other loan or loans, should fall within the following range. Within 5 times the annual income for a borrower with an annual income of less than 4 million yen Within 6 times the annual income for a borrower with an annual income of 4 million yen or more 2. A ratio of the repayment amount, including any other repayment or repayments, to the annual income should fall within the following range: Within 25% for a borrower with an annual income of less than 1.5 million yen Within 30% for a borrower with an annual income of 2.5 million yen or more Within 35% for a borrower with an annual income of less than 4 million yen Within 40% for a borrower with an annual income of 4 million yen or more
Daiichi Kangyo	A ratio of the annual repayment amount to the annual income (with the annual repayment amount including all the repayments of any other borrowings) Within 25% for borrower with an annual income of 2 million yen or more but less than 3 million yen Within 30% for borrower with an annual income of 3 million or more but less than 4 million yen Within 35% for a borrower with an annual income of 4 million yen or more

(11) Ratio of loan to purchasing price

BANKS	OPERATIONS
Daiichi Kangyo	80% to purchase housing, including lot 100% to newly construct a building (with lot already acquired or with leased land mortgaged) 80% to purchase a room or rooms in collective housing, and 80% to purchase housing lot

(12) Guarantor and security

BANKS	OPERATIONS
Tokyo Mitsubishi	No separate guarantee is required since Diamond Housing Credit, Ltd. (DHC) guarantees. Property is mortgaged to DHC.
Sakura	Lot and building to be covered by the loan are mortgaged to the guarantee agency designated by the Bank as first mortgager. The lender, however, is limited to a governmental depository, such as the Government Housing Loan Corporation or the like. - To jointly apply a borrowing from a public corporation, the mortgage should be given priority as referred to below. In principle, the borrower should contract fire insurance as designated by the guarantee agency. The right to claim for insurance should have mortgage established with the guarantee agency as mortgager.
Sanwa	The lot and building to be covered by the loan are mortgaged or root-mortgaged and registered by the guarantee agency. The amount of root mortgage should be set to 110% or more of the amount borrowed. The building is fire-insured for a long term. The guarantee agency may mortgage the fire insurance. Since the guarantee agency guarantees, no guarantor need be provided.
Daiichi Kangyo	The property covered by the loan should be mortgaged to Daiichi Kangin Credit Development as first mortgager and registered. If the borrower should have any other borrowings from a governmental organ, such as Government Housing Loan Corporation or the like and from a local government-related organ, Daiichi Kangin Credit Development, Ltd. may be given mortgager priority subsequent thereto. If the property covered by the loan should be shared, the co-owner's share should be also furnished as mortgage. Since Daiichi Kangin Credit Development guarantees, no guarantor is separately required. The building is fire-insured for a long term. And the right to claim for such insurance

	is mortgaged. The insurance should over the price for a new construction of the housing (reacquisition price)

(13) Commissions and guarantee charges

BANKS	OPERATIONS
Tokyo Mitsubishi	Paperwork charge 31,500 yen Guarantee charge (every 10 million yen in loan) to be paid to DHC 45,800 yen for a period of 5 years, 85,440 yen for 10 years, 119,820 yen for 15 years, 148,340 yen for 20 years and 191,370 yen for 30 years.
Sakura	Guarantee charge per million yen loaned 4,580 yen for a period of 5 years, 8,544 yen for 10 years, 11,982 yen for 15 years, 14,834 for 20 years and 19,137 yen for 30 years, for repayment equal installments with principal and interest 4,298 yen for a period of 5 years, 7,597 yen for 10 years, 10,195 yen for 15 years, 12,252 for 20 years and 15,237 yen for 30 years, for repayment equal installments with principal
Sanwa	30,000 yen (accepted by the guarantee agency) per loan may be charged separately to cover the expenses incurred on investigation of mortgage, etc. The guarantee charge varies with an amount borrowed and term of borrowing, ratio of repayment amount to annual income, etc. Example) 148,340 or 593,360 for loan amounting to 10 million yen for a borrowing term of 20 years.
Daiichi Kangyo	The borrower should pay guarantee and paperwork charges (31,500 yen) to Daiichi Kangin Credit Development, Ltd. Guarantee charge for a loan amount to 10 million yen (repayment in equal installments with principal and mortgage: 45,800 yen for a period of 5 years, 85,440 yen for 10 years, 119,820 yen for 15 years, 148,340 yen for 20 years and 191,370 yen for 30 years

(14) Interest rate level

BANKS	OPERATIONS
Sanwa	Variable interest rate type ... interest rate based on the Bank's "short-term prime interlocked long-term reference interest rates (more than 3 years)" Variable interest rate type with upper limit special clause --- An upper limit of interest rates is provided for as special clause, based on the Japanese yen TIBOR (Tokyo inter-bank offered rate) for a term of 6 months) during a special clause period of 5 or 10 years.

BANKS	OPERATIONS
Daiichi Kangyo	Variable interest rate type ... A variable interest rate applies, based on the Bank's preferred interest rates for short-term prime rate-interlocked long-term lending interest rates (for a term of more than 3 years). After loaned, the interest rate should be reviewed twice a year, based on the Bank's preferred interest rates (for a period of more than 3 years), short-term prime rate-interlocked long-term lending interest rates on April 01 and October 01. A new interest rate is apply , respectively, from the day next to the date at which the repayment is contracted in June and December. The same applies in the case of an upper limit interest rate setting type.

In the case of Sanwa, specific interest rate levels are as follows (for borrowings in January 2001)

Variable interest rate type:
2.500% annually for
Selective fixed interest type:
2.35% with the initial 3-year fixed interest rate selected
2.75% with the initial 5-year fixed interest rate selected
3.50% with the initial 10-year fixed interest rate selected
Variable interest rate with upper limit interest rate special clause:
2.600% with the initial 5-year upper-limit special clause type interest rate selected (upper limit of interest rates: 4.010% annually)
3.350% with the initial 10-year upper-limit special clause type interest rate selected (upper limit of interest rates: 4.190% annually)
<<Reference>> Deposit Interest Rates (before tax)
Saving deposit: 0.12% annually
1-year season deposit 0.15% annually
2-year season deposit 0.17% annually
3-year season deposit 0.20% annually
5-year season deposit 0.251% annually
10-year season deposit 0.408% annually

(15) Collective credit life insurance

Collective credit life insurance premiums are borne by the bank. (The collective credit life insurance has turned out as a critical mechanism to preserve the claims. The term, collective credit life insurance system, means that the principal for a credit is covered, with a banking institution as insurance contractor and receiver and borrower as insured.)

(16) Characterized loans and others by bank

BANKS	OPERATIONS
Tokyo Mitsubishi	Housing Incidentals Loan: A maximum of up to 5 million yen for a maximum term of up to 10 years is financed without either security or guarantor. Loan Repayment Support Insurance: Over a maximum period of three years, an insurance money would be receivable before the insured has come back to work, provided, however, that the insured has entered a hospital or had a therapy at home for more than 30 days as instructed by a medical expert due to an injury or disease suffered during the loan repayment period. Super Housing Loan: A maximum of up to 200% on an assessed value of security is financed to re-loan a housing loan or repurchase housing.
Sakura	Re-loan Support Type Housing Loan: A re-loan is available even if the security should be insufficient.
Sanwa	Sanwa Hosing Loan’s Exclusive Fire Insurance: Damages will be insured if the building and/or furniture should be damaged in a fire or theft. Loan Repayment Support Insurance: A loan repayment I supported in preparation for the case where the insured need enter a hospital or receive therapy for a long time due to a disease or injury
Daiichi Kangyo	Parent-Child Pair Housing Loan: A loan is repaired by parent and a child or children in amounts shared in cooperation of parent and children. The loan is limited up to a maximum of 70 million yen. Parent-Child Relay Housing Loan: A parent-child several and joint loan has the liabilities succeed from the parent to a child or children in the future.

4.4.3. Examination of Lendings by Housing-related Business Line

It is better to prepare the standardized examination procedures and documentation forms for those banks who are to offer housing-related loans. Proposed hereinbelow are the cases where housing-related lendings have been examined on a business line basis in Japan.

(1) Lendings-by-Business-Line Examination

Table 4-9 Lendings-by-Business-Line Examination Chart

Type			
Backgrounds	Features in Industry		
	Trends in Industry		
	Precautions		
Knowledge about Operations	Legislation		
	Land Transaction		
	Taxation		
	Precautions		
Keys to Examination	Employer		
	Organization		
	Performance		
	Immovables Owned		
	Land Acquisition Ability		
	Merchandise Planning Ability		
	Selling Ability		
	Financing/Fund-raising Ability		
	Precautions		
	Financial Standings	Assets in detail	
		Inventory assets	
		Turnover rate of total assets	
		Profit/loss status	
		Accounting system checkout	
		Profit in other departments	
		Fund raising	
Management Advice	Keys to Guidance	Inventory level	
		Project term	
		Affiliates	
		Precautions	
Keys to Promotion of Finance	What be Noted when Promoting and Newly Starting Finance		

Source: JICA Study Team, based on "Dictionary of Lending Examinations by Business Line" Financial and Fiscal Trend Research Center, Inc.

(2) Keys to Examination of Lendings by Business Line

While exchanging opinions with the person in charge on the part of Chinese banks, it has been recognized that there are some common points, irrespective of either domestically or overseas, in the field of bank finances and housing-related loans. According to the borrower's business features, for example, its financial standings are examined. With the judicial and economic environments surrounding the business line taken into consideration, a loan is examined in its amount and/or period. In many cases, moreover, the experience overseas is borrowed and effectively used.

The keys to an examination referred to below, though examples taken in Japan, could be considered serving as a useful suggestion to promote transactions, with a loan studied from a comprehensive point of view.

Line ① General Real Estate Broker

Back-grounds	Features in Industry	• Important position in macro-economics • Diversified forms of operations, • Many legal restrictions, • Significant fluctuations of operating performance • Significant fluctuations of land prices
	Trends in Industry	• Features in industry by region • Outline of leading enterprises • Demand/supply trends • Land pricing trends • Trends of demand for housing by region • Second-hand housing distribution status • Commercial building demand/supply trends
	Precautions	• Number of new construction commencing houses by region
Knowledge about Operations	Legislation	• Housing Lots/Buildings Dealing Act • National Land Utilization Plans Act • Urban Planning Act • Building Standards Act
	Land Transaction	• Regulations established or not • Development action permit system • Application restrictions

<table>
<tr><td></td><td>Taxation</td><td colspan="2">• Transfer：income tax, legal person tax, inhabitants’ tax, and transfer profit tax
• Ownership: land price tax, fixed asset tax and urban planning tax,
• Accusation: real estate acquisition tax, registration/license tax, and inheritance tax</td></tr>
<tr><td rowspan="10">Keys to Examination</td><td>Employer</td><td colspan="2">• Personal history,. expertise, reputation in trade, and management ability</td></tr>
<tr><td>Organization</td><td colspan="2">• Departmental manpower and internal systems</td></tr>
<tr><td>Performance</td><td colspan="2">• Departmental weight, changes in sales area, existence of bad properties owned, profit-making techniques and real estate investment overseas</td></tr>
<tr><td>Real estate owned</td><td colspan="2">• Location, area, legal control, acquisition timing, proceedings, book value, current value and mortgage value</td></tr>
<tr><td>Land Acquisition Ability</td><td colspan="2">• Information ability, acquisition ability, in-house check and purchase/sale balance</td></tr>
<tr><td>Merchandise Planning Ability</td><td colspan="2">• Demand strata, customer control system and tenant candidates</td></tr>
<tr><td>Selling Ability</td><td colspan="2">• Sales network, sales staff, number of salesmen, years of experience, settlement rate, changes in sales performance, sales scheme and customer control scheme</td></tr>
<tr><td>Fund-raising Ability</td><td colspan="2">• Borrowing system, mortgage assets owned, cash-flow, loaner and loan size</td></tr>
<tr><td rowspan="2">Financial Standings</td><td>Assets</td><td>• Terms for receipt of receivables, terms for receipt of outstanding accounts, securities, lendings to affiliates, advance payments, expenditure for work not completed, real estate project expenditure, inferior assets, calculated interest payable, devaluation loss of assets, and latent loss of assets</td></tr>
<tr><td>Inventories</td><td>• Turnover rate of inventories</td></tr>
</table>

		Turnover rate of total assets	• Working turnover rate of total assets; causes to let it turn unfavorable include an increase in stock due to sluggish sales, an extension of the period for a large project in progress, failure to obtain permit of development, etc.
		Accounting system checkout	• Sales-reckoning timing, interest reckoning standards, depreciation and consistency of accounting standards
		Departmental profit	• Highly profitable department, unprofitable department and cause/effect analysis
		Fund raising	• Recovery of sales, and status of support by banks
		Comparison with competitors	• Fluid asset ratio, fixed asset ratio, net worth ratio, liability ratio, operating balance ratio, borrowing dependence, return to sales ratio, working rate of return on total assets, interest burden to sales ratio, working turnover rate of total assets and number of inventory turnover days
Management Advice	Keys to Guidance	Inventory level	• Advise to switch properties in long-term stock over to lease
		Project term	• Advise to reduce the term of a project by enhancing the process control
		Affiliates	• Advise to manage financial affairs on a consolidated basis, and to dissolve deficiencies in affiliates and bad debts

Keys to Transaction Promotion	What be Noted when Promoting and Newly Starting Finance	• Offer related information. • Advise fund-raising methods. • Introduce builders. • Introduce buyers. • Guide fund transactions and prepare for contracting • Acquire deposit transactions. • Acquire settlement transactions.

Line ② Developers

Back-grounds	Features in Industry	• Acquire undeveloped land and develop real estate. • Fluctuate significantly in performance. • Significantly affected by land price fluctuations • Redevelop urban areas. • Convert farmland.
	Trends in Industry	• Features in industry by region • Outline of leading enterprises • Land status • Land pricing trends • Trends of demand for housing lots by region • House/flat distribution status • Trends of demand for commercial buildings
	Precautions	• Rate of changes in land pricing relative to a year earlier
Knowledge about Operations	Legislation	• Land standards law • Residential land and building transaction law • National land utilization law • Urban development law • Real estate specific joint project law • Specific purpose corporation law • Urban centers activation law
	Transaction Requirements and Development Flow	• Equivalent exchange system • Project order acceptance system • Land trust system • Land zoning project system • Fixed-term leasehold system • Real estate specific joint project system • Specific purpose incorporation system

<table>
<tr><td rowspan="12">Keys to Examination</td><td>Employer</td><td colspan="2">• Personal history,. expertise, reputation in trade, and management ability</td></tr>
<tr><td>Organization</td><td colspan="2">• Departmental manpower and internal systems</td></tr>
<tr><td>Operations</td><td colspan="2">• Parent company’s business line, operation size, operating territory, sales size and stock exchange listing</td></tr>
<tr><td>Real estate owned</td><td colspan="2">• Location, area, legal control, acquisition timing, proceedings, book value, current value and mortgage value</td></tr>
<tr><td>Land Acquisition Ability</td><td colspan="2">• Information ability, acquisition ability, in-house check and purchase/sale balance</td></tr>
<tr><td>Merchandise Planning Ability</td><td colspan="2">• Demand strata, customer control system and tenant candidates</td></tr>
<tr><td>Selling Ability</td><td colspan="2">• Sales network, sales staff, number of salesmen, years of experience, settlement rate, changes in sales performance, sales scheme and customer control scheme</td></tr>
<tr><td>Demand for funds</td><td colspan="2">• Fund planning and business planning</td></tr>
<tr><td rowspan="3">Financial Standings</td><td>Assets</td><td>• Terms for receipt of receivables, terms for receipt of outstanding accounts, securities, lendings to affiliates, advance payments, expenditure for work not completed, real estate project expenditure, inferior assets, calculated interest payable, devaluation loss of assets, and latent loss of assets</td></tr>
<tr><td>Inventories</td><td>• Turnover rate of inventories</td></tr>
<tr><td>Turnover rate of total assets</td><td>• Working turnover rate of total assets; causes to let it turn unfavorable include an increase in stock due to sluggish sales, an extension of the period for a large project in progress, failure to obtain permit of development, etc.</td></tr>
</table>

<table>
<tr><td rowspan="4"></td><td rowspan="4"></td><td>Accounting system checkout</td><td>• Sales-reckoning timing, interest reckoning standards, depreciation and consistency of accounting standards</td></tr>
<tr><td>Departmental profit</td><td>• Highly profitable department, unprofitable department and cause/effect analysis</td></tr>
<tr><td>Fund raising</td><td>• Recovery of sales, and status of support by banks</td></tr>
<tr><td>Comparison with competitors</td><td>• Fluid asset ratio, fixed asset ratio, net worth ratio, liability ratio, operating balance ratio, borrowing dependence, return to sales ratio, working rate of return on total assets, interest burden to sales ratio, working turnover rate of total assets and number of inventory turnover days</td></tr>
<tr><td rowspan="3">Management Advice</td><td rowspan="3">Keys to Guidance</td><td>Inventory level</td><td>• Advise to switch properties in long-term stock over to lease</td></tr>
<tr><td>Project term</td><td>• Advise to attach importance to the demand for small-scale projects.
• Advise to reduce the term of a project by enhancing the process control</td></tr>
<tr><td>Affiliates</td><td>• Advise to manage financial affairs on a consolidated basis, and to dissolve deficiencies in affiliates and bad debts</td></tr>
<tr><td>Keys to Transaction Promotion</td><td>What be Noted when Promoting and Newly Starting Finance</td><td colspan="2">• Offer related information.
• Advise fund-raising methods.
• Introduce builders.
• Introduce buyers.
• Guide fund transactions and prepare for contracting
• Acquire deposit transactions.
• Acquire settlement transactions.</td></tr>
</table>

Line ③ Interior Finish Work

Back-grounds	Features in Industry	• Many works are in small scale. • Sell kitchen, bathroom and toiletry equipment. • Sell furniture. • Install balcony and terrace. • Grow, coupled with an increase in demand for housing. • Sensitive to changes in macro-economics.
	Trends in Industry	• Trends in the interior market • Increase income levels. • Improve housing quality. • Evaluate housing. • Diversify housing needs.
	Precautions	• Not fully developed yet in designing an extension and/or modification of housing, including work execution techniques
Knowledge about Operations	Legislation	• Construction Enterprises Act • Permit/authorization system
	Operations	• Extend/modify building bodies. • Repair and refinish the interior. • Interior finish work • Replace and/install ancillaries. • Install terraces and balconies.
Keys to Examination	Employer	• Personal history, expertise, reputation in trade, and management ability
	Organization	• Departmental manpower and internal systems • Number of persons qualified
	Operation form	• Operating shop • Operation form • Contractor • Levels of design, work execution and supervision, customer evaluation • Price at which an order is received.
	Planning administration ability	• Planning and proposing ability • Demand strata and customer control system.

	Selling Ability	• Sales network, sales staff, number of salesmen, years of experience, settlement rate, changes in sales performance, sales scheme and customer control scheme	
	Demand for funds	• Borrowing system, mortgage assets owned, cash flow, lenders, and lending size	
	Financial Standings	Shop profitability	• Sales, gross profit, general administrative expenses, labor cost, incidentals, house rent, selling expenses, lendings to affiliates, interest rates, operating profits, non-operating expenses, operating income
		Accounting system checkout	• Sales-reckoning timing, interest reckoning standards, depreciation and consistency of accounting standards
		Departmental profit	• Highly profitable department, unprofitable department and cause/effect analysis
		Fund raising	• Recovery of sales, and status of support by banks
Management Advice	Keys to Guidance	Project term	• Advise to reduce the term of a project by enhancing the process control
Keys to Transaction Promotion	What be Noted when Promoting and Newly Starting Finance	• Offer related information. • Explore the demand for funds. • Acquire deposit transactions. • Acquire settlement transactions.	

Line ④ Residential Complex Developers

Back-grounds	Features in Industry	• Many farming lots have been applied in urban suburbs. • Sell to inhabitants in urban areas and to foreigners. • Sensitive to macro-economic fluctuations • Significantly affected by land price fluctuations.

	Trends in Industry	• Outline of leading enterprises • Demand/supply trends • Land pricing trends • Demand trends by region
	Precautions	• Location and entire design are critical.
Knowledge about Operations	Legislation	• Housing Lots/Buildings Dealing Act • National Land Utilization Plans Act • Urban Planning Act • Building Standards Act • Visiting Sales Act
	Contract System	• Membership system • Ownership system • Member participation system • Company-led system • House-to-house sharing • Overall sharing • Proprietary right sharing
	Taxation	• Transfer：income tax, legal person tax, inhabitants’ tax, and transfer profit tax • Ownership: land price tax, fixed asset tax and urban planning tax, • Accusation: real estate acquisition tax, registration/license tax, and inheritance tax
Keys to Examination	Employer	• Personal history,. expertise, reputation in trade, and management ability
	Organization	• Departmental manpower and internal systems
	Performance	• Demand and supply balance • Facility working ratio • New investment in facilities • Monetary value of modification work • Confidence in the industry • Membership right transactions
	Real estate owned	• Location, area, legal control, acquisition timing, proceedings, book value, current value and mortgage value

<table>
<tr><td rowspan="8"></td><td>Land Acquisition Ability</td><td colspan="2">Information ability, acquisition ability, in-house check and purchase/sale balance</td></tr>
<tr><td>Merchandise Planning Ability</td><td colspan="2">Demand strata, customer control system and buyer candidates</td></tr>
<tr><td>Management Status</td><td colspan="2">Selling facilities for sale, number of members, administration/operation scheme
Working ratio
Sales network, sales staff, workforce, years of experience, settlement rate, changes in sales performance, sales system and customer administration system
Royalties and changes in annual supervision fee income</td></tr>
<tr><td>Demand for funds</td><td colspan="2">Land acquisition expenses,
Construction work cost
Cost for supplies</td></tr>
<tr><td rowspan="4">Financial Standings</td><td>Assets</td><td>Terms for receipt of receivables, terms for receipt of outstanding accounts, securities, lendings to affiliates, advance payments, expenditure for work not completed, real estate project expenditure, inferior assets, calculated interest payable, devaluation loss of assets, and latent loss of assets</td></tr>
<tr><td>Turnover rate of total assets</td><td>Working turnover rate of total assets; causes to let it turn unfavorable include an increase in stock due to sluggish sales, an extension of the period for a large project in progress, failure to obtain permit of development, etc.</td></tr>
<tr><td>Accounting system checkout</td><td>Sales-reckoning timing, interest reckoning standards, depreciation and consistency of accounting standards</td></tr>
<tr><td>Fund raising</td><td>Recovery of sales, and status of support by banks</td></tr>
</table>

		Comparison with competitors	• Fluid asset ratio, fixed asset ratio, net worth ratio, liability ratio, operating balance ratio, borrowing dependence, return to sales ratio, working rate of return on total assets, interest burden to sales ratio, working turnover rate of total assets and number of inventory turnover days
Management Advice	Keys to Guidance	Project term	• Advise to reduce the term of a project by enhancing the process control
		Fund transaction	• Bond operation advice • How to raise funds, including up to recovery of membership right • Running fund raising
Keys to Transaction Promotion	What be Noted when Promoting and Newly Starting Finance	• Offer related information. • Introduce builders. • Introduce buyers. • Acquire deposit transactions. • Acquire settlement transactions.	

Line ⑤ Commercial Building Lenders

Back-grounds	Features in Industry	• Closely associated with macro-economic trends and entrepreneurial return trends • Expectable to secure profit as long as locating conditions are favorable
	Trends in Industry	• Features in industry by region • Outline of leading enterprises • Trends of demand for housing by region • Commercial building demand/supply trends • Changes in number of lenders • Size and equipment of building
	Precautions	• Locating conditions • Building equipment • Rent income • Fund raising • Operational profitability

Knowledge about Operations	Legislation	• Housing Lots/Buildings Dealing Act • National Land Utilization Plans Act • Urban Planning Act • Building Standards Act
	Operation forms	• Land trust system • Operation trust system • Equivalent exchange system • Construction cooperators' money system
	Taxation	• Transfer：income tax, legal person tax, inhabitants' tax, and transfer profit tax • Ownership: land price tax, fixed asset tax and urban planning tax, • Accusation: real estate acquisition tax, registration/license tax, and inheritance tax
Keys to Examination	Employer	• Personal history, expertise, reputation in trade, and management ability
	Organization	• Departmental manpower and internal systems
	Transactions	• Effective working area • Rent setting • Market rent • Rent revision • Caution money • Tenant obtaining method
	Real estate owned	• Location, area, legal control, acquisition timing, proceedings, book value, current value and mortgage value
	Merchandise planning ability	• Demand strata, customer control system, and tenant candidates
	Selling Ability	• Sales network, sales staff, number of salesmen, years of experience, settlement rate, changes in sales performance, sales scheme and customer control scheme
	Fund-raising Ability	• Borrowing system, mortgage assets owned, cash-flow, loaner and loan size

	Financial Standings	Operation profitability	• Initial investment cost • Running cost • Expenses, asset tax, administrative expenses, labor cost, and non-life insurance cost • Depreciation expenses
		Inventories	• Turnover rate of inventories
		Turnover rate of total assets	• Working turnover rate of total assets; causes to let it turn unfavorable include an increase in stock due to sluggish sales, an extension of the period for a large project in progress, failure to obtain permit of development, etc.
		Accounting Documents Checkout	• sales-reckoning timing, interest reckoning standards, depreciation and consistency of accounting standards • Bond recovery • Rent income correctness
		Funding plan	• Self-fund raising ability • Bank support status
		Comparison with competitors	• Fluid asset ratio, fixed asset ratio, net worth ratio, liability ratio, operating income ratio, borrowing dependence, return to sales ratio
Management Advice	Keys to Guidance	Project term	• Advise to reduce the term of a project by enhancing the process control
		Affiliates	• Advise to manage financial affairs on a consolidated basis, and to dissolve deficiencies in affiliates and bad debts
Keys to Transaction Promotion	What be Noted when Promoting and Newly Starting Finance	• Offer related information. • Advise fund-raising methods. • Take personal inheritance tax saving measures. • Introduce buyers. • Guide fund transactions and prepare for contracting • Acquire deposit transactions. • Acquire settlement transactions.	

4.5. Bad Debt Management - Ex-Post-Facto Risk Management

4.5.1. Discovering a Bad Debt in its Earlier Stages:

(1) Credit for Enterprises

Once a loan has been offered, a commercial bank should be able to detect the changes of loanee's arrears at an early stages through routine inspections to prevent possible areas or a default. To this end, the bank uses the following as analytical tools to determine signs of the loanee's arrears

1) Delay in presenting an annual report of financial statements.
2) Postponement of payment for outstandings,
3) A rapid increase in stock,
4) A significant increase in long-term debts,
5) A big change or changes in the balance sheet,
6) A rapid increase in non-operating expenses,
7) A plan or plans not implemented,
8) Inability to furnish necessary information,
9) A hike of cost and a decline of profit,
10) A long-term investment with short-term funds raised,
11) A delay in paying the interest and/or payable expenses in arrears,
12) A lower rate of growth in sales than that of inflation,
13) Overconcentration of sales on a customer or customers,
14) An alteration of the top management and a change in shareholders
15) Superannuation of fixed assets/equipment, and
16) A decrease in savings.

(2) Credit for Individuals

To administer and recover personal loans and to settle a problem or problems, if any, it is necessary to take into consideration the loanees' human rights.

If possible, therefore, the credit on personal loans should be desirably secured while making effective use of the information available in banks. At present, all banks in China have not established a satisfactory personal information system. With the credit card system becoming popular, however, the personal information obtainment means is likely to improve more than ever.

To discover a bad debt in personal loans, it is important to grasp the following points:

1) A credit card refund status,
2) A significant change in domestic situations of the loanee, and
3) A possible existence of multiple obligations,
4) A sudden requirement for expenditure,

5) Residence, occupation, employment, occupation change status, and any other reason,
6) A recent status of recent operations for a self-employer,
7) Health of the loanee,
8) Consuming habits of the loanee,
9) A change in assets owned by the loanee in its name

4.5.2. Loan Credit Classification Standards

(1) Chinese Credit Classification Standards

Table 4-10 Credited loans classification in China

Classification	Major Characteristics
Normal assets	No problem with repayment of principals and interests by debtor
Special Mention	a) Decrease in cash flow-in b) Signs of decrease in sales and profits and short cash flow c) Major financial indicators falling below trade average d) Voluntary change in fund allocation e) Decrease in motivation for repayment, uncooperative with banks f) Depreciation of secured properties g) Hard to secure mortgage and collateral Difficult for the bank to supervise the account customers
Substandard assets	a) Decrease in debtor's solvency b) Non-performance of third party liabilities c) Partial default of liabilities False reporting
Doubtful Assets	a) Production stop and extreme decrease in operating rate by debtor corporation b) Suspension of investments in fixed assets c) Excess of liabilities over assets d) Sued by bank Failure to improve solvency after default
Loss Assets	a) Short collateral value after default b) Depreciation of collateral value c) Debtor's bankruptcy No prospect of resuming operation after suspension of investments in fixed assets

Source: JICA Study Team, based on the materials available from People's Bank of China

(2) Credit Classification Standards in Japan

Table 4-11 Credit Classification Standards in Japan

CLASSIFIED ASSET	CLASSIFICATION STANDARDS IN FINANCE INSPECTION MANUAL
I Class Asset	a) The term, I-Class Assets, means the assets free from any problems in wholesomeness. b) Credit whose lendings are very highly likely to be recovered. A loanee, who has been showing a good business performance without any particular problem in financial standings, may fall within this class as normal debtor. In other words, I Class Assets may be deemed as the credit whose loan is highly likely to be refunded.
ⅡClass Assets	c) Credit that may bring about a loss in the future, with a little concern about its refund according to the classification in the financial inspection manual. The term, ⅡClass Assets, means the credit likely to have a loss, with a more or less concern about the refund, judging from the loanee's solvency and the like. although no loss has arisen at present. d) Defined as "assets, such as credit or the like, whose recovery is more risky than normal because various requirements to ensure that the credit are not satisfied, or for the reason that there is a doubt in faith" e) A lending could not normally help accompanying a certain risk. Ⅱ Class Asset, however, involves a higher level of risk than those normally worried about. It is the credit that requires special attention in its risk management in the future. Categorized in this class are those who may have had a problem in lending conditions, such as an exemption or reduction of interest, for example. In addition, others may have put their credit actually in arrears in refunding the principal or in paying interest, with a fear that they may fail to settle their debt. Included in this class, moreover, are those debtors who have a fear of bankruptcy or have been substantially bankrupt, involving a problem or problems in their obligations. Out of these debts, those which could not be covered with preferred mortgage fall in this class. f) Other loans whose funds may have been applied under many problematical accounts fall in this class, including such a case where a loan has extended over a longer period without duly studying a recovery plan This case, however, is considered to have a higher possibility of falling in II Class.

CLASSIFIED ASSET	CLASSIFICATION STANDARDS IN FINANCE INSPECTION MANUAL
Ⅱ Class Assets	g) Some credit that requires control is also included in the normal credit. The term, control-requiring credit, as used herein, means the credit in arrears for 3 or more months (loan whose principal or interest refund has been in arrears for three or more months as started to count on the day next to the contracted due date) and credit offered under relaxed lending conditions (credit on the loan whose lending conditions have been compromised to a certain extent in favor of loanees, trying to reconstruct or support the debtor who has fallen into economic difficulties). h) The term, "risky credit," means the credit offered to those loanees who have a fear of bankruptcy. The term, "credit for reconstruction in bankruptcy or equivalent thereto," means the credit offered to those loanees who have been bankrupt either substantially or really.
Ⅲ Class Asset	i) Loanees who may soon have to file bankruptcy, and from whom it is difficult to recover a refund with security or guarantee, and recovery of credit is a serious concern, there is a high probability of incurring a loss, fall in this class. Under the current circumstances however, it is difficult to estimate an amount of loss reasonably. Nevertheless, it is not absolutely impossible to estimate the loss but it is considered appropriate that a banking institution fairly familiarized with the loanees' personal asset status should be able to estimate an amount of the loss in accordance with their rules and assessment. j) A portion considered difficult to recover with security or guarantee out of those loanees who have a fear of bankruptcy falls in this Ⅲ Class Asset. k) Credit on those accounts who may be deemed highly probably leading to bankruptcy because an improvement plan has not been proceeding smoothly, (for example, with difficulties to manage at present.) Immediately after the bankruptcy of an enterprise, moreover, the security, even if available, has devaluated, bringing about a difference from the price on the real disposal. These losses also fall within III Class. l) Ⅲ Class Asset has conventionally had 50% or equivalent reckoned as an amount estimated as loss under the conventional asset-evaluating principles. More recently, however, some have begun to assert that the loss should be reckoned as 70% or equivalent subject to the guidelines

CLASSIFIED ASSET	CLASSIFICATION STANDARDS IN FINANCE INSPECTION MANUAL
	proposed by the Finance Reconstruction Committee. Most importantly, as a matter of course, a banking institution should establish an amount of loss under their own reasonable standards.
Ⅳ Class Asset	m) The term, Ⅳ Class Asset, means that assets recovery is considered totally impossible. Amortization and/or reverse application are required. The debtor, for example, has been bankrupt, has liquidated, disorganized, or reorganized a corporate entity, composed with creditors or put into an otherwise legally bankrupt condition. Or, the debtor may substantially be deemed insolvent, being banned from transacting with banks. In such a case, the lendings without guarantee or security and not expressly expected to recover are included in this class. n) Those assets evaluated as Ⅳ Class Asset may be considered almost dead. These assets, however, are not absolutely impossible to recover but may be partially recoverable. Even in such a case, however, the assets categorized here are those which were judged unrecoverable or of no value as of the reference assessment date. o) The assess classified as IV Class must go through such proceedings as amortization or reverse application so as to keep assets wholesome.

Source: JICA Study Team, based on Finance Inspection Manual, Finance Supervising Agency

4.6. Managing a Bank in Private Housing Finance

To support the private housing finance in China, Industrial and Commercial Bank of China is representative of general commercial banks while China Construction Bank is representative of long-term credit banks. (Industrial and Commercial Bank of China <I&CBoC> and China Construction Bank <CCB> are to be referred to as the two banks hereinafter.) Problems, therefore, will be arranged in the order below, with the two banks' assets and liabilities taken up in detail or from an ALM (asset and liability management) point of view.

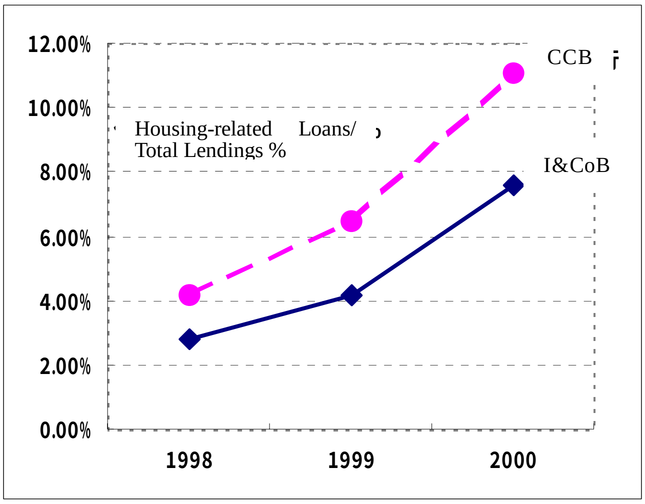
4.6.1. ALM by a Commercial Bank

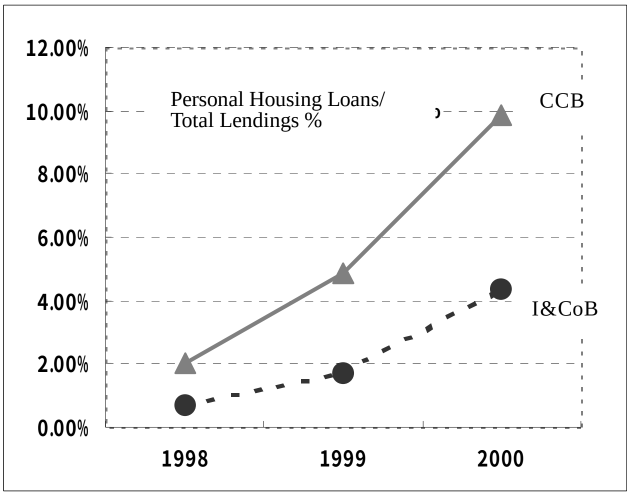
(1) Changes in asset structure

As explained in the beginning, the development of private housing finance in China has been giving a significant impact to the Chinese banks, especially commercial banks represented by the two banks, I&CBoC and CCB. More specifically, it has brought about a change in the commercial banks' asset structure, thereby raising a problem in the conventional ALM.

In the past, the commercial banks concentrated their lendings on state-owned enterprises so that the ALM was focused on the attendance to state-owned enterprises. An increase in housing-related lendings, especially in private housing loans, however, is about to change the structure of assets in commercial banks. This tendency has intensively appeared in the two banks, I&CBoC and CCB, too.

Figure 4-11 Changes in Weight of Housing-related Lendings in Two Banks, %





Source: JICA Study Team, based on Finance Inspection Manual,Finance Supervising Agency

The changes in the commercial banks' asset structure are very significant for their risk management. The housing-related lendings for legal persons require a special security called the "right of using land" which is differently from the conventional finance to a state owned enterprise, so as to establish a new scheme to evaluate the assets while protecting themselves against a price fluctuation risk.

For a personal housing loan, moreover, the debtor is an individual person, mainly salaried. For a commercial bank to offer a loan to an individual, therefore, new operations are borne such as grasping a credit rating, setting a security guarantee, recovering the lending, and so on. A new comer bank has initial expenses incurred. Through ordinary operations, moreover, some additional expenses will arise.

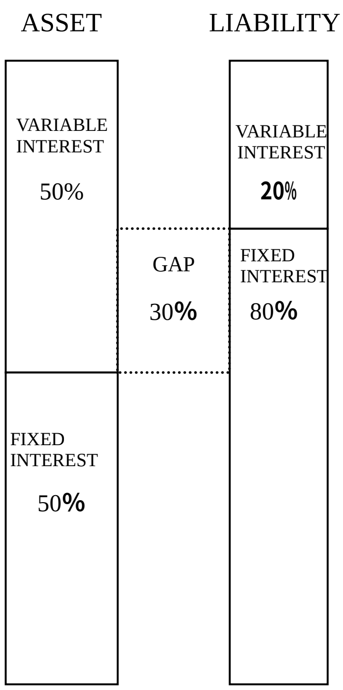
(2) Objective of ALM (asset/liability management)

Now, what is meant by the changes in the two banks' asset structure tries to be arranged in order by using the ALM techniques usually applied by a bank.

The core of a bank ALM lies in an interest-sensitive management. In other words, a difference between fund operating term and raising period, between fixed-interest asset/liability and variable interest asset/liability, should be analyzed and managed.

In some cases, the difference is called “a Gap”. Thus it is referred as “Gap Analysis”.

Figure 4-12 Interest Sensitivity Analysis



Source: JICA Study Team,

As illustrated above, if a bank should have a gap arise between assets and liabilities, or if it should change, the gap will affect the bank’s expenditure and revenue. The gap analysis, therefore, is of great importance for the management of a bank.

A table below shows the direction in which how an interest gap between assets and liabilities will affect expenditure and revenue. With the conclusion first, it may be said that a growth of housing-related lendings and of personal housing loans will increase the assets with variable interest. With the market interest rate rising, therefore, the bank will have an advantageous configuration of asset and liabilities with fixed-interest assets at a higher percent (as illustrated above) or with a positive gap of fixed-interest liabilities.

The case referred to above, however, will be reversed if the interest rate should be predicted to go on declining.

Table 4-12 Sensitivity of Assets and Liabilities to Interest Rates and Direction in which Expenses and Profits are Changing

ASSET		LIABILITY		INTEREST	REVENUE	EXPENSE	PROFIT
Variable Interest	offset	Variable Interest	①	up	increase	increase	unchanged
			②	down	decrease	decrease	unchanged
Fixed Interest	offset	Fixed Interest	③	up	unchanged	unchanged	unchanged
			④	down	unchanged	unchanged	unchanged
Variable Interest	GAP	Variable Interest	⑤	up	increase	unchanged	increase
Fixed Interest		Fixed nterest	⑥	down	decrease	unchanged	decrease
Variable Interest	GAP	Variable Interest	⑦	up	unchanged	increase	decrease
Fixed Interest		Fixed Interest	⑧	down	unchanged	decrease	increase

Source: JICA Study Team,

As gathered from the table above, no interest gap has appeared in Cases ①, ②, ③ and ④. In any other cases, however, where there is an interest gap, it is necessary to adjust assets and liabilities according to the real effect of interest gaps.

An analysis of the cases has resulted as follows:

In Case ⑤, it is reasonable to try to increase the variable-interest assets and the fixed-interest assets in preparation of a predicated interest hike.

In Case ⑥, to the contrary, the variable-interest assets should be decreased while increasing the variable-interest liabilities since the interest rate is likely to decline.

In Case ⑦, either variable-interest assets or fixed-interest liabilities will be decreased in anticipation of an interest rate raising.

In Case ⑧, the variable interest funds will be raised while increasing the fixed-rate assets in anticipation of an interest rate declining.

4.6.2. Appropriate Net Worth Ratio

(1) Ratio of Net Worth in a Bank

On those days in the beginning of 1980s, state-owned commercial banks (antecedents to the existing four major commercial banks) in China had a net worth ratio of approximately 20%. Since then, banks have had the capital account increased in a slower pace than that of increase in total assets. As a result, the net worth ratio in each bank has continued decreasing.

For the latest three years, the two banks, I&CBoC and CCB, have had their net worth ratio unchanged at a low level.

Table 4-13 Ratioes of Net Worth in 2 Banks (I&CoB and CCB) for Latest 3 Years

I&CoB	1998	1999	2000	CCB	1998	1999	2000
Capital	183,893	181,475	187,366	Capital	100,476	106,869	114,850
Total Assets	3,238,738	3,539,866	3,973,737	Total Assets	1,923,646	2,201,065	2,531,695
Net Worth Ratio	6%	5%	5%	Net Worth Ratio	5%	5%	5%

Source: JICA Study Team, based on Applicable Financial Annual Books and Web Sites of Both Banks

A low ratio of net worth has reflected the fact that a bank has a poor level of resistance to risks. If so, depositors have a decrease in reliability on the bank and they would not deposit their money there with a sense of security. The finance system would invite a crisis unless the bank deposits are stabilized.

Table 4-14 A Time-Series of Changes in Ratio of lendings, Obligations and Net Worth in State-owned Banks (as averaged)

1980－1995 %

YEAR	LOANS/TOTAL ASSET	DIPOSIT/ TOTAL ASSET	NET WORTH RATIO
1980	92%	63%	19%
1981	90%	66%	17%
1982	88%	65%	19%
1983	87%	68%	17%
1984	89%	67%	14%
1985	93%	67%	13%
1986	94%	66%	12%
1987	92%	66%	11%
1988	92%	65%	10%
1989	92%	69%	9%
1990	91%	72%	8%
1991	89%	75%	8%
1992	90%	81%	8%
1993	89%	80%	9%
1994	83%	82%	7%
1995	81%	86%	5%

Source: "Theory and Practice for Management of Default Loans at Commercial Banks", Fudan University Press, July 1999

The term, ratio of net worth, is defined as referred to below.

Table 4-15 Net Worth Ratio Definition

	Definition	Upper Limit
Net Worth Ⅰ:	A) Ordinary shares B) Preferred shares C) Capital reserves D) Legal reserves	Less intangible
Net WorthⅡ：	A) Off-balance reserves B) Security evacuation profit C) Real estate D) Bad debt reserves E) Convertible debentures F) Subordinate debenture	Not to exceed Capital Ⅰ Allowed to reckon by 55％ To be reckoned within 1.25％ of risk assets To be reckoned at 50% or less of Net Worth Ⅰ
Total Net Worth:	Net Worth Ⅰ＋Net WorthⅡ	Less A) Investment in finance affiliates B) Long-term investments in all banking institutions
Risk Asset	Loan balance ×１００％	
Ratio of Net Worth：	Total net worth ÷ loan balance	

Source:： *Banking Supervision System of China*. Chinese Youth Publishing Company, April 1997

Table 4-16 Net worth ratios of banks, Credit/Finance/Trust Companies

(As of end of 1993, unit = %)

Capital sufficed banks			Capital deficit banks		
	Net worth ratio I	Gross net worth ratio		Net worth ratio I	Gross net worth ratio
China Construction Bank	9.3	11.5	Agricultural Bank of China	5.2	5.4
Jiano Tong Bank	10.6	11.4	. Bank of China	7.1	7.5
Guang Dai Bank	58.0	58.0	Industrial and Commercial Bank of China	5.6	6.1
Hua Xia Bank	30.0	30.0			
Guangdong Development Bank	22.0	25.0	Business Bank of Zhong Xin	7.8	7.8
Wukuang Development Bank	12.6	12.6	Yikou Zhaoshang Bank	7.4	7.4
Industrial Bank of Fu Jian	14.2	14.2	Yan Tai Savings Bank	4.7	4.7
* Nongcun Xinyongshe	10.2	10.2			
* Dushi Xinyongshe	9.5	9.5			
* Caiwu Gonsi	17.7	17.8			
* Jinrong Xintuo Touzi Gonsi	22.6	23.1			

NOTE: For items marked with＊, individual statistics are unavailable. Instead, national totals are shown.

Source: *Banking Supervision System of China*. Chinese Youth Publishing Company, April 1997

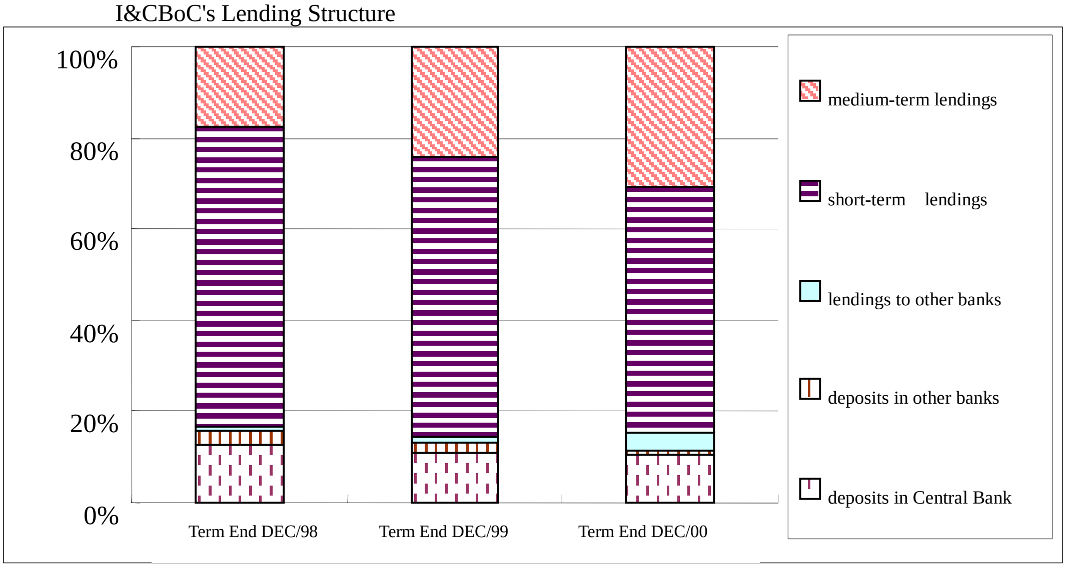
(2) Risk Weight of Bank-Lending Assets

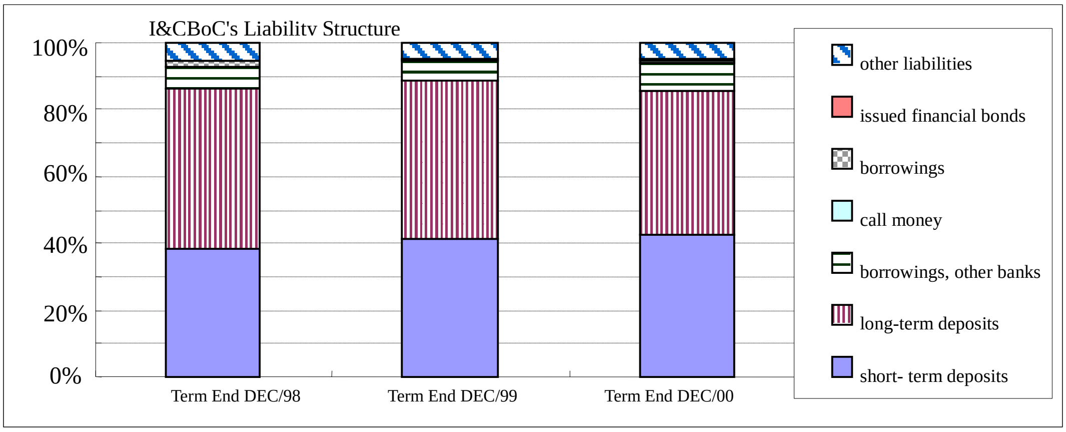
As widely known, bank-lending assets do not have a uniform risk weight. Nevertheless, no fair evaluation would be available even if banks arbitrarily determine their own risk weight. The Basel committee has mapped out a policy specifying 0% for the public sector in the home country, 20% for another bank, 50% for housing-mortgage loans, and 100% for any other lendings.

The two banks, I&CBoC and CCB, have a lending asset configuration and a liability configuration. (Please refer to Fig. 4-13.)

The lending assets have a relatively low risk weight in the public sector (including the Central Bank) and approximately 20% for another banks. And approximately 80% of the lending assets show a risk weight of 100% (including miscellaneous lendings).

Figure 4-13 Changes in Configuration of Lending Assets and Liabilities in I&CboC





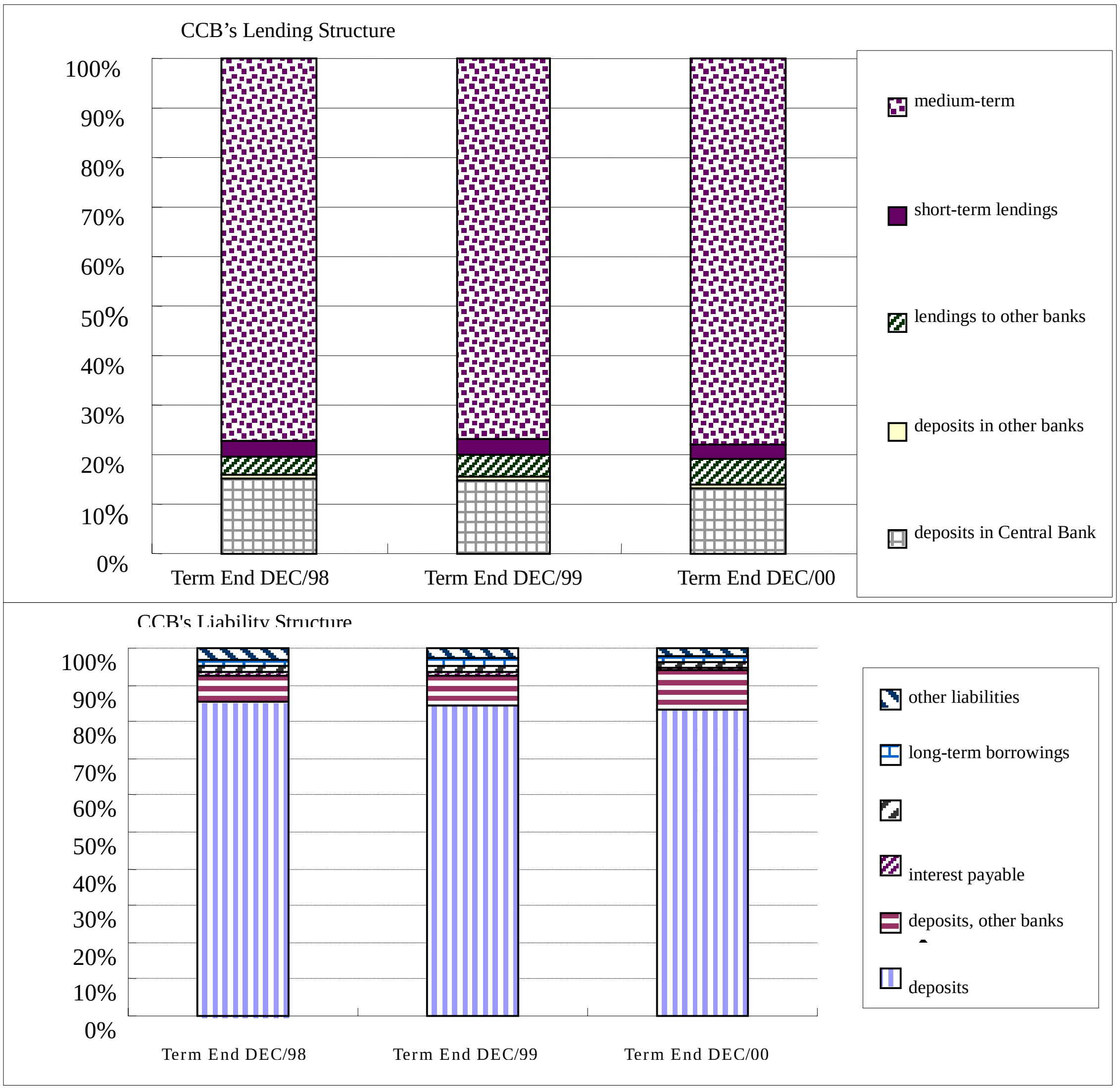
Source: JICA Study Team, based on Applicable Financial Yearbooks and Each Bank's Web Site

For a structure of liabilities, both I&CBoC and CCB have deposits occupy 80 thru 90%. I&CBoC has had short-term deposits as liabilities increased up to a level of from 40% to more than 50%. Both banks have shown a low percentage of issued bonds (financial debentures) or long-term borrowings.

I&CBoC has shown an increase in weight of long-term lending assets, thereby showing a stronger tendency toward an imbalance from a maturity structure point of view.

CCB has shown a stable configuration of lending assets.

Figure 4-14 Changes in Configuration of Lending Assets and Liabilities in CCB



Source: JICA Study Team, based on Applicable Financial Yearbooks and Each Bank's Web Site

The two banks have not statistically shown that housing mortgage loans are included in lendings. As already referred to, however, the housing-elated lendings have had their weights increased, with the lead taken by the two banks. From this, it may be safely gathered that the two banks have had their risk weight decreased in their lending assets.

With the above taken into comprehensive consideration, the balance sheets the two banks have shown a tendency toward an increase in credit term and a decrease in obligation term, though slightly. So long as the maturity structure issue has not been dissolved, they have still had a fear of financial crisis persistently with short-term despots drawn even if the risk weight should decrease. Against this fear, the two banks should desirably increase their capital.

More recently, listing banks on the exchange market has been drawing a lot of attention. To be successfully listed on the stock exchange market, however, it is necessary to meet such requirements as accurate accounting information, highly transparent transaction rules, fair trade conditions and people’s constant willingness to invest.

Table 4-17 Balance Sheet – Industrial and Commercial Bank of China

in million RMB

ASSETS	End of Term DEC/98	End of Term DEC/99	End of Term DEC/00	1999 % Increase/ Decrease vs. Year Earlier	2000 % Increase/ Decrease vs. Year Earlier
Cash	24,952	42,989	29,502	72%	-31%
Deposits with the Central Bank	350,672	304,912	295,766	-13%	-3%
Due from Banks	74,578	69,691	23,851	-7%	-66%
Lending to other Banks	24,095	35,634	120,748	48%	239%
Loans	2,271,539	2,427,122	2,413,591	7%	-1%
Short-term	1,794,943	1,740,350	1,537,169	-3%	-12%
Medium & Long-term	476,596	686,772	876,422	44%	28%
Less: Bad Loan Provision	-7,916	-16,609	-10,377	110%	-38%
Securities Investment	273,552	323,947	792,537	18%	145%
Short-term					
Medium & Long-term	273,552	323,947	792,537	18%	145%
Less: Investment Loss Provision	-82	-187	-149	128%	-20%
Fixed Assets	60,110	76,140	92,616	27%	22%
Less: Accumulated Depreciation	-15,488	-16,755	-20,001	8%	19%
Other Assets	182,726	292,982	235,653	60%	-20%
TOTAL ASSETS	3,238,738	3,539,866	3,973,737	9%	12%
LIABILITIES	**End of Term DEC/98**	**End of Term DEC/99**	**End of Term DEC/00**	**1999 % Increase/ Decrease vs. Year Earlier**	**2000 % Increase/ Decrease vs. Year Earlier**
Deposits	2,631,768	2,982,378	3,248,519	13%	9%
Short-term	1,172,570	1,394,408	1,603,986	19%	15%
Long-term	1,459,198	1,587,970	1,644,533	9%	4%
Due to Banks	197,615	188,081	308,635	-5%	64%
Inter-bank Borrowing	11,496	8,110	15,108	-29%	86%
Borrowings	40,762	26,599	24,001	-35%	-10%
Bonds Issued	102	67	21	-34%	-69%
Short-term					
Long-term	102	67	21	-34%	-69%
Other Liabilities	173,102	153,156	190,087	-12%	24%
Owners' Equity	183,893	181,475	187,366	-1%	3%
Paid-in Capital	171,422	167,417	167,417	-2%	0%
Capital Reserve	987	947	1,204	-4%	27%
Surplus Reserve	8,200	10,354	13,509	26%	30%
Undivided Profit	3,284	2,757	5,236	-16%	90%
TOTAL LIABILITIES AND EQUITY	3,238,738	3,539,866	3,973,737	9%	12%

Source: JICA Study Team, based on Applicable Financial Yearbooks and Each Bank’s Web Site

Table 4-18 Balance Sheet – China Construction Bank

in million RMB

ASSETS	End of Term DEC/98	End of Term DEC/99	End of Term DEC/00	1999 % Increase/ Decrease vs. Year Earlier	2000 % Increase/ Decrease vs. Year Earlier
Cash	15,437	33,017	24,404	114%	-26%
Deposits with the Central Bank	245,583	229,198	235,697	-7%	3%
Due from Banks	14,233	13,916	12,662	-2%	-9%
Lending to other Banks	58,755	68,134	90,183	16%	32%
Other receivables	48,898	53,197	54,142	9%	2%
Loans	1,257,943	1,200,945	1,386,386	-5%	15%
Less: Bad Loan Provision	-2,576	-11,683	-10,545	354%	-10%
Loans, net	1,255,367	1,189,262	1,375,841	-5%	16%
Interest receivable	38,752	21,087	18,452	-46%	-12%
Less: Bad Debt Provision	-285	-385	-64	35%	-83%
Interest receivable, net	38,467	20,702	18,388	-46%	-11%
Securities purchased under resale agreements			19,940		
Investment	163,004	501,025	603,871	207%	21%
Less: Investment Loss Provision	-148	-720	-751	386%	4%
Investment, net	162,856	5,003	603,120	-97%	11955%
Fixed Assets, net	56,624	66,507	69,310	17%	4%
Other Assets	27,426	26,827	28,008	-2%	4%
TOTAL ASSETS	1,923,646	2,201,065	2,531,695	14%	15%
LIABILITIES	End of Term DEC/98	End of Term DEC/99	End of Term DEC/00	1999 % Increase/ Decrease vs. Year Earlier	2000 % Increase/ Decrease vs. Year Earlier
Deposits	1,551,956	1,764,433	2,010,284	14%	14%
Deposits from other banks	123,482	170,504	251,201	38%	47%
Borrowings from other banks	3,663	3,647	1,798	0%	-51%
Borrowing from the Central Bank	4,280	4,090	4,620	-4%	13%
Interest payable	18,752	21,602	24,265	15%	12%
Other payables	32,667	31,166	38,695	-5%	24%
Long-term borrowings	26,760	38,915	37,181	45%	-4%
Other Liabilities	61,610	59,839	48,801	-3%	-18%
Owners' Equity	100,476	106,869	114,850	6%	7%
Paid-in Capital	85,094	85,119	85,115	0%	0%
Reserves	13,184	16,792	20,729	27%	23%
Undivided Profit	2,198	4,958	9,006	126%	82%
TOTAL LIABILITIES AND EQUITY	1,923,646	2,201,065	2,531,695	14%	15%

Source: JICA Study Team, based on Applicable Financial Yearbooks and Each Bank's Web Site

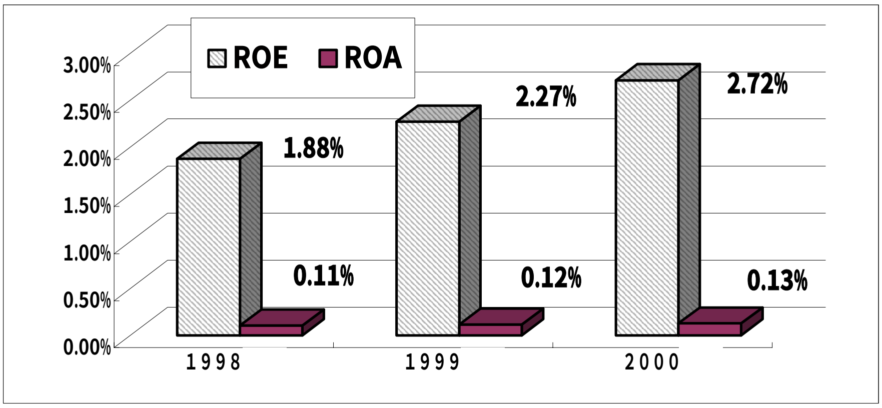
4.6.3. Cost Control by Commercial Banks

(1) ROA and ROE in Commercial Banks

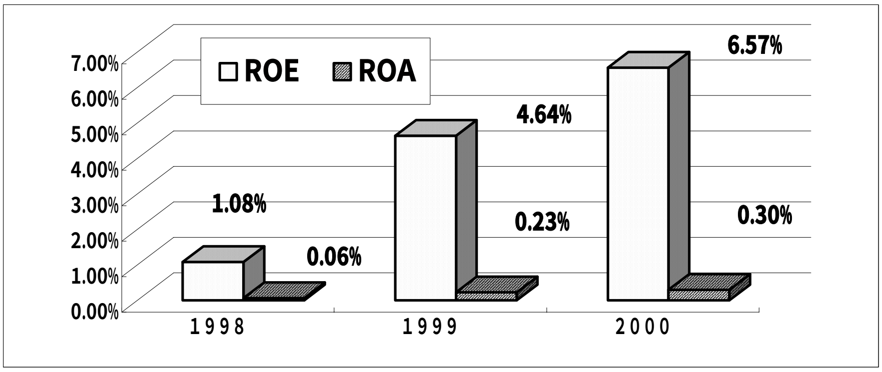
ROA (return on assets) and ROE (return on equity) are the indicators of that efficiency, which the funds invested by a bank has had. From another point of view, it may be safely said that these two indicators indicate the individual profitability of a bank

A comparison of the numerical values given in tables below would allow us to gather that China Construction Bank is more profitable than Industrial and Commercial Bank of China, with the former's two indicators showing a higher level.

Figure 4-15 ROA and ROE in 2 Banks, I&CBoC and CCB



- Industrial and Commercial Bank of China



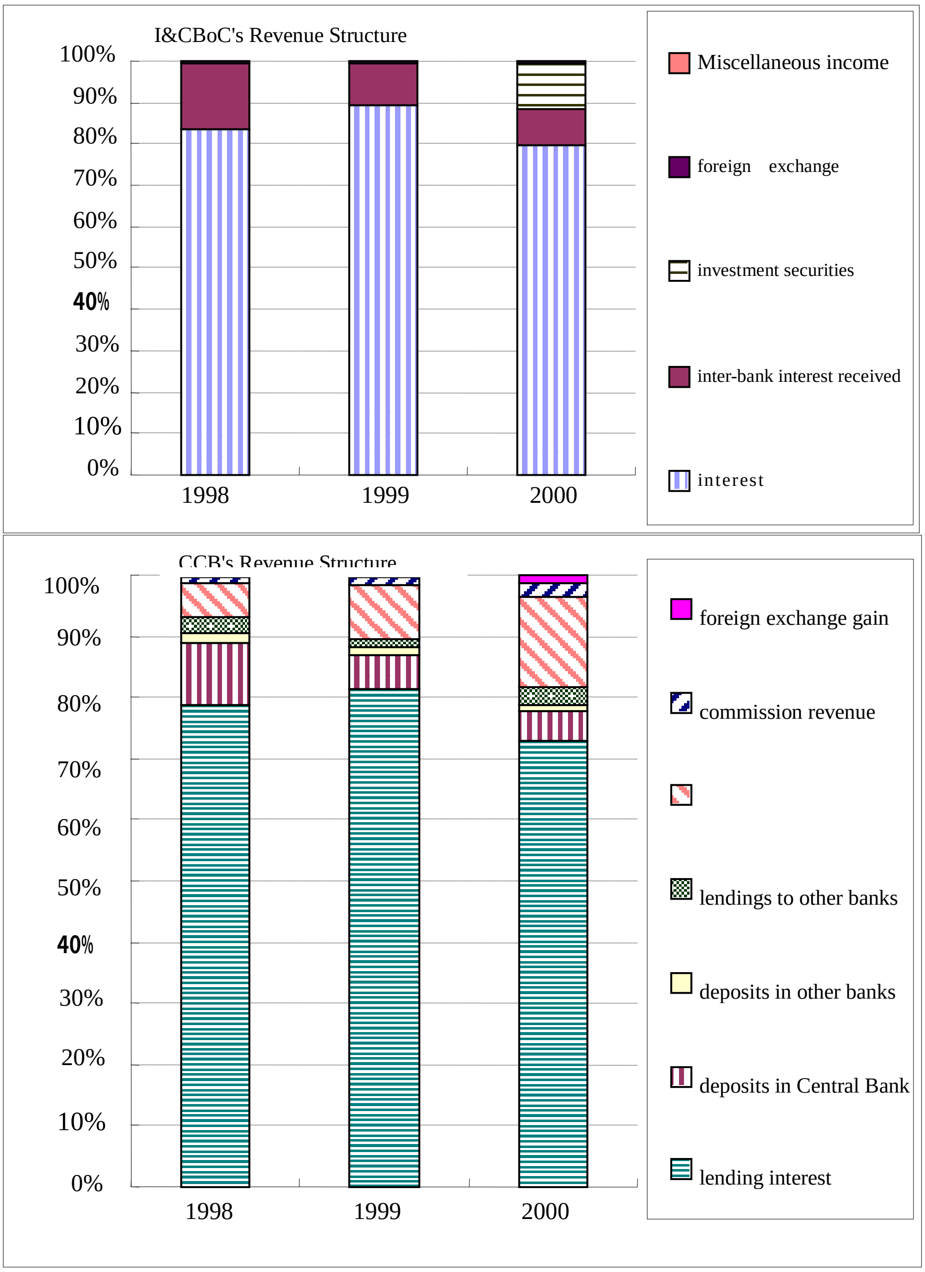
- China Construction Bank

Source: JICA Study Team, based on Applicable Financial Yearbooks and Each Bank's Web Site

(2) Revenue Structure in Commercial Banks

To secure an income, a bank extends the sources of revenue through their sales efforts. Each bank has their own revenue structure which vary according to their activity pattern. A review of the revenue structures in the two banks, I&CBoC and CCB, tells us that the former has had their revenue arise mainly from the interest receivable in general lendings, and on an inter-back basis. In the accounts closed for Year 2000, this bank's investment securities occupied an exceptionally high weight in their revenue. The latter, CCB, has been receiving a constantly large amount of interest in general lendings and from the Central Bank while showing an increase year by year in interest received from investment securities.

Figure 4-16 Revenue Structure in 2 Banks, I&CBoC and CCB



Source: JICA Study Team, based on Applicable Financial Yearbooks and Each Bank's Web Site

Fig. 4-16 show that, banks have tended to have revenue courses more diversified than three years ago. At the same time, however, the two banks, I&CBoC and CCB, have increased their revenue on a term net income basis.

On the basis of a net income for the term, I&CBoC increased their revenue by 20% for 1999 and by 23% for 2000, both as compared with a year earlier. CCB, on the other hand, increased their revenue by 3.5 times for 1999 and by 52% for 2000, both as compared with a year earlier, likewise.

What must be pointed out here, however, is the fact that either bank has informed their applied reserves with extreme inaccuracy. Consequently, it has been impossible to determine the reverse application cost at present. There are possibilities, moreover, that the income for the term of the two above-mentioned banks, I&CBoC and CCB, may be overvalued.

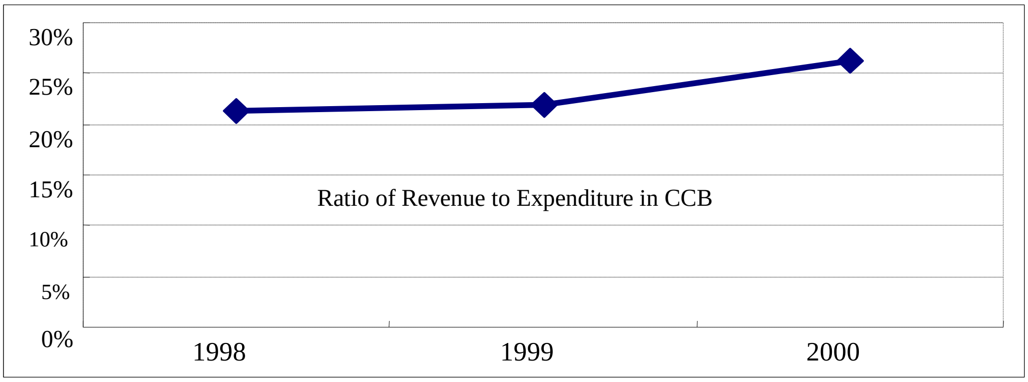
In the future when the reserve application system will be institutionalized, the reserves for risk assets will be reckoned by a consistent accounting method and will turn out to be a significant impact on the revenue of a bank.

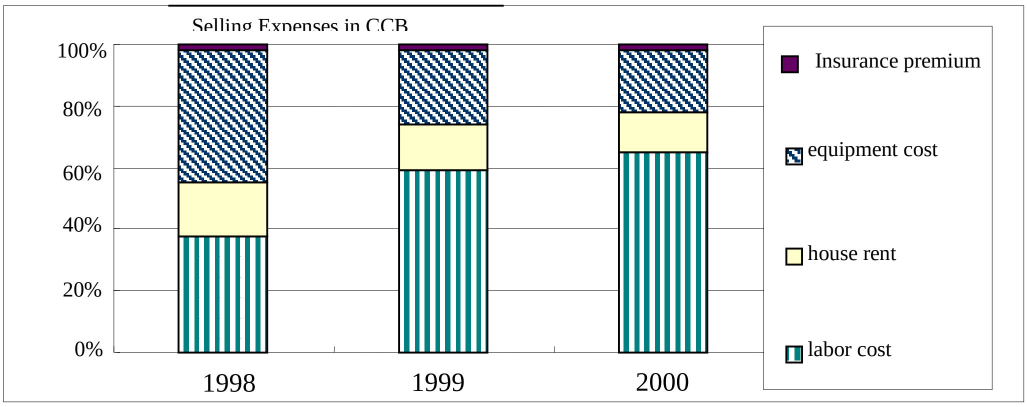
(3) Expenditure Control in Commercial Banks

While pursuing for revenue, a bank must control how much expenditure has been incurred to obtain one unit of revenue. That is, the bank must exchange the cost control. One of the indicators used for this control is a ratio of return on operating cost.

Wages, welfare cost house rent, interior finish/equipment lease fees, depreciation expenses, maintenance cost, insurance premiums, and deferred asset amortization, and so on are included in the operating expenditure of a commercial bank. Wages, that is, labor cost, among others, reach a relatively large amount.

Figure 4-17 Ratio of Revenue to Expenditure in CCB



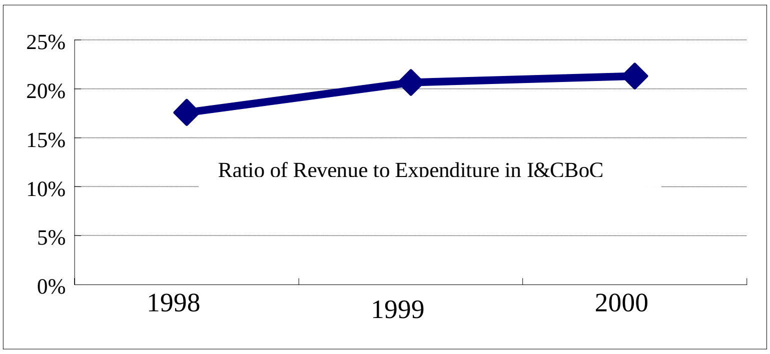


Source: JICA Study Team, based on Applicable Financial Yearbooks and Each Banks' Web Site

In the operating expenditure for CCB, the labor cost has a highest weight, which is growing furthermore.

As a result of an increase in operating expenditure, I&CBoC has also increased their ratio of revenue to expenditure.

Figure 4-18　　　Ratio of Revenue to Expenditure in I&CboC



Source: JICA Study Team, based on Applicable Financial Yearbooks and Each Bank's Web Site

Housing-related lendings, especially personal housing loans, may be classified as retail operations.　How the ratio of income to expenditure could be reduced will be a critical challenge for a commercial bank.

After China has been conferred WTO membership, moreover, it could be predicted that the entry of foreign capital banks into China will accelerate.　As a commercial bank in China, it is necessary first of all to solidity the footing in the retail sector, and strive to enhance the profitability.　Likewise, they will have to decide to build up the ERP (intelligently systematizing banks individually) and ASP (intelligently systematizing, using a network) by promoting the changeover to intelligent technologies.

Table 4-19 Profit and Loss Statement – I&CBoC

in million RMB and %	1998	1999	% gain/ loss vs. term earlier	1999	2000	% gain/ loss vs. term earlier
	Published Financial Yearbook			Disclosed by I&CBoC		
OPERATING INCOME	180,827	166,672	-8%	187,741	179,804	-4%
Interest Income	149,709	147,173	-2%	147,173	141,089	-4%
Interbank Income	28,708	17,092	-40%	17,092	15,611	-9%
Fee & Commission Income	1,451	1,614	11%	1,614	2,608	62%
Bond Interest Income				21,069	19,856	-6%
Exchange Income	615	441	-28%	441	415	-6%
Other Operating Income	344	352	2%	352	225	-36%
OPERATING EXPENSES	177,199	177,350	0%	177,350	164,149	-7%
Interest Income	99,651	114,056	14%	114,056	99,260	-13%
Intebank Expenses	22,542	7,984	-65%	7,984	11,509	44%
Fee & Commission Expenses	4,149	2,329	-44%	2,329	346	-85%
Operating expenses	31,799	34,436	8%	34,436	38,327	11%
Exchange loss	40	0		0	0	
Other Operating Expenses	19,018	18,545	-2%	18,545	14,707	-21%
Business tax and surcharges	13,037	12,768	-2%			
OPERATING PROFIT	-9,409	-23,446	149%	10,391	15,655	51%
Investment Income	13,722	21,315	55%	246	171	-30%
Non-operating income	408	7,029	1623%	7,029	2,385	-66%
Non-operating expenses	1,269	772	-39%	772	854	11%
Business tax and surcharges				12,768	12,270	-4%
PROFIT	3,452	4,126	20%	4,126	5,087	23%

Source: JICA Study Team, based on Applicable Financial Yearbooks and Each Bank's Web Site

Table 4-20 Profit and Loss Statement -- CCB

in million RMB and %	1998	1999	% gain/ loss vs. term earlier	1999	2000	% gain/ loss vs. term earlier
	Published Financial Yearbook			Disclosed by I&CBoC		
INTEREST INCOME						
Loans	98,822	91,494	-7%	91,494	74,762	-18%
Deposits with the Central Bank	12,691	6,012	-53%	6,012	5,062	-16%
Deposits with other banks	1,927	1,390	-28%	1,390	953	-31%
Lending to other Banks	3,128	1,799	-42%	1,799	2,816	57%
Discounted bills	505	327	-35%	327	312	-5%
Securities Investment	7,208	9,849	37%	9,849	15,288	55%
Other interest income	64	12	-81%	12	44	267%
Total interest income	124,345	110,883	-11%	110,883	99,237	-11%
INTEREST EXPENSES						
Deposits	52,164	54,011	4%	54,011	42,626	-21%
Borrowing from the Central Bank	2,475	273	-89%	273	43	-84%
Deposits from other banks	9,102	4,194	-54%	4,194	4,955	18%
Borrowings from other banks	563	282	-50%	282	269	-5%
Financial bonds	57	44	-23%	44	102	132%
Discounted bills	130	51	-61%	51	98	92%
Long-term borrowings	1,008	852	-15%	852	1,029	21%
Total interest expenses	65,499	59,707	-9%	59,707	49,122	-18%
Net Interest Income	58,846	51,176	-13%	51,176	50,115	-2%
Provision for loan losses	19,946	10,514	-47%	10,514	3,364	-68%
Net Interest Income after Provision for loan losses	38,900	40,662	5%	40,662	46,751	15%
NON-INTEREST INCOME	2,117	4,850	129%	4,850	5,200	7%
Investment income, net	280	254	-9%	254	404	59%
Fee income	1,020	1,493	46%	1,493	2,345	57%
Exchange gain	453	247	-45%	247	1,245	404%
Non-operating income	171	288	68%	288	473	64%
Other income	193	2,568	1231%	2,568	733	-71%
NON-INTEREST EXPENSES	39,373	38,146	-3%	38,146	43,468	14%
Operating expenses	27,034	27,287	1%	25,396	27,475	8%
includes: Salary and employee benefits	6,597	7,510	14%	8,610	9,744	13%
Occupancy expenses	2,971	2,202	-26%	2,202	1,909	-13%
Equipment rentals and maintenance	7,537	6,769	-10%	3,567	3,051	-14%
Insurance expenses	292	268	-8%	268	262	-2%
Amortization of intangible and deferred assets	1,381	1,665	21%	1,665	2,903	74%
Depreciation				3,112	3,732	20%
Provision for investment losses				471	2,071	340%
Fee expenses	2,269	2,167	-4%	475	294	-38%
Exchange loss	58	69	19%	69	1,054	1428%
Non-operating expenses	641	646	1%	646	2,186	238%
Business tax and surcharges	8,515	7,929	-7%	7,929	6,618	-17%
Other	856	48	-94%	48	38	-21%
Income before Income taxes	1,644	7,366	348%	7,366	8,483	15%
Income taxes	557	2,408	332%	2,408	943	-61%
Net Income	1,087	4,958	356%	4,958	7,540	52%

Source: JICA Study Team, based on Applicable Financial Yearbooks and Each Bank's Web Site

4.7. Changing Real Estate into Securities ---- as a challenge in the future

A bank should never finance a developer or the like before having a positive understanding of real estate transactions. In this sense, various problems involved in transacting the real estate are taken up here. In addition, the changeover of real estate over to securities will take place in China in the near future.

4.7.1. Real Estate Evaluation and Investment Return

A real estate transaction entails borrowing funds from the third party other than seller and buyer. In many cases, the real estate itself is mortgaged to offer the fund. A value of this mortgage need be accurately known by the lender. In this sense, it is necessary to establish a technique for evaluating the price. In the case of a "changeover to securities," it is also important to evaluate the real estate. At the same time, a finance with real estate used as a tool needed to establish a price evaluation technique for the fund lender, to correctly know the value of mortgage.

An investment in real estate would incur a large amount of expenses, (including but not being limited to) the handling expenses to acquire the real estate and the maintenance cost so that the real estate may earn. Despite the fact that such a large amount of expenses are required, investments are being made in real estate because earnings available are larger than the expenses.

The return of an investment in real estate has its nominal value defined as follows:

Nominal return = [selling price - purchase price (capital gain) + income by term (income gain)]/purchase price

Its effective value is defined as follows:

Effective return = nominal return - commodity price hike

In addition, a real estate investment is characteristically accompanied with a risk. The term, risk, means that what the revenue will be in reality cannot be known.

Such a real estate investment as referred to above involves the risk highly lucrative with a long investment period required.

According to such characteristics, a real estate investment theory could be described, if roughly classified, in two types: one is an analysis with importance attached to income and term and the other to income and risk.

A representative of the former is the net current value or internal return and that of the latter an asset selection theory (portfolio theory). According to the portfolio theory, risks are expressly taken up and both income and risk are treated as independent factors while striving to clarify an optimum combination of two or more assets.

(1) Incorporating risks in income:

An actual real estate investment is accompanied with risks. More specially, the real estate invested has risks as follows:

1) Credit risk	A risk of failing to recover the cash flow arising from real estate
2) Market risk	A risk based on the uncertainties of predication on the market (price fluctuation risk, interest rate variation risk, etc.
3) Business risk	A risk immanent in real state itself
4) Liquidity risk	A risk of delay in recovering the cash flow due to discrepancies in operating and raising funds in the real estate industry

Such risks are uncontrollable by investors individually. They are called “objective risks” accordingly.

(2) Incorporating risks in interest rates:

Even at an identical nominal interest rate, an associated risk, if any, would reduce the effective interest rate. In other words, a risk premium should be subtracted from the nominal interest rate. With risks taken into account, the effective interest rate may be defined as follows:

Effective interest rate = nominal interest rate - commodity price hike - risk premium

According to the portfolio theory, an investment term is not expressly treated. Nevertheless, it tries to compare two or more assets and clarify their reasonable combination, with eyes set on risks.

A significant impact is given to a shift from indirect finance to direct one, which may be re-expressed as a shift from relative type transactions to security type. Nevertheless, it may be reckoned as a changeover of the representative asset finance to securities.

4.7.2. Changeover of Real Estate to Securities, and Risks

For a fund raiser to change an asset in securities, the financial assets, real estate and other fixed assets are removed from the asset account on the fund raiser’s own balance sheet and they are transferred to a special-purpose vehicle (SPV) founded for the purpose of changing assets in securities. The SPV issues security certificates to support the income arising from its assets to raise funds. A changeover of assets to securities, therefore, may be considered to accelerate a shift of indirect finance to direct one. This signifies that the risk-distributing function preformed so far by a bank should be performed on the market. On those indirect finance days, a bank was always gathering information to screen good borrowers and lenders because the bank bears the risks involved in leading. In such mechanisms established so far, no risks could be transferred to the depositors, essentially the investors.

A progress of the changeover to securities would signify that investors should take the risks conventionally borne by banks. It is very inefficient, however, for an investor to gather the information helpful for determine a risk. This is the very reason why the indirect finance was predominant. Banks centrally gather the information necessary to evaluate risks rather than individual investors (depositors) do. In consideration of this information-producing feature, banks make profits. This is nothing but the indirect finance. With such situations on the background, information gathering has a prerequisite for an immense cost requirement. Though progress has been made in computer technologies in speeding up the information communication, today has not allowed us to obtain the information enough to determine a credit risk at low cost. The changeover of assets to securities could never make progress without making some contrivances about the information gathering.

Risks involved in changing real estate over to securities could be described, if roughly classified, in three categories: credit risk, liquidity risk, and structural risk. As a source of the risks referred to above, the following could be considered peculiar to real estate:

1) Price fluctuation risk (market risk in the narrow sense):
   This is a risk that the declining real estate prices and rentals might lead to a decrease in pricing for the property.
2) Out-of-date risk:
   This is a risk that the property suffers from a deterioration of environments, and has its commercial value relatively reduced in comparison with competitive properties available in the periphery in addition to a physical wear and tear of the property itself (an out-of-date risk in the narrow sense). Exemplar cases could be seen in an external design of property, equipment (computer adaptability, lighting, etc.).
3) Sismic risk
   This is a risk that an earthquake might dismantle and/or rupture the property.
4) Environmental risk:
   This is a risk that a serious change (deterioration) taking place in the environments surrounding the property may degrade the value of the property.
5) Regional risk
   This is a risk that a regional characteristic or characteristics may adversely affect the cash flow and/or selling price.

4.7.3. Changeover to Securities and Infrastructure Buildup

Japan has not satisfactorily built-up the infrastructure considered essential to fostering a security-oriented commodity market. In addition, there are a wide variety of restrictive factors and impediments. The following may be considered factors impeding a changeover of assets to securities.

(1) Problems in legislation:

1) Regulations relating to real estate: The regulations relating to real estate development, including the building Standards Act, environmental assessment, etc. are severe enough. There are also many regulations established by local governmental bodies.

2) Practices in a real estate rent-a-lease contract: The existing rent-a-lease contract is oriented for a short time. A notice prior in 6 months would permit the contract to be terminated unconditionally (Article 27, Land/Building Lease Act). The cash flow arising from rents remains unstable.

3) Legal risks existing in Bankruptcy Act, Stock Company Reconstruction, and Reliability Act, etc.: If a player in the changeover to securities should be bankrupt, the existing Bankruptcy Act permits a risk to exist in a cash flow of payments to investors. For example, there are problems involved in receiver’s right to deny, validity of responsible goods limited, and so on.

(2) Problems in taxation

1) Under the existing real estate taxation system, acquisition, holding, selling and the like are taxed at a high rate. Especially distribution taxes, such acquisition tax, registration license tax, stamp tax, etc., are levied with taxes at a higher rate. than those in major countries overseas. This is nothing but raising the cost for a changeover to securities.

2) There is a double taxation problem. SPV should perform its functions as a conduit. It is necessary to secure a far lager income on behalf of investors by avoiding all the taxes levied at the SPV level. In this sense, the United States of America has established the REMIC (real estate mortgage investment conduit) taxation system to avoid a double taxation. Any organizations established under certain rules of management in the USA are allowed to use the REMIC as conduit.

3) The taxation system has been being revised too frequently especially in relation to real estate. Since a transfer profit tax has been being reviewed often, it is difficult to grasp the timing for a transfer of real estate.

4) An investment-incentive taxation system has not been built up. In the USA, there are some investment incentive systems, such as the Accelerated Cost Recovery System, an investment tax withdrawal system, etc. In Japan, it is also necessary to implement some investment incentives, such as accelerated depreciation, depreciation term reduction, etc.

(3) Problems on the real estate market

1) No system has been built up to assess a real estate risk. Especially the information relating to real estate has not been disclosed satisfactorily. In addition, there are few expert organs to analyze the market and to evaluate investments.

2) The standards under which the real estate has its fair market price assessed remain ambiguous though essential to a changeover to securities. To conduct on the due diligence conducted in the USA, moreover, an appropriate system has not been developed yet sufficiently.

(4) Problems on the security market

There is no market environment that would permit individual investors to positively investment in the commodities hanged over to securities. The commodities changed over to securities are considered securities under the Security Transaction Act but not listed on the market. Mostly, moreover, these commodities are sold on a private recruit basis. As a result, the information relating to such commodities has not arrived at individual investors and it is difficult to purchase them with a small amount of investment money.

4.8. Specific Measures to Orderly Establish Credit Risk Management System - with Exemplar Cases in Japan Taken for Reference

Banking institutions, with the lead taken by four major banks in China, especially, China Construction Bank (CCB) and Industrial and Commercial Bank of China (I&CBoC) have been increasing the balance of personal housing loans. According to the explanations given by CCB and I&CBoC, the personal housing loans have shown a very low rate of bad debt occurrences. These banks have conventionally offered loans mainly to state-owned enterprises. A gradual increase in ratio of personal loans to their total lendings is favorable for the Chinese banks from the viewpoint that lending assets will be improved qualitatively.

Isn't an increase in balance of personal housing loans, however, problematical in the future? From a fund-raising point of view, it involves an issue, mismatch of funds between short-term borrowings and long-term lendings. If all the interest-fluctuation risks should be converted to borrowings, the latter will have to take the former until the borrowings have been completely refunded.

From a credit risk point of view, the Chinese banks have so far loaned to a rich stratum mainly resident along the eastern coast. In addition, the risks involved have been often taken by developers. Such a way of doing things is a transient measure. From now on, those other than the rich stratum will increase as loanees. Not only along the eastern cost but also in inland areas, there will be a gradually increasing number of loanees. Lendings with risks taken by developers, therefore, will be naturally limited in the future.

A review of the circumstances with such a standpoint as referred to above taken would allow us to say that banks will have to take a variety of risks. In this stage, however, it may be safely said that Chinese banks should establish a credit risk management scheme, in particular. Now, will it suffice to establish the credit risk management scheme for personal housing loans only?

It may be asserted that, out of the bank risk management scheme, a market risk management system has been being built up by Chinese banks over a certain number of years. As far as the credit risk management system is concerned, however, it could not be said that the system has been established satisfactory, although it has come to be recognized more deeply for recent years than ever. With housing loans only taken-up, the recently increasing inter-bank competition has often make banks offer very attractive articles to loanees without taking risks into due consideration. In this sense, warnings have been repetitively given by the People’s Bank of China, supervising and controlling Chinese banking institutions.

In other words, an established credit risk management scheme must be a credit risk management system to cover all the lendings offered by a bank. If credit risks should be firmly established, the risk management will come to be established firmly enough to cover other risks, such as market risk, fluidity risk, paperwork risk, system risk and the like. Reportedly, the credit risk management system is to cover approximately 60% of all the risks for a bank. So, it is keenly desired for China to establish a credit risk management system promptly.

Realistically, a credit risk management system should be also established in a form suitable for the national situations of China and as tailored to the realities of each bank. Now, how should this project be promoted specifically? Banking institutions in Japan have had a great deal of bad debts, coupled with a collapse of the bubble economy. A certain number of years and months will be required for the Japanese banks to dispose their bad debts. In reality, each Japanese bank has been recently seriously tackling the establishment of a risk management system all the more. In this sense, it is considered useful that the Japanese cases be studied for reference.

Banking institutions in Japan may be described in four major groups that have a real capacity, above all; Mitsubishi Tokyo Financial Group (hereinafter referred to as the “Mitsubishi Tokyo Group” for short), Mizuho Financial Group (hereinafter abbreviated as “Mizuho Group), Mitsui Sumitomo Group (hereinafter referred to as “Mitsui Sumitomo”) and UFJ Group. How these Japanese financial groups have been conducting on their activities would be helpful for Chinese banks, we believe. Referred to hereunder in addition to the risk management by group are Individual banks, such as Tokyo Mitsubishi Bank (hereinafter referred to as “Tokyo Mitsubishi”), Fuji Bank (hereinafter referred to as “Fuji”), Daiichi-Kangyo (hereinafter referred to as “DKB”), Industrial Development Bank of Japan (hereinafter referred to as the IBoJ), Mitsui Sumitomo Bank (hereinafter referred to as “Mitsui Sumitomo”), Sanwa Bank (hereinafter referred to as “Sanwa”) and Tokai Bank (hereinafter referred to as “Tokai”).

Summarized below is the risk management adopted by the Japanese four major financial groups while primarily taking up the credit risk management, based on the disclosure journals of 2001 edition issued by each of the financial groups and of the banks in Japan.

4.8.1. Building up Credit Rating System

The term, credit rating, signifies that credit risks are evaluated to a standardized scale, classified, and indicated in simple symbols.

Each member company in the Mitsubishi Tokyo Group applies bad debt reserves properly and depreciates according to the credit ratings standardized within the group. In credit ratings, the default rates corresponding to each level of the ratings are modified into bench marks. To secure objectivity and demonstrativeness, furthermore, a financial showings-by-business-line quantitative evaluation model has been developed to statistically analyze a correlation between customers' financial data and default data.

In accordance with the Group's policy, Tokyo Mitsubishi has introduced a credit rating system while self-assessing the assets, based on the credit rating system, to reckon an appropriate level of bad debt reserves.

While paying attention to a possible movement of the new BIS regulations, Tokyo Mitsubishi is now preparing a new credit rating system, under which the defaults rate corresponding to each level of credit ratings, are modified into bench-marks while taking for a common scale those default rates which have been positioned at the center of the internal rating techniques in the new BIS Regulation draft. In addition, a financial showings-by-business-line quantification appraisal model, furthermore, has been developed to calculate an assumed default rate by statistically analyzing a correlation between debtors' data and default data, too.

The Mizuho Group has been making effective use of credit rating as an important infrastructure for credit risk management. A credit rating is determined, based on a quantitative financial assessment to which a qualitative assessment, such as sales activity bases, or the like, is added, giving an objective picture of the creditability on a debtor.

DKB, in principle, gives a credit rating of 15 levels to a prospect debtor while standardizedly grasping the credit risks about all assets. In addition, DKB has positioned a credit rating operation as the primary work for self-assessment operations. Thus, the credit rating is linked with the debtor section in the self-assessment. A credit rating operation is carried out whenever the credit may be offered newly. Besides, every credit rating is reviewed at least once a year to swiftly reflect the debtor's financial showings. If the debtor should have a change in its credit status, the credit rating is to be reviewed from time to time. Thus, the system is allowed to timely grasp a portfolio of assets all over the Group. By March 2002, meanwhile, three banks, Fuji, DKB and the IBoJ, have planned to change entirely over to a rating architecture standardized in all of the three banks. New credit ratings are so designed as to take into full consideration the relations among external ratings, self-assessment system and competent regulatory authorities.

DKB has sectionalized ratings/debtors and classes as follows:

Applicable assets lendings, returns of approved payments, foreign exchanges, lent securities, derivative transactions, interest not received, advance payments and the like. And those to be rated include general business legal persons, intermediate legal persons, non-profit making legal persons, national and local public organizations, selling natural persons, banking institutions, SPC and so on.

Credit Ratings	Debtors	Classes
1 thru 10	Normal	Ⅰ
11 — 1	Debtors with caution required	Ⅱ
11 — 2	Debtors with caution required	Ⅱ
12	Debtors with fear of bankruptcy	Ⅲ
13	Debtors substantially bankrupt	Ⅳ
14	Debtors really bankrupt	Ⅳ

The IBoJ has had enterprise examination techniques originated from grasping the realities in not only financial but also managerial aspects, while comprehensively analyzing and evaluating the trends in the banking industrial sector. To determine a credit rating, it is necessary to study the features, problems, and challenges relating to every account from a variously angled point of view so as to understand their business qualities. Such studies and understandings, moreover, are helpful to advise accounts about how to properly address the managerial problems and challenges. The IBoJ has been placing emphasis on the buildup of credit risk management techniques based on credit rating while making effective use of examination techniques from such a living business management point of view. The IBoJ has been using their credit ratings as an indicator to determine how creditable a debtor prospect individually. These credit ratings serve as a footing of credit risk management. More specifically, out of various financial indicators, an optimum indicator group is used to quantitatively assess financial showings, first of all. Then, a qualitative assessment of business line features, and operation bases is made to arithmetically obtain an assessment architecture composed of then stages for credit ratings. It serves as a standardized indicator in assessing the creditability of debtors irrespective of whether they may be commercial or financial entities either in Japan or overseas. Credit ratings are operated as one of the critical standards to determine the creditability as gathered from the fact that they are incorporated in the decision-making system relating to credit examinations. Besides, the assessment architecture is also effectively utilized as an important indicator in the process of quantifying the credit risks involved in the entirety of a credit portfolio. In this sense, it is important to realistically grasp a change in the creditability status of a debtor so as to reflect it on the credit ratings properly in time. In the IBoJ, analysis's belonging to Enterprise Examination Section, and are monitoring credit ratings constantly, based on the more detailed fact-finding analysis, while taking into consideration the business line trends, such market trends as stock prices, etc., including credit events grasped.

The in-house rating system established by Mitsui Sumitomo is composed of two rating categories: one is the Debtor Ratings as an indicator to show the certainty with which a debtor performs its obligations, and the other "Project Ratings" as an indicator to show the certainty with which the credit offered is recoverable. The "project ratings" are set while taking into account the conditions as the guarantee, credit term, mortgage and the like, based on the debtor ratings. The self-assessment, meanwhile, is positioned as the process of determining a debtor to be rated subordinately to the debtor ratings so as to secure its compatibility with the rating architecture.

Mitsui Sumitomo is rating debtors as referred to below. (In a parenthesis, the former is a section of debtors in the self-assessment and the latter a section of credit disclosed under the Finance Regeneration Act). a, b, c, A, B and C standard for their respective subsections.

1) [a, b, c] (Normal account/normal credit) Debtors show a very high level of the certainty with which they perform their obligations.
2) [a, b, c] (Normal account/normal credit) Debtors show a high level of the certainty with which they perform their obligations.
3) [a, b, c] (Normal account/normal credit) Debtors have sufficient certainty to perform their obligations.
4) [A, B, C] (Normal account/normal credit) Debtors are considered to have certainty to perform their obligations. Nevertheless, there are possibilities that their certainty may be affected by a significant change, if any, in trends of the economy and in environments surrounding the industrial sector from now on.
5) [A, B, C] (Normal account/normal credit) Debtors have no problem for the time being in terms of their certainty to perform their obligations. Nevertheless, such certainty is not deemed to be secured in the future. And there are possibilities that it may be affected by a change, if any, in trends of the economy and in environments surrounding the industrial sector from now on.
6) (Normal account/normal credit) Debtors have no problem for the time being in terms of their certainty to perform their obligations. Nevertheless, their business showings have some uncertainties and there is a fear that they may fail to perform their obligations in the future.
7) (A, B, C) (Out of the debtors with caution required, those with control required require to be controlled while deeming those with caution required as normal credit.) Debtors require caution in control from now on, with a problem, or problems in lending terms

and conditions, and in obligation performance, with business showings sluggish or unstable, and/or while involving an issue or issues in financial standings, etc.

8) (Debtors with fear of bankruptcy, risky credit) Debtors have difficulties to manage their business although not bankrupt. With their management improvement plan and the like not in smooth progress, they are considered very highly likely to turn bankrupt in the future.

9) (Debtors substantially bankrupt, credit insolvent and being reconstructed, or equivalent thereto) Debtors are substantially bankrupt though neither legally, nor formally insolvent because they are deemed to have fallen in serious difficulties to manage without being likely to be reconstructed.

10) (Debtors bankrupt, credit insolvent and being reconstructed, or equivalent thereto) Debtors are substantially bankrupt legally and formally.

Sanwa has been rating their debtors for creditability by assessing their financial standings from three points of view; “safety,” “profitability” and “cash flow.” And this bank is conducting on credit ratings objectively in 10 stages (16 stages, including additional ones). In addition to the review made once a year, the credit ratings are reviewed according to a debtor’s status.

To conduct on credit risk management objectively in a standardized manner, Tokai has been giving a credit rating to every debtor except for personal loanees. From the viewpoint of maintaining objectivity, both quantitative and qualitative assessment techniques are jointly used. For the legal persons operating in Japan, who are main object of Tokai ‘s credit operations, a highly reliable rating model has been adopted, which was made by statistical techniques, based on the bankruptcy data relating to Tokai’s accounts. Credit ratings are used to determine whether or not the credit be offered, and to control debtors individually as referred to below. Besides, the credit ratings serve as the base to control the corporate management, based on a quantification of credit risks.

(Credit Ratings in Tokai) (In a parenthesis, the former is a debtor self-assessed and the latter the credit disclosed under the Finance Regeneration Act).

1) A, 1B and IC Ultra-excellent (Normal account and normal credit)

2) Excellent (Normal account and normal credit),

3) Good (Normal account and normal credit)

4) Level ratio favorable (Normal account and normal credit)

5) Level (Normal account and normal credit)

6) Level ratio poor (Normal account and normal credit)

7) Allowable (Normal account and normal credit)

8A) Debtors with caution required but without repayment in arrears (Account with caution required and normal credit)

8B) Debtors with caution required and repayment in arrears for 1 month or more (Account with caution required and normal credit)

8C) Debtors with caution required and repayment in arrears for 3 months or more (Account with caution required and credit with control required)

8D) Debtors with lending conditions relaxed (Account with caution required and credit with control required)

9) Debtors with fear of bankruptcy (Account with fear of bankruptcy and risky credit)

10A) Debtors substantially bankrupt (Account substantially insolvent and credit being reconstructed, or equivalent thereto)

10B) Debtors bankrupt (Account bankrupt, and credit with reconstruction from bankruptcy underway, or equivalent thereto)

4.8.2. Building up Risk Management Organization/Scheme

The Mitsubishi Tokyo Group has organized three risk management departments: one is to integrally manage risks, the second to control credit risks, and the third to control market risks. A general risk management committee meeting is held every three months. With the results of this meeting taken into consideration, a risk management policy governing the entire group is mapped out in a meeting of the Board of Directors and/or in a corporate management meeting.

In Tokyo Mitsubishi, the General Risk Management Section is comprehensively managing every risk as a control section to operate and manage risks. For individual risks, a management section is organized to make a risk management on a risk by risk basis. Committees involved include the Risk Management Committee, the ALM Committee, the Investment and Financing Committee, and the Information Security Management Committee. For the risk management system in Tokyo Mitsubishi, each operation department tries to separate the promotion of operations from their examination so as to establish a system where both can perform the functions of checking and balancing to each other. The Finance Planning Section is in charge of the examination system, and credit operations on an entire bank basis so as to promote the rationalization and efficiency increase in the financing process.

The Mizuho Group has established a credit risk management scheme as referred to below. Any critical matter relating to credit risks is decided by the Board of Directors. The Portfolio Management Committee is a management policy council relating to the credit risk management. And this committee is generally examining and arranging the credit portfolio operations within the Group. Consolidated Risk Management and Credit Planning Departments are jointly planning and promoting the particulars fundamental to the credit risk management.

To integrally manage risks, Fuji has the Corporate Management hold the specializing meetings on a risk type by risk type basis, to decide and monitor a risk management policy. And various committees follow them up mobily. As far as an integral risk management-related policy is concerned, moreover, Fuji has established such a scheme as to hold the “Risk-related Corporate Management Meeting” twice a year to sum up the policy while following it up in the monthly meetings of Corporate Management. A Chief Risk Officer (CRO), moreover, is appointed to take exclusive control over a diversity of risk management. The CRO takes office separate from, and independent of any profit-making departments, to monitor a variety of risks from an across-risk point of view, thereby playing a powerful checking function. In Fuji, a meeting of the Credit Risk Corporate Management establishes the credit risk taking upper-limit guidelines and a portfolio operation policy. In addition, the Credit Strategic Committee follows up the portfolio operation status and reflects it upon a specific policy. A view of their scheme to examine and control individual projects would tell us that domestic headquarters have had exclusive examination departments organized on a business line by business line or size by size basis for transactions with big and leading enterprises and on a region by region basis for transactions with individual persons and medium- and small-sized enterprises. In addition, a New Business Examination Section is organized to accumulate and examine the knowledge in the industrial sector and the technical know-how, such as technology assessment, etc.

DKB has an organization scheme and examining functions as roughly described below. The Credit Risk Management Committee is organized as one of their corporate management committees. This committee has an objective of discussing and taking corrective action against various problems involved in credit services and credit risk management, with the chair taken by an officer in charge of risk management. The Finance Planning Section is a department in charge of credit risk control all over the bank. The Consolidated Risk Management Section is a department in charge of credit risk measurement.

In the IDBoJ, Examination and Consolidated Risk Management Departments, both independent from any sales section, are collaborating to control and manage the credit risks entirely on an in-house basis. The credit risk management in a bank may be described on two sides, if roughly divided. The first is the credit risk management by monitoring individual accounts and groups. The second is the risk management by monitoring credit portfolios as a whole, including all of individual transactions. The IDBoJ thinks it important to conduct on these two risk management’s in parallel. In the IDBoJ, Examination Department is in charge of the credit risk management on a transaction by transaction basis to give a credit rating in accordance with corporate examination techniques. At the same time, a scheme is structured to normally monitor the credit status of an enterprise in reality to map out a credit management policy and to examine the credit projects both in Japan and overseas. To manage the credit risks in the entirely of a credit portfolio, moreover, the Consolidated Risk Management Department is in charge of measuring the level of risks by making effective use of a financial engineering-oriented technique while analyzing and monitoring a portfolio. Both departments are collaborating to each other to proceed with analysis and assessment. While trying to upgrade the level of operation techniques, and to share the analytical results. Examination and Consolidated Risk Management Departments are jointly reporting and proposing the general situations of risks to the corporate management in the meetings of the Board of Directors, of the corporate management, of the Credit Committee, of the Credit Portfolio Committee and the like.

In case of Mitsui Sumitomo, each department is properly managing those risks which should be done so according to the departmental duties in charge. From a comprehensive risk management point of view, furthermore, an the Internal Risk Management Department is organized independently of any operation departments so as to manage risks comprehensively and systematically together with the Corporate Management Planning Department. With the importance of risk management taken into account, an administration scheme is constructed as headed by the Board of Directors. More specifically, each section in charge of risk management maps out a "basic policy for risk management." After approved by the Corporate Management meeting, that policy is deliberated by the Risk Management Committee organized in the Board of Directors, in a meeting of which it is finally resolved. Mitsui Sumitomo has a concrete credit risk management scheme as described below. Finance Planning Department establishes a credit policy, plans, and maps out the in-house rating system/credit risk measurement techniques, plans crediting, such as rules of the rights to offer and/or propose credit, manages credit portfolios, including bad debt management, and integrally manages credit risks. Planning Survey Department makes surveys relating to industries and industrial sectors, and investigates the individual enterprises. Through these surveys and investigations, the Department tries to grasp the realities in mayor debtor enterprises, find out debtors with a fear of creditability deterioration in earlier stages and discover growing enterprises. With Examination Section organized in each operation department, credit projects under charge are examined, and portfolios under charge are managed. Those enterprises who have been really or substantially bankrupt are put under concentrated control of Finance Administration Department, in principle, while striving to dispose of the bad debts in earlier stages. In summary, the corporate staff division includes Consolidated Risk Management Department, Finance Planning Department, and Portfolio Management Department while the corporate service division has Finance Management Department and Enterprise Survey Department.

The UFJ Group has a risk management scheme as described below. An executive officer in charge of the Risk Management Unit is responsible to recognize, grasp and properly manage each and all of the risks that the Group has. In addition, this officer reports a status of risks, and as required, proposes to the corporate management. Besides, he or she provides the corporate management with the information on risk capital management. Risk Management

Committee is organized as an advisory committee on behalf of the executive officer in charge of risk management. It is defined as a council organized to recognize various risks that the Group has and to build up a scheme to properly manage and operate such risks. In UFJ Holdings, General Risk Management Department is charged with the functions to control a variety of risk management, market risk/fund fluidity risk management and operational risk management. To exclusively address the credit transactions, nucleus of operations, on the other hand, Credit Planning Department is organized to exclusively handle the credit risk management. Credit Planning Department, UFJ Holdings, is in charge of the credit risk management all over the Group while monitoring credit risk. The finding in such monitoring are periodically reported to the Board of Directors, Group Management Committee, Executive Officer in charge of risk Control Unit and Risk management Committee.

Sanwa has an organization/system as described below. An executive officer in charge recognizes, grasps, and properly manages each and all of the risks to which Sanwa is exposed. In addition, he or she reports a status of risks, and proposes, as required, to the Board of Directors. Each risk management control section independently measures and monitors each risk. And it is made as a rule for each section to periodically report a status of risks to the board of directors, Corporate Management Executive Committee and to the corporate management by way of various meetings involved. General Risk Management Department plans and develops the regulations and policies relating to the general management of various risk, and generally adjusts the risk management in developing new operations, products and schemes. In addition, General Risk Management Department strives to upgrade the general risk management framework. To enhance the Risk-Return Operations and the Action against Problematical Credit, Sanwa has organized an examination section in the retail company/legal person company. Credit Planning Department, independent of sales/examination sections, is in charge of performing the function of controlling the credit risk management. In addition, Credit Audit Department, an organ completely independent of any other organizations, periodically verifies that the risk management is being properly conducted in sales offices, either domestic or overseas, affiliates and related headquarters.

Tokai has established a system to control and manage the risks all over the bank, with the lead taken by Control Management Headquarters composed of Risk Management Department, Finance Control Department, Paperwork Administration Department and systems Department. Risk Management Department is an independent organ to monitor every risk, including market ones, from an overall in-house point of view while reporting to the corporate management. This department controls every related section as promotion secretariat for Risk Control Committee (committee organized to enhance the risk management functions on an overall in-house basis). In addition, Risk Management Department reports risks directly to the corporate management daily, monthly and from time to time (in emergency or the like), being charged with a role of practically implementing the related corrective action in cooperation with every section concerned. A status of revenue and risks all over the Tokai Group is reported to a Risk Control Committee's meeting and to an Executive Officers' meeting, both held monthly. Thus, Tokai has established a system for the overall corporate management to widely recognize and manage the bank's risks. In addition, the personnel having a plenty of knowledge and experience in operations, furthermore, are stationed in Operation audit Department to implement a comprehensive internal audit. Thus, a system has been established for Operation Audit Department to report audit findings directly to the corporate management. To control the credit risk management all over the bank, Tokai has organized Finance Control Department as organ independent of any other business units. Finance Control Department establishes credit-related basic policies and rules, including a credit policy and a credit rating system. At the same time, this department monitors a status of credit risks all over the bank and maps out appropriate corrective action against any possible problems. When monitoring the status, Tokai measures a credit risk while attaching importance to a viewpoint of portfolio management. Finance Control Department, moreover, studies credit risk management techniques and develops credit-related systems/rating models. In Tokai, Finance Control Department grasps and analyzes a status of credit risks on an overall in-house basis, whish is monthly reported to the Corporate Management meeting after examined by Risk Control Committee. In addition, key points involved are reported to the Board of Directors while the particulars critical in executing operations are reported to the Executive Officers' meeting. To decide whether or not the credit be offered on an individual case by individual case, Tokai has organized a department/section in charge of examinations inside each business unit so as to properly address the needs on the part of accounts through a technical and mobile examinations. As far as examination authorities are concerned, an amount allowable for credit is defined on a credit rating rank by credit rating rank basis. As far as the credit audit is concerned, Operation Audit Department is organized as organ independent of each business unit.

4.8.3. Measuring a Credit Risk

The Mitsubishi Tokyo group is now proceeding with the buildup of field-proven data in the past available from member companies in the Group. Highly advanced calculations, moreover, are indispensable to simulate the rating of an individual debtor, inter-industrially related factors and recovery rates different from credit to credit. To this end, a calculation model has been developed to allow for a free use of advanced financing technologies, thereby making effective use of credit risks.

To quantitatively measure a credit risk, Tokyo Mitsubishi has proceeded with the buildup of field-proven defaults by credit rating and field-proven recoveries by type of security in the past, thereby calculating a risk, based on the in-house data. Such credit risk level measuring results are reflected upon various portfolio operations and policies. To establish a physical constitution of revenue having a return compatible with credit risks, Tokyo Mitsubishi operates pricing, based on a prediction of losses and implements a capital cost concept and reflects it upon loan spread operations. For the credit with control required, Tokyo Mitsubishi has introduced a discounted current value process and reckons an amount of reverses, based on the cash flow estimated debtor by debtor. As far as normal debtors and those with caution required other than those with control required are concerned, the conventional field-proven bad debt reverse application rate system has been changed over to the bankruptcy probability method to calculate an amount of reverses while reckoning the general bad debt allocations, based on a predicted amount of losses by debtor as calculated with credit risk measured.

Fuji has measured credit risks as roughly described below. In relation to almost all the credit transactions, a realistic amount of credit is grasped daily, with credit and security values taken into consideration to arithmetically obtain a mean amount of losses (credit cost) predicted for the coming one year and a maximum excess of the losses expanded beyond the predicted cost (= credit risk level). The counts relating to a measurement of credit risks are not only analyzed and reported from a diversity of angles, such as by type of transactions, by rating, by region, by business line, etc. but also compared with the net worth in a form integrated with a market risk and the like as integrated risks. Consequently, the data contribute to an appropriate risk taking by the bank as a whole. On the other hand, such counts are also effectively used for decision making by the corporate management through an optimization of lending spreads, distribution of the risk capital required in each operation group, capture of the revenue after departmentally adjusting risks on a managerial information system and assessment of the performance vs. the risk capital.

DKB has been measuring credit risks as roughly described below. From the viewpoint of proceeding with a buildup and enhancement of asset portfolio management and controlled accounting systems, DKB constructed a "credit risk measuring system" in 1998, thereby starting to measure the credit cost and the credit risk level by region, by credit rating and by business line. In 1999, this system was upgraded so that measurements could be taken while reflecting the maintenance statuses and others in detail by enterprise size and by project. Consequently, DKB is now able to make effective use of the measurements taken in relation to the profitability and risk level distribution status on a project by project basis, with bad debit cost taken into accounts, for the purpose of improving the risk to return and of enhancing the asset portfolio management.

Mitsui Sumitomo, on the other hand, uses some specific methods to calculate the extent to which they may lose in the future. To this end, this bank has been accumulating the data in the past by debtor and by credit project (to construct a database) and establish such parameters as rating change probability, recovery percentage and the like so as to obtain the probability of losses distributed all over portfolios (what amount of losses there are with what probability). Through approximately ten thousand cycles of simulations, Mitsui Sumitomo has been grasping the portfolio risk dispersion effects and concentration risks. At the same time, they have been making effective use of credit risk measurement results over a wide range of operations from mapping out a managerial plan to assessing an individual credit risk.

To make credit risks measurable, Sanwa has been specifically using the financial data of debtors in the past to obtain their default percentage by rating so as to arithmetically obtain a distribution of losses distributed in portfolios in the future, based on a simulation. Thus, Sanwa has been obtaining the risks in portfolios as a whole in the forms of “mean loss” and “maximum loss.” The “mean loss” stands for a mean level of the value predicted to be lost over the coming one year. And the “maximum loss” represents the maximum value predicted to be lost over the coming one year. The credit risks so made measurable cover a range of legal persons domestic and overseas, natural persons and banking institutions. Making credit risks measurable, moreover, enable us to grasp the effects of credit concentration/dispersion.

4.8.4. Portfolio Management

In the Mizuho Group, the risk management has had its importance attached to portfolios. To this end, the possibilities that a bad debt loss may arise from portfolios are calculated as two major values measured by a statistical technique; one is the mean amount of losses predictable for one year ahead (credit cost) and the other the maximum excess amount expandable beyond the predicable value (= credit risk level). The credit cost, among others, is taken for the loss to be covered by the revenue obtainable from credit transactions and effectively utilized as a reference value to establish transaction guidelines. In addition, credit portfolios are monitored from a diversity of viewpoints so that the credit risk level may fall within a range of the risk capital assigned. And a restriction or restrictions are set on a portfolio, as required. Specific credit portfolio management methods are such as to limit an amount of credit, as required, while monitoring how credit is concentrated on large accounts, and to periodically monitor the extent to which credit is concentrated on a specific line of business and/or a specific region.

Fuji has been managing portfolios as roughly described below. Portfolios are monitored and analyzed periodically from viewpoints, such as by business line, by region, by in-house rating, by large credit account group and so on. Thus, the portfolios are managed so that the credit risks owned will fall within a strict range of allowances. For breakdown of lending portfolios by business line, they are being continuously monitored by the Corporate Management Meeting” and by the Credit Strategic Committee from the viewpoint of making surface that a balance of lendings by business line are not biased toward a specific line of business and/or that a configuration of portfolios has not changed rapidly.

What is meant by making credit risks measurable for the IDBoJ is a technique to quantitatively grasp the credit risks involved in the entirety of credit protocols owned by the IDBoJ by making effective use of credit ratings. Some may think that the credit risk management would suffice as long as the credit in individual transactions is perfectly controlled. Nevertheless, a credit risk level in the entirety of credit portfolios would increase all the more according as the credit is more concentrated on a specific enterprise, line of business, nation or region. Upon startup of transaction, for example, an enterprise or line of business may have been deemed as an account promising in the future. It is likely, however, that a change in environments might downgrade their business showing rapidly. A concentration of credit on a specific business line or a specific region, moreover, might bring about a concentrated significant loss with higher probability in the event of a change in environments or of an unforeseeable accident. Such accidental events should be assumed in advance and prevented. To this end, the risk management is considered to require a viewpoint of "dispersion in a portfolio." The IDBoJ has been using the measurement-oriented approach applied credit control technique to effectively adjust the concentration of credit on a specific enterprise group, business line and/or region for the purpose of attaining an appropriate portfolio. More specifically, the IDBoJ has implemented "Upper Limits of Credit by Rating" and "Guidelines of Portfolios by Enterprise" as techniques to control the concentration of credit on a specific enterprise/group, and another operational technique called the "Guidelines of Portfolios by Region and by Business Line" to control the concentration of credit on a business line/region. The IDBoJ has an outlook of the active credit portfolio management while reducing the credit cost by making an advanced risk management. The term, active credit portfolio management, means the positive portfolio management aimed at minimizing risks and maximizing the return by conducting on the acquisition and sale of assets strategically.

Mitsui Sumitomo has a credit portfolio management framework composed of the following five points:

1) Take appropriate risks within a range of net worth.
2) Suppress the concentration of risks.
3) Secure a return enough to pay for risks taken.
4) Compress the credit in question.
5) Tackle with an active portfolio management.

To eliminate the risk of excessively concentrating the credit on a specific account, line of business or region while managing portfolios, the UFJ Group has specified the "upper limits of credit" and "credit-limiting business lines" so as to diverse credit risks.

4.8.5. Implementing an Assigned Capital System (to distribute the risk capital; to manage by means of risk capital)

To operate risks at a high level matched with a target revenue and with operation strategies, the Mitsubishi Tokyo Group has been operating an assigned capital system. Under this system, the economic capital obtained by calculating various risks to a standardized scale is assigned to each of the segments, such as by affiliate, by risk, by operation or the like, but within a range of net worth.

The Mizuho Group has introduced a management system, under which the risk capital with its financial source taken in the net worth or the like is distributed to each business unit, which in turn has implemented a management scheme to conduct on business activities with the unit's own risk capital taken for upper limit. In this new framework, the RARCO indicator is used to assess the performance by comparing the distributed risk capital with a return. With this assessment result taken into account, resources are distributed efficiently so as to tackle with an improvement of capital efficiency.

(NOTE) RAROC (Risk Adjusted Return On Capital) represents the profitability of distributed capital. It is an indicator used to evaluate the capital efficiency. RAROC is obtained by dividing the return after adjusting statistically predictable risks by capital.

Fuji has been also distributing the risk capital. More specifically, the credit risk level obtained, based on a risk quantification technique, is added to a market risk level so that risk levels can be integrally grasped. In order that such a sum of risk levels may not exceed the financial physical power, Fuji is managing and controlling risks so that they may fall within a range of allowances predetermined, based on the capital account, etc.

To materialize a management with risk-return well balanced and to secure a sufficient level of wholesome from a comprehensive point of view, Mitsui Sumitomo has implemented the "management by risk capital" as part of their corporate management control system to effectively the capital according to an operational strategy to cover each of the risks involved in credit, market, paperwork and systems but within a range of Mitsui Sumitomo's managerial physical power (net worth). Especially in credit/market risk categories, the maximum value of the risk capital that could be taken during a term is defined as the "risk capital extremity." And a risk capital guideline is established, as required, but within a range of the "risk capital extremity" to conduct on the risk management.

4.8.6. Establishing Regulations/Manual

With "Fundamentals to and Norms of Credit Operations" established, Fuji has been striving to have a generally applicable credit stance and secure the wholesomeness of lending assets while every bank clerk engaged in credit operations are sharing the fundamentals and criteria.

DKB established the "Basic Policy for Credit Risk Management" as the basis to tackle with the credit risk management in 1999. At the same time, the "Credit Portfolio Management Regulations" has been established to provide for the fundamentals to various types of risk limits and monitoring lines from the viewpoint of dispersing risks while avoiding a concentration of credit ion a specific region/business line.

Mitsui Sumitomo has established the Risk Management Rules containing the fundamentals that should be taken into consideration in relation to risk management. Simultaneously with the inauguration as a new bank in 2001, Mitsui Sumitomo established the Credit Policy, which provides for the universally applicable and basic principles, guidelines, and criteria for credit operations, with the management philosophy and behavior norms taken into account.

In the UFJ Group, UFJ Holdings has established the Credit Risk Management Rules as framework to manage credit risks. Based on these rules, each bank belonging to the Group has provided for various regulations, standards and provisions in detail for calculations of the credit risks, such as credit ratings, country ratings, credit risk measurement, self-assessment and so on.

To conduct on an appropriate risk management, Sanwa has had the Board of Directors make a resolution of the risk management regulations, including the Basic Rules of Risk Management. While periodically reviewing these regulations, Sanwa maps out a "comprehensive risk policy" and a "management policy" on a risk by risk basis in the middle of every business term while taking with the challenges and measures involved in risk management. To attain an optimum risk-return balance on a medium-/long-term basis in the asset-liability management, Sanwa has constructed a scheme to integrally manage both credit and market risks as a "comprehensive management of return and risk" while striving to attain a higher level of risk management more than ever.

II-5.

Basic Policy and Policy Measures for the Development of Viable Security/Guarantee Systems

5. Basic Policy and Policy Measures for the Development of Viable Security/Guarantee Systems

5.1. Necessity for Development of Viable Security/Guarantee Systems

5.1.1. Present State of the Existing Security/Guarantee Systems for Housing Loans

(1) Improvement of the Existing Security/Guarantee-related Legal Systems

The People's Republic of China Security/Guarantee Law (promulgated on June 30, 1995 and put into force on October 1, 1995) forms the framework of the country's security/guarantee systems.

On the other hand, the People's Republic of China Real Estate Control Law (put into effect on July 5, 1994) and the Law on Urban Real Estate Control Law (put into effect on May 9, 1997) refer to real estate-related security/guarantee.

And the Privately Owned Housing Finance Law (promulgated on May 14, 1998 by the Peoples' Bank of China), and the Housing Public Reserve Management Law (put into effect on April 3, 1999) refer to security/guarantee for housing finance.

Furthermore, Bylaws on the Enforcement of the Agricultural Bank of China Provisional Private Housing Finance Guarantee Management Law (put into force on July 14, 1997 by the Agricultural Bank of China), the Industrial and Commercial Bank of China Private Housing Finance Guarantee Management Law (put into force on September 25, 1997), Bylaws on the Enforcement of the China Construction Bank Beijing Branch Private Housing Finance Security (put into force in 1998), as well as the Housing Asset Forming Guarantee and Control Law (put into force jointly by the Ministry of Construction and the People's Bank of China), directly refer to security/guarantee for housing finance, which is regarded as a joint directive by the Ministry of Construction and the People's Bank of China.

Except for the above-mentioned joint directive, all the laws and bylaws that concern security/guarantee for housing finance provide for only specific aspects of security/guarantee for housing finance. It can be said that in China the framework of a viable security/guarantee legal system for housing loans has yet to be developed.

(2) Current Fundamental Concepts of Security/Guarantee for Housing Finance

The above-mentioned joint directive by the Ministry of Construction and the People's Bank of China (the Housing Asset Forming Guarantee and Control Law) forms the current framework of security/guarantee for housing finance in China. We may point out the following four fundamental concepts of security/guarantee for housing finance in China.

1) The guarantee organization is a real estate broker as a business corporation, not a

financial institution. It is an independent entity which cannot be an affiliate of any financial institution.

2) Principle of voluntariness of guarantee. The loan customer may decide on whether or not to demand guarantee at his or her own discretion. The guarantee organization can also decide on whether or not to accept guarantee at its own discretion.

3) When the loan customer goes into default, the guarantee organization becomes responsible for performance by subrogation. It should also support the loan customer who has found it difficult to continue to occupy the housing when dealing with the relevant security (mortgage).

4) Regulations on the scope of operations of guarantee organizations, lower limit of capital for the establishment of guarantee organizations, and the limitations on the amount of guarantee fee serve as guarantee organizations' means to avoid risks.

Table 5-1 shows the main points of the existing security/guarantee systems in China.

Table 5-1 The Main Points of the Existing Security/Guarantee Systems in China

Supervision/management system	Ministry of Construction, city governments (in actuality, city governments are mainly responsible for supervision and management of guarantee organizations) The People's Bank of China participates in supervision and management of guarantee organizations only indirectly.
Basic nature of the guarantee organization	Real estate service company (a kind of real estate broker) Independent business corporation Limited-liability company or joint-stock company
Conditions concerning size and qualifications	Capital stock registered in the amount of 1 million RMB or more Holding of a certain quantity of housing stocks
Organizational structure	An organization operating in a certain urban area No coordination between regions or districts The Ministry of Construction has virtually no control over the operations of guarantee organizations
Financing	Part of city government's budget (including overhead expenses) Assignment of national assets Investment by (major) developers
Settlement of mortgage	Essential (within 30 days after conclusion of guarantee agreement) Effective until full payment of principal and interest
Insurance of collateral	There's no relevant provision but it is possible to demand compulsory insurance. Guarantee organization is designated as primary beneficiary.

Debt collection	Disposition of credit is possible but is hard to make. Guarantee company has the obligation to provide the loan customer with consultation on housing or help the loan customer find housing.
Scope of business	To specify housing finance as guarantee It is possible to engage in business other than real estate brokerage.
Risk reserve	Essential (to be included in guarantee fee) To be managed by means of special account
Limitation on size of guarantee	Not more than 30 times the amount of capital stock registered
Information network	Differs from one city to another (yet to be fully developed)
Human resources development	There still are no relevant or qualifications or training programs.

Source: JICA Study Team

(3) Present Conditions of the Existing Guarantee Organizations

In China, a considerable number of cities started the housing finance guarantee business in the second half of 1999. These guarantee organizations are mostly business corporations. China's cities where the housing finance guarantee business was carried out on an experimental basis by such guarantee companies, include Shenyang in the northeastern region, Shanghai in the coastal region, and Chengdu in the western region.

For example, Shenyang Real Estate Guarantee Company, which was established in March 1999, has provided housing finance guarantee to a total of 13,870 households (total loan amount: 2.77 billion RMB) as of July 2001. Shanghai Housing Asset Formation Guarantee Company, established in August 2000, started housing finance operations in March 2001. At present, the company has a total of 20 service offices. As of July 2001, the company provided housing finance guarantee to a total of 17,000 household (total loan amount: 1.5 billion RMB). [1]

The existing guarantee companies are mostly joint-stock companies. They are broadly divided into those which are financed mainly by major developers and those which are financed mainly by public organizations such as the Provident Fund Management Center. They can also be broadly divided into those which provide mainly provident funds and those which provide housing loans, including commercial bank housing loans.

Shanghai Housing Asset Formation Guarantee Company provides only housing finance guarantee for housing finance by the use of provident funds. As such, the guarantee company can be said to be typical of large-scale guarantee companies financed mainly by the

[1] Source: The Ministry of Construction's data and the hearing survey of Shanghai Housing Asset Formation Guarantee Company

Provident Fund Management Center. The amount of the company's capital stock registered, which is 300 million RMB (limit of warranty: 9 billion RMB), is the largest in the country. The Provident Fund Management Center has a 55 percent stake in the company.[2] The company's guarantee business is characterized by:

1) Public in nature (affiliation with the Provident Fund Management Center).
2) Inclusion of insurance (fire/earthquake insurance) on collateral in guarantee fee.
3) Subrogated performance by the guarantee company (loan customers being exempted from any liability) at the time of decline in value or loss of the collateral as a result of an unexpected explosion, a natural disaster or an unexpectedly falling body.

Judging from the existing guarantee companies' operations, the start of the housing finance guarantee business has been obviously instrumental in expanding the scope of the housing finance business and promotion of housing development. On the other hand, however, there has been a slowdown in the growth of the housing finance guarantee business in some cities and increasing risk pressure. Moreover, such problems as the low level of supervision and management of housing finance guarantee, and the small number of housing finance guarantee specialists relative to the high growth potential of the housing finance guarantee business are beginning to come to the surface.

5.1.2. Necessity for Development of Viable Security/Guarantee Systems

(1) Objective of Development of a Viable Security/Guarantee System

In China, the objective of development of a viable housing finance security/guarantee system is threefold.

1) To help enhance housing loan customers' creditworthiness, which is likely to greatly affect the quality of national life, as a kind of established social system. In this respect, this system is expected to directly result in establishment of a nationwide credit system, especially an improvement in individuals' creditworthiness.
2) To support those who are desirous to receive housing loans, particularly housing loans for those who belong to the low- to medium-income group. In this respect, this system is to form the basis for promotion of housing development and the healthy growth of the housing finance system. It will also help promote the smooth implementation of the central government's long-term housing policy.
3) To support those housing loan customers who find it difficult to repay housing loans.

[2] Public organizations other than the Provident Fund Management Center have interests in the company . (Source: Hearing survey of Shanghai Housing Asset Formation Guarantee Company)

In this respect, this system will contribute not only to the stabilization of national life but also to the stabilization of China's society as a whole.

(2) Necessity for Development of Viable Security/Guarantee Systems

It has been widely recognized that credit risks involved in housing finance are lower than other types of finance because it also involves mortgage collateral. In recent years, however, there have been dramatic changes in the circumstances in which housing finance finds itself--for example, the rapid pace of liberalization, the internationalization and securitization of finance, the problem of multiple consumer loans attributable to excessive consumption of goods and services, and the increase of business bankruptcies, jobless persons, diseases and personal bankruptcies.

To financial institutions, risk is an age-old question. Even when strict operational and financial restrictions were imposed on financial institutions, to have a firm grasp of credit risk (risk of bad debts), and operational risk (scandals and operational errors), and to manage these risks properly were financial institutions' important managerial challenges.

One of financial institutions' fundamental principles of provision of loans is the principle of safety. This means that it is essential for financial institutions to recover loans. To this end, financial institutions conduct credit investigations of loan customers, and at the same time take measures for credit protection such as mortgage, guarantee and insurance. In the case of housing loans which involves long-term loans in relatively large amounts to individuals, in particular, credit investigation and measures for credit protection are especially important.

Not only in China bus also elsewhere, one of the most important challenges facing the country's housing guarantee systems is to minimize the risks of individual housing loan customers and financial institutions, as well while maximizing the purchasing power of those individuals who are desirous to use housing loans. For this reason, it is essential to develop viable guarantee systems which fit in with the needs of housing loan users as well as viable guarantee mechanisms, and develop an appropriate risk management system and appropriate risk management techniques through such guarantee mechanisms.

Furthermore, in China housing prices are rather high relative to the average income level. This means that housing purchasers are likely to borrow heavily, suffering from a heavy monthly loan repayment burden. It will therefore be necessary to introduce a long maturity period credit accommodation system for housing loan users and reduce the monthly loan repayment burden imposed on them in order to make it easy for individuals belonging to the low- to medium-income group to purchase housing.

5.2. Basic Policy for the Development of Viable Security/Guarantee Systems

5.2.1. Development of Viable Security/Guarantee Systems

(1) Introduction of a Viable Supplementary Credit Mechanism

Generally, in China an individual desiring to use a housing loan is required to offer the housing acquired as collateral to the financial institution, and asks friends or acquaintances to stand guarantee for him or her. In actuality, however, it is very difficult for individuals desiring to use housing loans to secure guarantors, due to the present conditions of the country and changes in the country's social climate.

To financial institutions, housing finance means long-term loans to individuals. It is necessary for financial institutions to acquire trustworthiness investigation/mortgage management know-how, different from that applied in financing to corporate businesses. They must also take precautions against increased risks as a result of the expansion of the loan business. For these reasons, financial institutions are hesitant to expand their loan business.

On the other hand, individuals desirous to use housing loans find it difficult to use housing loans due to the difficulty in smoothly securing proper means of guarantee, often forced to abandon their home purchasing plans. This is a serious direct impediment to the Chinese Government's housing development promotion policy.

One of the effective ways to overcome such bottleneck can be the introduction of a viable supplementary credit system which centers on agency guarantee, and which is to replace personal guarantee by the guarantor. In Japan, the establishment and spread of an agency guarantee-centered supplementary credit system was a very important factor to promote the rapid growth of housing finance by private financial institutions after 1965.

It should also be noted that the supplementary credit business and the loan business are complementary to each other. It is essential to maintain conformity between the loan business and measures for credit protection. Guarantee is a kind of loan business and therefore security guarantee organizations are required to carry out a financing function.

(2) Introduction of a Mechanism of Assignment of Different Roles to the Public Sector and the Private Sector

As the number of housing loan users increases in the country, the corresponding increase in the default rate will become inevitable.

As proposed in II-3 and II-4, it is important that public housing finance and private housing finance be complementary to each other, and both servicing different users based on different policy goals, in order to support viable housing finance systems. It is equally important to establish a public guarantee system in parallel with a private guarantee system. It is thus essential to introduce a mechanism for assignment of different roles to the public and private sectors, as a step toward the development of such guarantee systems.

Generally, a public guarantee system fulfills its functions through public guarantee organizations. In Japan, there are two types of supplementary credit system for housing loans: namely: one operated and managed by public guarantee organizations, and the other operated and managed by private guarantee organizations.

A public guarantee system should carry out its function in order to increase the number of housing loan users, in parallel with its function to support the central government's housing development promotion policy through enhancement of individuals' motivation purchase housing. For this reason, the operations of public guarantee organizations should be targeted at housing finance by government policy, namely housing loan customers and housing loans that are very likely to promote the implementation of the central government's housing policy. In light of the nature of individuals who need guarantee, it is necessary to minimize the guarantee cost even if risk management by private guarantee organizations is required. It can be said that provision of services advantageous and convenient to users through risk management and cost management at the highest level are the primary missions of public guarantee organizations.

(3) Introduction of an Organizational Mechanism That Merges a Cross-sectional Service System with a Centralized Supervision/Management System

China has a vast expanse of land. In the country, therefore, the level of economic development, industrial structure, and financial service differs widely from one region to another. On the other hand, the country's housing industry concerns all the people, promotion of purchase of housing being the primary objective of the central government's housing system reform plan.

Under such circumstances, it is necessary to develop a centralized supervision/management system which reflects the central government's housing policy, and which helps increase overall operational efficiency, while it is necessary to develop a service system in which the framework of the security guarantee system supporting housing finance is cross-sectional.

From the standpoint of risk management, it is unlikely that presence of independent and isolated guarantee organizations in every city or region will realize economies of scale. In the case of default, especially default attributable to a temporary increase in the unemployment rate which is caused by a change in industrial structure in a specific region, the operations of guarantee organizations in the region become inflexible, which may totally suppress such guarantee organizations' functions.

In China, there is a total of approximately 100 guarantee organizations established according to the principle of one guarantee organization in one city.[3] With the exception of the guarantee organization in Shanghai, all these guarantee organizations are small ones and there are no close business connections among them. In light of the past experiences in many other countries, including Japan, it will be advisable to establish guarantee organizations which are capable of nationwide operations, and which reflect the regional level of expertise in developing an overall guarantee system. This will be a very effective way of maximizing economies of scale and minimizing total risk. It will also be effective in promoting centralized supervision and management by the competent authorities.

(4) Introduction of a Mechanism for Additional Guarantee for Risk Distribution

For sufficient risk distribution and credit protection, it is necessary to take into consideration the introduction of a mechanism for additional guarantee, in addition to demanding mortgage and guarantee.

To distribute risks by buying specific insurance is a usual mechanism for additional guarantee. In Japan, real estate properties for which loans are provided on condition that such properties are insured against fire and that the insurance claim right is pledged. In such case, private guarantee organizations' fire insurance is covered by affiliated property insurance companies, or designated property insurance companies. However, the Government Housing Loan Corporation, which is a public guarantee organization, employs a "special fire insurance" system, in which property insurance companies jointly guarantee insurance. In the case of loan users (debtors), group credit life insurance serves as a means of credit protection when debtors die or physically disabled. Group credit life insurance is among many private financial institutions' necessary conditions for provision of housing loans. The Government Housing Loan Corporation does not require group credit life insurance. In actuality, however, most of its housing loan customers take out a group credit life insurance policy.[4]

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3 Source: Hearing survey of the Ministry of Construction Housing/Real Estate Bureau (as of November 2001)

4 Today as much as 96 percent of users of loans of the Government Housing Loan Corporation take out a group credit insurance policy. The total number of effective group credit insurance contract for a period from October 1980 to the end of March was 4.73 million, the total contract price being 61.6286 trillion.

5.2.2. Establishing the Foundation of Viable Security/Guarantee Systems

In developing a viable security/guarantee system, it is essential to create conditions conducive to the development of relevant institutional infrastructure, or the smooth functioning of the system.

It is necessary to develop a legal system concerning credit, real right, right to demand compensation, auction, and management and recovery of credit, which is to form the core of institutional infrastructure. China has already joined the WTO. It is urgently necessary for the country to start the work to develop a relevant legal system, in anticipation of increased market competition, to result from foreign businesses' entry into the country's market, which is certain to follow the country's entry into the WTO.

Furthermore, it is essential to establish competent credit information organizations and at the same time accumulate data on personal credit, in order to create judgment criteria concerning personal credit. In creating such databases, it is necessary to develop a system mechanism whose advantages both credit accommodation organizations and customers can enjoy. From the standpoint of efficiency, however, guarantee organizations are not required to establish their credit information arms or develop personal data on their own. If a mechanism for utilization of financial institutions' data is developed, it is possible for guarantee organization to attain their objectives in the area of personal credit information. In such case, how such information system is to be developed, and how effectively such information is to be utilized are of vital importance.

On the other hand, credit operations such as verification of compensation credit are operations which require specific know-how, and therefore it is essential to train personal credit specialists, who are also to acquire credit recovery techniques. In this connection, it is essential to take a strategic, systematic approach to the establishment of a public organization responsible for certification. It is also necessary to develop a training system for propagating relevant expert knowledge and know-how. It would be better to develop a training system for propagating relevant expert knowledge and know-how in reference to the certification system.

5.3. Basic Policy for the Establishment of Viable Security/Guarantee Systems

5.3.1. Development of Viable Guarantee Systems

On the basis of the basic concepts of a viable security/guarantee system as stated in the preceding section, in this section, the framework of a plan to develop a viable guarantee system for housing loans through the improvement and reforms of the existing systems is proposed, with emphasis on the establishment of a public guarantee system that is directly related to housing finance by government policy and the development of an additional guarantee system designed to distribute and thereby reduce risks.

(1) Establishment of Public Guarantee Organizations

1) Introduction of a Supplementary Credit Mechanism That Centers on Guarantee by Public Guarantee Organizations

One of financial institutions' basic principles of provision of loans is the principle of safety. This means that it is imperative for financial institutions to recover loans. To this end, financial institutions conduct credit investigations of loan customers, and at the same time take measures for credit protection such as mortgage, guarantee, and insurance. In the case of housing loans which involve long-term loans in relatively large amounts to individuals, in particular, credit investigation and measures for credit protection are especially important.

In China, housing prices are rather high relative to the average income level. This means that housing purchasers are likely to borrow heavily, suffering from a heavy monthly loan repayment burden. It is therefore very important to introduce a long maturity period credit granting system for housing loan users, and reduce the monthly loan repayment burden imposed on housing loan users in order to make it easy for individuals belonging to the low- to medium-income group to purchase housing. The need for the central government to establish a public guarantee organization to promote the establishment of a viable personal credit system and a security/guarantee system until such systems attain full growth on its own responsibility is worth considering.

2) Main Points of Establishment of Viable Public Guarantee Organizations

The necessary and important factors for the establishment of viable public guarantee organizations are utilization of economies of scale, discovery of the causes of delays in repayment of loans, determination of guarantee and accumulation of liability reserve, concrete measures to recover the right to demand compensation, enactment of relevant laws and regulations, and determination of the legal status of guarantee organizations.

A. Utilization of Economies of Scale

In order to give stability to the possible accident rate (loan repayment delay rate), it is necessary to keep the average accident rate at a certain level. In the case of housing finance, it is rare that a single housing loan user borrows heavily. The amount of loan provided to each individual housing loan user is small. In addition, such loan users vary greatly in occupation and type of business. As a consequence, the average amount of loss remains almost constant. If these advantages are to be fully utilized, economies of scale should be first utilized. Guarantee organizations should shift from regional to nationwide operations. In light of the history of guarantee as part of the housing finance business in Japan, it can be said that a regional guarantee system involves very high risks. In order to distribute such risks, it is desirable that guarantee organizations operate on a nationwide scale.

B. A Discovery of the Causes of Delays in Repayment of Loans and Development of Measures to Compress Arrearage

After subrogated performance by the guarantee organization, it is necessary to find out the causes of delays in repayment of loans in order to smoothly proceed with recovery of the right to demand compensation. The main methods for getting a firm grasp of the causes of delays in loan repayment concern a) prospect of elimination of the causes of delays in loan repayment, b) details of income and expenditure, c) details of net debt, d) family structure/age/occupation, e) details of occupation of housing, f) loan customer's willingness and ability to continue to repay loans, g) repayment track record and h) special circumstances. It is important to prepare, pigeonhole and analyze management cards, interview cards, on-site study cards, etc. on the basis of the results of such surveys.

The important necessary conditions for achieving a balance between income and expenditure in guarantee organizations, are the determination of guarantee fee and the rate of recovery of the right to demand compensation acquired after subrogated performance. It can safely be said that the rate of recovery of the right to demand compensation[5] is the key to the success of the guarantee business.

C. Determination of the Amount of Guarantee Fee and Accumulation of Liability Reserve

[5] For reference, the Public Financed Housing Finance Guarantee Association determines the amount of guarantee fee on the basis of the rate of recovery of the right to demand compensation, which is set at 60 percent, in Japan.

Housing finance is characterized by long period of time of loan repayment. As a consequence, a certain percentage of housing loan customers become incapable of repayment of loans due to socio-economic changes, unemployment or disease. Such percentage is referred to as accident (delay in loan repayment). In determining the amount of guarantee fee, it is essential to determine the accident rate (rate of delays in loan repayment) first. Guarantee fee consists of loss contribution (net rate) and clerical work expenses (additional rate). It is necessary to appropriate a sum of money to cover future performance by subrogation and clerical work expenses. The basic concepts of guarantee fee are as itemized below.

a. The amount of guarantee fee is to be calculated on the basis of expected loss contribution (net rate) and clerical work expenses (additional rate).

b. The net rate for the amount of guarantee undertaken is to be calculated at an annual rate for the guarantee period.

c. As to the guarantee period, the number of years which has a fraction is to be rounded up to the nearest whole number.

d. The net rate of the amount of guarantee fee is to be calculated as follows: the probability of final loss is multiplied by, the sum of the rate of loan repayment for the year for repayment of the principal and interest in equal installments, and the product of the present value ratio for the guarantee period.

e. The additional rate of the amount of guarantee fee is to be calculated by determining a fixed percentage of the sum of money to cover contract-related clerical work expenses, management-related clerical work expenses, subrogated performance-related clerical work expenses, compensation-related clerical work expenses, and recovery-related clerical work expenses. There are two types of approaches to the concept of additional rate--"fixed sum" approach on the one hand, and "fixed sum plus fixed rate" approach on the other.[6]

Guarantee fee is collected when guarantee is undertaken in the form of lump-sum payment for the whole guarantee period. As to the determination of the amount of guarantee fee at the time of establishment of the guarantee system in China, the country still has no sufficient past records of housing finance and the accident rate,

[6] It will be easy to understand the "fixed sum plus fixed rate" approach if it is recognized that the time and labor required to calculate amount of contract-related clerical work expenses remain the same regardless of the amount of credit guaranteed. On the other hand, the "fixed sum" approach closely reflects personnel/nonpersonnel expenses and commodity prices. Some say that the "fixed rate" approach is a better approach because it causes the subsequent rises in commodity prices to be reflected in the guarantee rate. Here the "fixed rate" which includes inflation hedge is adopted.

and the causes of delays in loan repayments have not yet been fully investigated. Furthermore, it is extremely difficult to give a fairly accurate forecast of the future occurrence of delays in loan repayment. It is necessary, therefore, to create an estimated accident rate (rate of performance of guarantee responsibilities) and review the problem of guarantee fee again when the differential between estimated and actual figures become obvious.

Furthermore, loans are sometimes repaid ahead of schedule. In such case, whether or not to pay back part of the guarantee fee paid in lump sum greatly affects guarantee organizations' finances.[7] Guarantee fee is collected on the assumption that it will be utilized during the whole guarantee period. The accident is also based on this assumption. When refunding of guarantee fee in proportion to the remainder of the guarantee period for ahead-of-schedule loan repayment is chosen, it is necessary to take relevant measures such as a high accident rate for the period immediately following the undertaking of guarantee.[8]

D. Measures to Recover the Right to Demand Compensation

If guarantee organizations' earnings are to be stabilized, it is important to increase the rate of recovery of the right to demand compensation, as well as to maintain an appropriate number of guarantee undertakings. Guarantee organizations may commission entrusted financial institutions to carry out guarantee operations. Since the determination of the condition of debtors is essential for the planning of guarantee operations, guarantee organizations should carry out debtor management operations on their own.

It is important to get a clear grasp of the condition of debtors and collaterals through interviews with debtors, surveys of the present state of collaterals, and verification of details of past negotiations, and consultation with entrusted financial institutions, prior to the formulation of the policy on recovery of the acquired right to demand compensation.

In working out a policy for recovery of the right to demand compensation, the

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[7] In Japan, if a 30-year loan is paid off as agreed on, the amount of outstanding loan after the lapse of 10 years should be more than 80 percent of the total amount of loan. In the case of the Housing Loan Corporation, it is approximately 50 percent, the differential being repaid ahead of schedule. Moreover, those housing loan customers who repay loans ahead of schedule are generally well off and they are very unlikely to fall into arrears with loan repayments. Long (more than 6 months) delays in loan repayment occur shortly after the provision of loans and it is approximately 10 years before the frequency of occurrence of such delays in loan repayment is reduced by half.

[8] The methods for calculating the amount of insurance premium and that of liability reserve are explained in the text.

following factors should be taken into consideration.

a. Voluntary repayment: the debtor indicates his or her intention to repay the loan in lump sum and it is certain that the total amount of loan will be recovered.

b. Token repayment: the debtor's intention to repay the loan has been confirmed but the debtor is found to be incapable of lump sum repayment.

c. Dividend participation: third party auction is in progress and there is no need to give notice of auction.

d. Exercise of right of pledge: where it is appropriate to recover the right to demand compensation through exercise of the right of pledge.

e. Subrogated performance: repayment by a person other than the debtor

f. Compulsory execution: the debtor has sufficient funds and it is appropriate to recover the right to demand compensation through compulsory execution.

g. Other necessary measures

E. Determination of the Legal Status of Guarantee Organizations (Guarantee Organizations as Public Service Organizations)

Housing loan users have to spend a large amount of money, including payment of guarantee fee, at the time of purchase of housing. It is imperative for guarantee organizations to try hard to reduce housing loan user's financial burden. At the same time, it is desirable that in light of the need to stabilize the operational base of guarantee organizations as public service corporations, guarantee organizations be granted the status of non-taxable, non-profit corporation, being exempted from payment of shareholder dividend and profits tax.

3) Framework of Public Guarantee Organizations

As stated earlier, there is a strong need to fully utilize economies of scale, get a clear grasp of the cause of delays in loan repayment, formulate arreary compression measures, determine guarantee fee, accumulate liability reserve, and manage recovery of the right to demand compensation. In this context, it is considered best to establish guarantee organizations that operate on a nationwide scale, and at the same time meet regional needs. It is also necessary that operations of such public guarantee organizations be carried out through close link with the reform of the housing provident fund system, namely, the shift to financial organizations, and to government policy-based financial organizations.[9] In this way, guarantee

[9] Establishment of the Central Housing Bank of China. 2. Detailed in the basic policy for the reforms

organizations will be able to function satisfactorily as part of future government policy-based housing finance systems. Table 5-2 shows the main points of the framework of public guarantee organizations.

Table 5-2 The Main Points of the Framework of Public Guarantee Organizations.

Item2	Remarks
Name (tentative)	Central Housing Guarantee Organization
Nature of organization	Public service organization Non-taxable corporation Type of business: finance
Scope of business	Housing finance guarantee/insurance Housing brokerage established by government policy
Supervision/management system	Joint management by the Ministry of Construction, the People's Bank of China and the Ministry of Finance Ministry of Construction: supervision and management of guarantee systems/policies People's Bank of China: supervision and management of guarantee-related outsourced financial services Ministry of Finance: supervision and management of budget and other financial matters
Organizational structure	Regional organizations to operate on a nationwide scale Headquarters → provincial branches (one branch in one province) → City service offices (one office in one city)
Headquarters' main functions	Adjustment of the central government's policies relating to finance guarantee by government policy Adjustment of the central government's policies relating to general finance guarantee Adjustment of security/guarantee systems/policies (appraisal of performance, appraisal of collaterals, performance guarantee, completion guarantee, etc.) Development and location of manpower (personnel management, training) Coordination between organizations operating on a provincial scale (personnel, fund) Coordination with entrusted financial institution's headquarters, affiliated insurance companies and other organizations Bond issuance
Provincial branches' main functions	Coordination with local governments (personnel, fund) Adjustment of provincial guarantee-related systems/policies Coordination with branches of entrusted financial institutions/affiliated insurance companies Provincial risk management (risk reserve, debt collection, etc.) Manpower development at the provincial level (personnel management, training) Coordination among city service offices within provinces
Main functions of city service offices	- Coordination with city governments Coordination with contact officials of entrusted financial institutions/affiliated insurance companies Guarantee fee management

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of the public housing finance guarantee systems.

	Debt collection (debtor management)
Financing	Central and local finances (budget) Investment by Central Housing Bank of China (tentative name) and its affiliates Bond issuance (when necessary conditions are met) Guarantee fee (maintenance expenses)
Risk management system	Integration with loan operations (unification of screening operations) Systematic management of guarantee fee Pooling-type risk reserve at the provincial level (fund accommodation at the time of occurrence of concentrated default) Direct management of debtors (non-business commission)
Business trust/partnership system	Outsourcing operations such as screening, guarantee fee collection and account management to commercial banks Tie-up with insurance companies for additional guarantee operations

Source: JICA Study Team

(2) Establishment of Commercial Bank-Affiliated Guarantee Organizations

1) Introduction of a Supplementary Credit Mechanism That Centers on Guarantee by Private Guarantee Organizations

Commercial banks' criteria for judging personal creditworthiness focus on debtors' ability to repay debts and credit limit.

Generally, housing loan users are required to offer the housing purchased as security and also ask one his or her friends or acquaintances to stand surety for him or her. In actuality, however, it is very difficult for individuals desirous to use housing loans to secure guarantors due to the present conditions of the country, and fast changes in the and social climate in the country.

To financial institutions, housing finance means long-term loans to individuals. It is necessary for financial institutions to acquire creditworthiness investigation/mortgage management know-how, different from that applied in financing to corporate businesses. They must also take precautions against increased risks as a result of the expansion of the loan business. For these reasons, financial institutions are hesitant to expand their loan business.

One of the effective ways to overcome such bottleneck can be the introduction of a viable supplementary credit system which centers on agency guarantee, and which is to replace personal guarantee by the guarantor. In Japan, the establishment and spread of an agency guarantee-centered supplementary credit system was a very important factor to promote the rapid growth of housing finance by private financial institutions after 1965.

2) Important Points That Commercial Banks Should Note in Establishing Affiliated Guarantee Organizations

Establishment of commercial bank-affiliated guarantee organizations is the most important step in the process of creation of private agency guarantee organizations.

Among the factors necessitating the establishment of commercial bank-affiliated housing finance guarantee companies are private financial institutions' need to enhance credit protection, in anticipation of future expansion in housing finance, and streamline relevant clerical work, and the social and economic need for agency guarantee that replaces blanket bond in affiliated housing finance.[10]

In establishing commercial bank-affiliated guarantee companies, special attention should be paid to the following requirements, in addition to the five necessary conditions--utilization of economies of scale, discovery of the causes of delays in loan repayment/development of measures to compress delays, determination of guarantee fee/accumulation of liability reserve, concrete measures to collect debts, and determination of the legal status of guarantee organizations.

a. To guarantee housing finance by the parent company (commercial bank).

b. To take over all of the parent company's screening and security guarantee operations.

c. To guarantee housing finance organizations against default attributable to earthquake and other disasters.

d. To be able to show flexibility in debt collection, and many other matters on the strength of close relationship with the parent company.

e. To be able to cover guarantee in general consumer finance, not limiting its business to housing finance.

3) Framework of Commercial Bank-Affiliated Guarantee Organizations

China's major commercial banks (notably the four major commercial banks such as the Industrial and Commercial Bank of China and the China Construction Bank) have already become so large-sized that they are operating on a nationwide scale. Such financial institutions are able to fully utilize economies of scale within their corporate groups (parent companies and subsidiaries as guarantee organizations), and to develop branches that provide different regions with different financial services.

[10] Affiliated housing finance is joint housing finance by a financial institution and one of its affiliated companies. This type of housing finance is generally provided to purchasers of houses sold by real estate brokers.
Non-affiliated housing finance is housing finance which financial institutions provide to individuals who plan to have their housing built or those who plan to purchase housing directly by financial institutions.

In actuality, however, it is difficult for all commercial banks to develop commercial bank-affiliated guarantee organizations at a time. So only those commercial banks which are qualified to meet the regional financial needs may establish affiliated guarantee organizations. In future, those relatively small-sized commercial banks which are still incapable of operating on a nationwide scale may consider establishment of guarantee companies, to be jointly owned by a number of such commercial banks on an as required basis, since it will be impossible for these commercial banks to establish affiliated guarantee companies on their own.

Table 5-3 show the main points of the framework of private guarantee organizations.

Table 5-3 The Main Points of The Framework of Private Guarantee Organizations

Item	Remarks
Nature of organization	Joint-stock company Taxable corporation Type of business: finance
Scope of business	Housing finance-related guarantee Other guarantee/insurance operations
Supervision/management system	Supervision carried out mainly by the People's Bank of China
Organizational structure	Regional organizations to operate on a nationwide scale which are wholly owned by individual commercial banks or jointly owned by groups of commercial banks Headquarters provincial branches (one branch in one province) City service offices (one office in one city) It is possible to establish more than one affiliated company in the same region.
Headquarters' main functions	Coordination with the headquarters of the parent company (financial institution) Coordination with other affiliated guarantee companies at the provincial level Fund, pooling of risk reserve, coordination Development and location of manpower (personnel management, training) Bond issuance
Provincial branches' main functions	Coordination with provincial branches Coordination with contact officials of entrusted banks Guarantee fee management Debt collection
Main functions of city service offices	Coordination with financial institutions' city service offices Coordination with contact officials of entrusted banks Guarantee fee management Debt collection
Financing	Investment and bond issuance by the parent company (financial institution) Guarantee fee (maintenance expenses)
Risk management system	Integration with loan operations (unification of screening operations) Systematic management of guarantee fee within members of the corporate group Pooling-type risk reserve at the provincial level (fund accommodation at the time of occurrence of concentrated default) Scope of business: not limited housing finance
Business trust/partnership system	Outsourcing operations such as screening, guarantee fee collection and account management to the parent company (commercial bank) Tie-up with insurance companies which are members of the corporate group

Source: JICA Study Team

(3) Establishment of an Additional Guarantee System

1) Introduction of Additional Guarantee Insurance

In the case of housing finance, which usually covers a long period of time, it is inevitable that accidents occur at certain intervals. It is important to stabilize the possible accident rate (arrearage rate). In an economy where changes in the social climate, the financial climate, and the labor market result in changes of industrial structure. It is imperative to always anticipate occurrence of risks which are not within the scope of guarantee permissible within the framework of the existing guarantee systems. It is essential, therefore, to develop an additional guarantee system to hedge against such unusual risks.

In the case of public guarantee organizations, which are to play an important role in increasing the number of housing loan users, and in supporting policy guidance concerning housing, risks which are more devastating, and which are more hard to predict are likely to occur. In planning to establish a public guarantee organization, therefore, it is essential to include a mechanism to hedge against such unusual risks in the design of its organizational structure.

It is possible for the design of an additional guarantee system to have more than one alternative. In actuality, however, housing loan users are required to pay a considerable amount of guarantee fee (insurance premium). In principle, therefore, the total amount of guarantee fee (including that for additional guarantee), should be minimized in order to minimize housing loan users' financial burden.

Insurance premium for additional guarantee may be included in guarantee fee which housing loan users have to pay. In light of the present situation of the insurance business in the country, however, it would be more effective to work out a scheme that links with group life/nonlife insurance and group credit insurance. In the case of these types of insurance, insurance premiums may be kept at lower levels.

It is essential to develop a mechanism that integrates security, guarantee and insurance into a unified guarantee scheme through the introduction of additional guarantee insurance.

2) Mechanism of Additional Guarantee Group Insurance

A. Personal Insurance

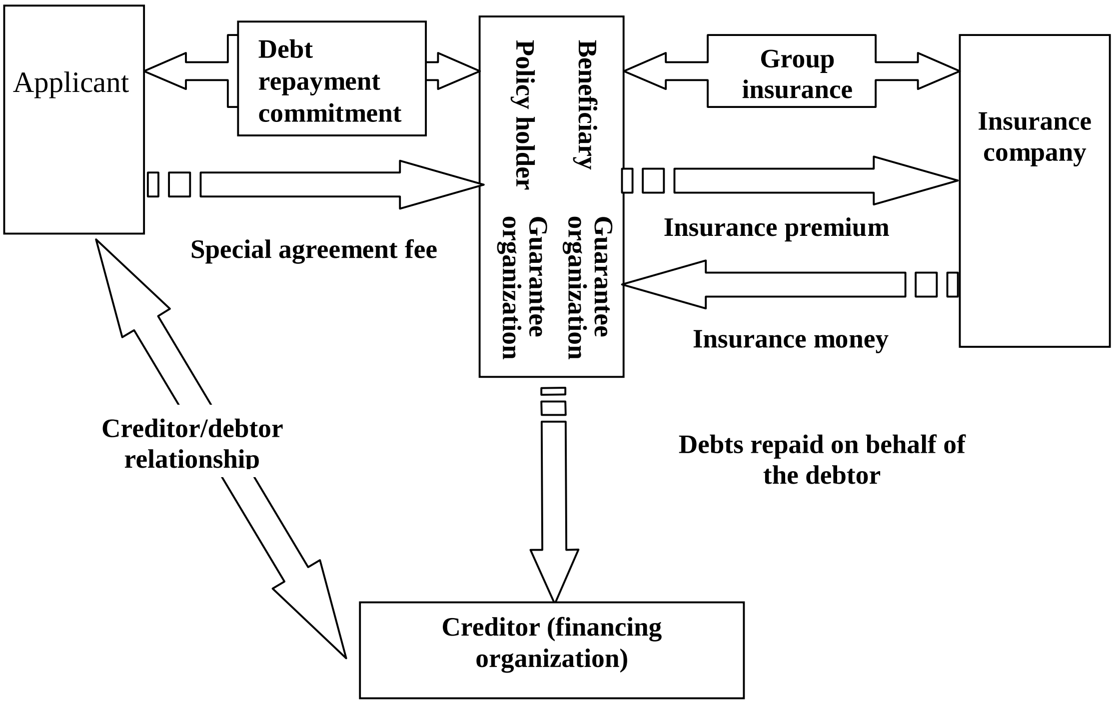
a. Objective

To repay a debtor's debts in full by insurance premium, in order to safeguard the debtor's housing, and protect the financing organization's credit when a debtor dies or is physically disabled and thereby distribute the risks of the housing loan user, the financing organization and the guarantee organization.

b. Mechanism

The housing loan customer concludes a debt repayment by group credit life insurance commitment agreement (tentative name) with the guarantee organization. The guarantee organization concludes a group credit life insurance contract, in which the guarantee organization is designated as policy holder and beneficiary, with the relevant life insurance company and pay the outstanding debts to the financing organization, and other organizations concerned by insurance money paid by the insurance company. (See Fig. 5-1)

Figure 5-1 Mechanism of Additional Guarantee Group Insurance



Source: The Housing Loan Progress Association

When a personal credit information system is yet to be developed, it is desirable that such repayment commitment agreement be compulsory.

c. Operations

Leading life insurance companies which are operating on a nationwide scale are to jointly underwrite such insurance policies. Related clerical work is to be carried out at the regional level. At the time of start of such insurance operations, however, it would be desirable that only a single qualified insurance company be assigned to carry out such insurance operations.

Since such insurance arrangement is often made in accordance with policy guidance, the central government may support such insurance through relevant budgetary appropriations, on an as needed basis, for the purpose of establishing specific operational units, developing lower than usual insurance products and providing specific financial services.

d. Insurance Premium

The insurance rate is to be calculated taking into consideration the total number of housing finance debtors as the insured, their average age, and the total amount of insurance money.[11]

B. Impersonal Insurance

a. Objective

To repay the debt or restore the damaged housing to its former state by insurance money, when the housing purchased through housing finance is damaged by a fire or a similar disaster, in order to protect the credit of the financing organization and the guarantee organization.

b. Operations

The same as the above-mentioned personal insurance operations.

c. Coverage

Impersonal insurance covers damage caused by disasters and accidents, such as fire, thunderbolt, explosion, wind disaster, flood and plumbing equipment breakdown. It is necessary to check if impersonal insurance covers damage caused by earthquake, eruption or seismic sea wave (tsunami).

It is desirable that the coverage for such impersonal insurance be broader than for similar impersonal insurance that individuals conclude with insurance companies.

d. Insurance premium

In Japan, the insurance rate for special agreement fire insurance is lower by approximately 50 percent than ordinary fire insurance. The insurance rate for special agreement earthquake insurance is lower by approximately 7.5 percent than ordinary earthquake insurance.

3) Establishment of Additional Guarantee Organizations (Development of Additional Guarantee Products)

The functions of insurance organizations that provide additional guarantee-related insurance services or products will have a policy guidance effect on public guarantee organizations' services. If financially feasible, it would be possible to establish public insurance organizations that specialize in additional guarantee operation. It would also be possible to attain a similar objective, by developing housing finance additional guarantee insurance products taking advantage of the operational base and network of the existing insurance companies. In such case, it will be necessary for

[11] In Japan, the insurance rate is approximately 0.3 percent per annum(real interest rate) for private housing finance. In the case of the special group credit life insurance agreement system, which applies to housing finance by the Housing Loan Corporation and other organizations, the special agreement insurance rate is 0.258 percent.

the central government to support insurance companies as regards government policy-based insurance products by budgetary appropriations or deregulation.

If a certain insurance company that provides additional guarantee insurance services to public guarantee organizations is to be chosen, it is desirable that such insurance company be one which operates on a nationwide scale and is therefore capable of utilizing economies of scale.

Summarized in Table 5-4 are the main points of establishment of viable additional guarantee insurance organizations.

Table 5-4 The Main Points of Establishment of Viable Additional Guarantee Insurance Organizations.

Item	Remarks
Nature of organization	- Independent public insurance organization or the public service division of insurance company
Scope of business	- Insurance operations, including housing finance additional guarantee insurance operations
Supervision/management system	- Supervision or financial division of insurance company (supervision of public budget)
Organizational structure	- Regional organization that operates on a nationwide scale (to support public guarantee organizations) - One system in one region, in principle
Headquarters' main functions	- Development of housing finance additional guarantee insurance products - Coordination with public guarantee organizations' headquarters and financial institutions' branches - Coordination with the Ministry of Construction, the Ministry of Finance, the People's Bank of China and the insurance industry
Provincial branches' main functions	- Coordination with branches of public guarantee organizations and financial institutions - Preparation of regional manuals of housing finance additional guarantee insurance - Pooling and systematic management of insurance premiums
City service offices' main functions	- Coordination with contact officials of public guarantee organizations - Group insurance operations
Financing	- Investment by insurance companies - Partial financial support - Insurance premiums (maintenance expenses)

Source: JICA Study Team

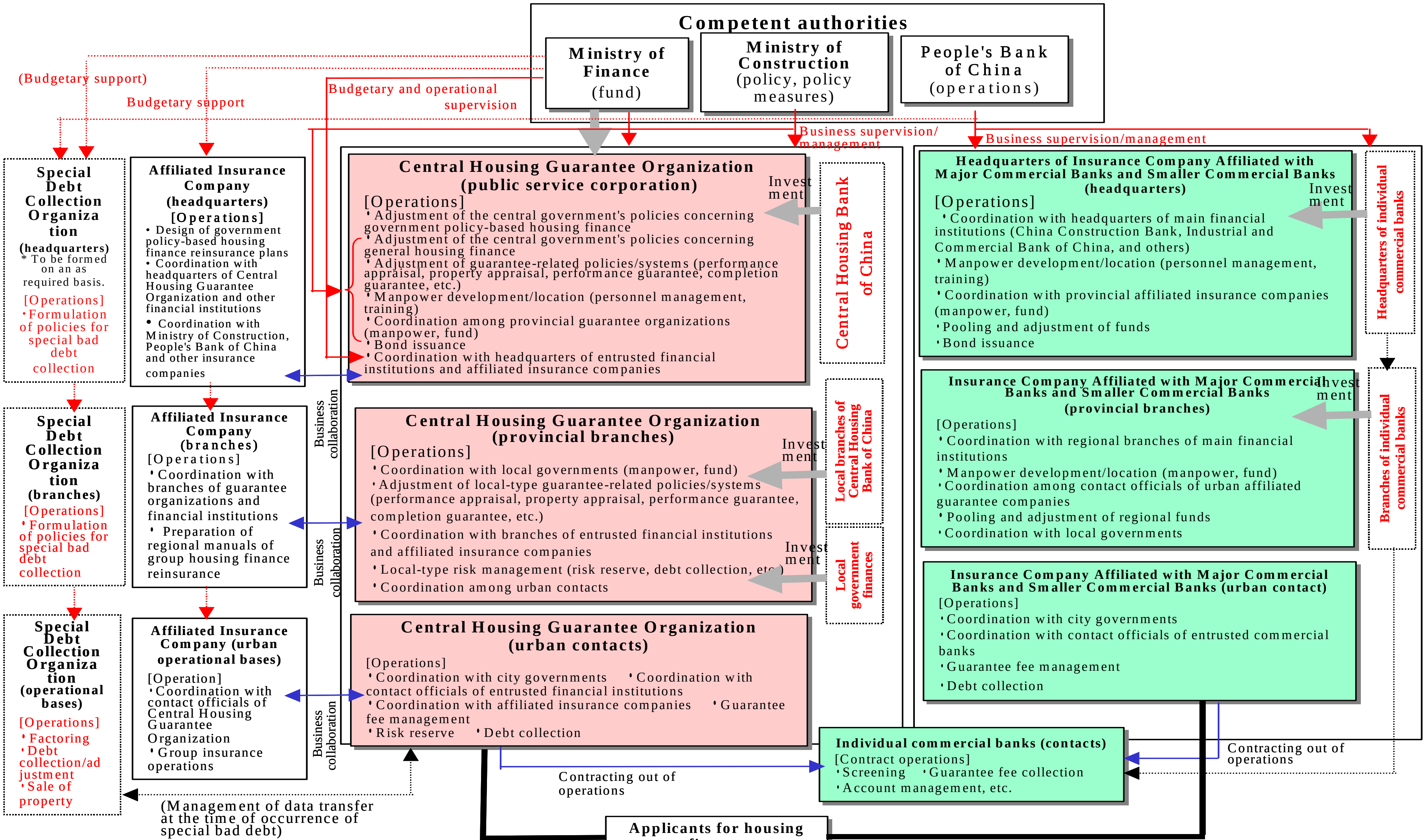
4) Debt Collection Organizations

Furthermore, it will be necessary to consider establishing debt collection organizations that deal with the special bad debt problems on an as required basis.

(4) Overall Image of Security/Guarantee System (Organization) for Housing Finance in China

On the basis of the above-mentioned proposal as well as the overall image of the guarantee organizations and mechanism, a proposal is made for the establishment of a security/guarantee system for housing finance in China (on the next page).

Figure 5-2 Image of Guarantee System/Mechanism



Source: JICA Study Team

5.3.2. Establishment of a Firm Basis of Development of Guarantee Systems

(1) Adjustment and Improvement of the Existing Related Legal Systems

Whether debt collection can be carried out smoothly, is the primary consideration of the country's guarantee organizations, although expansion in credit accommodation is equally important. Organizations that extend credit, namely guarantee organizations, must have a correct understanding of the three-way relationships among establishment of a comprehensive credit accommodation database, debt collection, and consumer relief. To that end, it is necessary to adjust and improve the legal systems concerning credit, real right, right to demand compensation, auction, credit management and collection business.

(2) Establishment of an Industry-wide Certification System

At a glance, investigative activity called credit confirmation seems to be simple. In actuality, however, it requires specific know-how, and is one of the most important basic activities. It can safely be said that the degree of success of the agency guarantee business is determined by the rate of recovery of the right to demand compensation. For this reason, it is essential not only to adjust and improve the existing related laws and regulations, but also to establish training organizations that train specialists, including debt collection specialists, and public organizations to certify qualified specialists.

(3) Development of a Training System

If recovery of the right to demand compensation is to be successful, it is necessary to create a "communication bridge" that connects creditors and debtors. Counseling for ensuring debt repayment is the only viable means of communication. In a sense, it is important to create a relationship of mutual trust between creditors and debtors. In this context, it is necessary to develop a training system that enables trainees to acquire expert knowledge and know-how. It will be effective to develop such training system in parallel with the above-mentioned certification system.

(4) Development of an Information System

Individual housing loans have to be provided and processed in small amounts and in large numbers. Furthermore, there are no proven methods of selecting creditworthy loan customers. As a result, the work to deal with delays in debt repayment and bad debts requires a great deal of time. This means that rational measures to improve recovery of bad debts in the workflow from screening, to credit accommodation, to clerical work, to collection and to recovery of bad debts have yet to be taken.

Development of a personal information databank is the first step toward the improvement of such circumstances. In creating this type of databank, it is necessary to develop a system whose advantages both benefit organizations that extend credit and their customers. Such databank must contribute to the solution of the problems of protection of personal privacy and corporate egoism, as a databank acceptable to all the parties concerned.

Table 5-5 gives an outline of development of personal credit information systems in Japan.

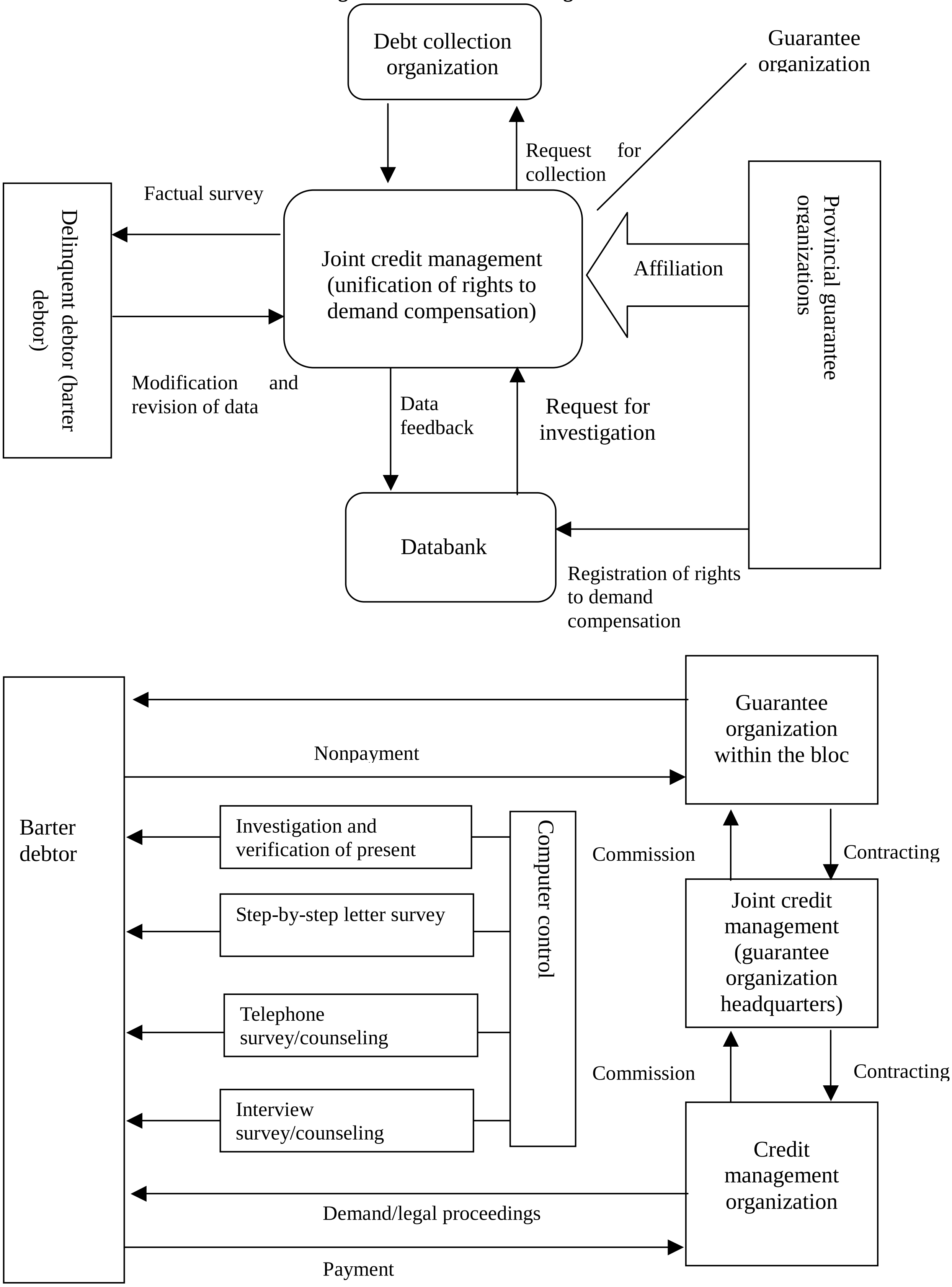
Table 5-5 An Outline of Development of Personal Credit Information Systems in Japan.

		National Bank Personal Credit Information Center	Federation Credit Information Centers	Central Communication Bureau, Inc. (C.C..)	Credit Information Center, Inc. (C.I.C.)
Founded by:		Federation of Bankers Associations of Japan	Regional Consumer Finance Industry Association	consumer finance companies and credit sales companies (22 companies in total)	Credit Industry Association, Inc, Japan Credit Information Center, Inc., National Credit Sales Association, Inc., etc. (41 companies in total)
Founded in		October 1988	September 1974	August 1979 (began operation in April 1980)	September 1984 (began operation in April 1985)
Number of centers/number of member companies		Approx. 2,600 companies	33 centers/approx. 3,700 companies	52 companies	874 companies
System used/number of member companies using the system		(membership system) Banks, other financial institutions, corporations which carry out personal credit operations and which were recommended by banks	(membership system) Consumer finance companies, other companies	(membership system) Consumer finance companies, major credit sales companies, credit companies affiliated with major retailers	(membership system) Credit sales companies, department stores, credit companies affiliated with home electrical products manufacturers
Quantity of owned data		Approx. 36.52 million items	Approx. 11.67 million items (as of end of February	Approx. 12.40 million items	Approx. 65 million items
Number of inquiries received (per month)		Approx. 1.96 million	Approx. 4.3 million	Approx. 0.8 million	Approx. 6.44 million
Main types of questions asked	Information concerning credit	Type of transaction, information on consumer loan transactions (use, amount, type of affiliation, date of execution, date of final repayment)	Date of provision of loan, amount, type of lending (new lending, further advance), type of loan (consumer loan, credit loan, bill discount, real estate security/personal estate security, loan secured by amount receivable)	Date of conclusion of agreement, amount of contract, form of agreement (unsecured credit, real estate security, etc.), scheduled date of acquittance, past record of acquittance	Product name, type of agreement, date of conclusion of agreement, loan amount, amount of outstanding liability, contract number, number of times loans are repaid by installments

		National Bank Personal Credit Information Center	Federation Credit Information Centers	Central Communication Bureau, Inc. (C.C..)	Credit Information Center, Inc. (C.I.C.)
	Information concerning accident	Types of accident (arrearage, recovery of arrearage, subrogated performance, compulsory cancellation, nonpayment, suspension of transaction, etc.), date of occurrence of accident Information concerning suspension of transaction include the bill clearing house number.	Arrearage, subrogated performance, outstanding loan, nonpayment, missing, bankruptcy, legal action, transaction carried out under disguised ownership	Arrearage, subrogated performance, bad debts written off, attachment, nonpayment, bankruptcy, settlement out of court, missing, legal action	Occurrence of arrearage, past payment received, past due acquittance, past due cancellation, bad debt, subrogated performance, performance of guarantor’s obligation, reference materials

Source: Public Housing Finance Guarantee Association

Figure 5-3 Data Bank Image



Source: JICA Study Team

Data 1. Overview of Credit Supplement System in Japan

In using a housing loan, it is common that the property to be purchased by the financed fund should be offered as security to the financial institution, and an appropriate guarantor should be designated. However, with changes in the social environment such as advance of nuclear families, elevation of loan amounts, and increase of housing loan users, it has become very difficult for borrowers to designate their guarantors.

Meanwhile, financial institutions have been hesitating to expand housing loans because these loans means financing to individual persons over many years, and the examination of borrowers' creditworthiness, and the security management need certain know-how which is basically different from conventional enterprise finance. What was devised to break such bottleneck is a credit supplement system by use of institutional guarantee.

One of the background factors that allowed rapid growth of housing loans by private financial institutions from 1965, has been the establishment and spreading of the credit supplement system.

Data 1.1. Status Quo of Credit Supplement System and its Characteristics

The credit supplement system for housing loans in Japan is, as shown in the table below, classified into two groups, i.e., supplement by public institutions and that by private institutions.

Table 5-6 Schedule of (Major) Institutional Guarantee System

		Individual house	Rental house	Land reclamation for housing purposes	Common spaces of apartment house (remodeling)
Public institutions	Public funds	The Government Housing Loan Guarantee Corporation	Megalopolis Noninflammable Construction Corporation House Improvement Development Corporation	—	Apartment Houses Management Center
	Private loans	The Government Housing Loan Corporation (Housing loan insurance)	The Government Housing Loan Corporation (Housing loan insurance)	The Government Housing Loan Corporation (Housing loan insurance)	—
Private institutions	Public funds (annuity, etc.)	Non-life insurance companies (Housing loan guarantee insurance) Guarantee companies	—	—	—
	Private loans	Guarantee companies Installment sale companies	Guarantee companies Installment sale companies	—	—

Note: Guarantee companies are mainly those affiliated to financial institutions.

Source: JICA Study Team

Table 5-7 Comparison between Housing Loan Insurance System and Private Security Institution System

Insurance (Guarantee institution)		The Government Housing Loan Corporation (Housing loan guarantee insurance)	Non-life insurance company (Housing loan guarantee insurance)	Guarantee company affiliated to city bank (Housing loan guarantee)	Guarantee company affiliated to local bank (Housing loan guarantee)	Guarantee company affiliated to secondary local bank (Housing loan guarantee)	Guarantee company affiliated to credit association (Housing loan guarantee)
Applicable financial institutions		All financial institutions (excluding housing loan-specialized companies, etc.)	All financial institutions	Affiliated financial institutions, etc.	Affiliated financial institutions, etc.	Affiliated financial institutions, etc.	Affiliated financial institutions, etc.
Insurer (Guarantee requesting party)		Financial institution	Debtor	Debtor	Debtor	Debtor	Debtor
Insured (Guaranteed party)		Financial institution	Financial institution	Financial institution	Financial institution	Financial institution	Financial institution
Qualifications for housing loan borrower	①Age	No restrictions	In case of no tie-up loan, 20 years or more (70 years or less at the time of full repayment)	20 years or more (70 years or less at the time of full repayment)	20 years or more but less than 60 years (Less than 70 years at the time of full repayment)	20 years or more but less than 65 years (Less than 70 years at the time of full repayment)	20 years or more but less than 65 years (Less than 70 years at the time of full repayment)
	② Annual income	No restrictions	In case of no tie-up loan, ¥1 million or more	¥1 million or more	No restrictions	¥1.5 million or more	No restrictions
	③Length of service	No restrictions	In case of no tie-up loan, 3 years or more	No restrictions	3 years or more	No restrictions	3 years or more
Limit of insured (guaranteed) amount		¥600 million or less per loan	¥20 million or more (subject to annual income restriction)	¥60 million or less (subject to annual income restriction) For rental house, ¥100 million	¥30 million or less (subject to annual restriction) For rental house, ¥300 million	¥30 million or less (subject to annual restriction)For rental house, ¥50 million	¥30 million or less (subject to annual restriction)

Insurance (Guarantee) term	6 months or more (bridging loan - no restriction)	25 years or less	30 years or less Rental house Fixed rate - 20 years or less Floating rate - 30 years or less	30 years or less	30 years or less	Fixed rate - 20 years or less Floating rate - 30 years or less
Subject of loan (Individual loan) (Traders loan)	New construction, purchase, extension or remodeling of house, purchase of land Rental house, land reclamation for house for sale, etc.	New construction, purchase, extension or remodeling of house, purchase of land Not applicable	New construction, purchase, extension or remodeling of house, purchase of land Rental house	New construction, purchase, extension or remodeling of house, purchase of land Rental house	New construction, purchase, extension or remodeling of house, purchase of land Rental house	New construction, purchase, extension or remodeling of house, purchase of land Not applicable
Security, etc.	Physical security or guarantor	Physical security, effecting fire insurance	Physical security, effecting fire insurance, effecting group credit life insurance	Physical security, effecting fire insurance, effecting group credit life insurance	Physical security, effecting fire insurance, effecting group credit life insurance	Physical security, effecting fire insurance, effecting group credit life insurance
Insurance (Guarantee) ratio	Individual loan 0.18% ~ 0.32% Traders loan 0.45% ~ 0.50%	Individual loan 0.313%	Individual loan 0.2% Traders loan 0.2%	Individual loan 0.2% Traders loan 0.2%	Individual loan 0.2% Traders loan 0.2%	Individual loan 0.2%
Commission	None	None	Individual loan ¥30,900 Traders loan ¥51,500 (including consumption tax)	Individual loan ¥30,900 Traders loan ¥51,500 (including consumption tax)	Individual loan ¥30,900 Traders loan ¥30,900 (including consumption tax)	Individual loan ¥30 million or less - ¥30,900 ¥50 million or less - ¥51,500 (including consumption tax)
Coverage of insurance (guarantee)	Uncollected principal (90%)	Uncollected principal, interest, penalty for arrears	Uncollected principal, interest, penalty for arrears	Uncollected principal, interest, penalty for arrears	Uncollected principal, interest, penalty for arrears	Uncollected principal, interest, penalty for arrears

Source: The Government House Loan Company

Data 1.2. Credit Supplement System by Public Institutions

(1) Housing Loan Insurance System

1) History up to creation of the system:

The Japanese government, to solve the issue of shortage of dwelling houses after the World War II, was urged to strongly proceed with a policy to promote construction of houses by people's own efforts. However, financial institutions in the private sector focused their funds solely to industries, and the position of housing loans was at an extremely low level due to their previous performance, because they were fixed for a long period of time and high risks of lending loss. The financial institutions considered housing loans unfit to their finance from a viewpoint of marketability, and low-profitability compared to financing the industrial companies.

Thus, in order to smoothen lending of private funds for house construction, and to promote construction of houses, in 1955 the "Housing Loan Insurance Law" (Law No. 63 of July 11, 1955) was enforced. Purpose of this Law is to insure housing loans lent out by private financial institutions as funds necessary for construction of people's houses by themselves. This housing loan insurance system is, in private financial institutions' financing housing funds, a method to prevent lending loss risks by means of insuring the Government Housing Loan Corporation. The system was created as a special credit supplement system for housing loans for the first time in Japan with reference to the Federal Housing Administration's insurance system in the United States (FHA), etc.

In the 1970's, the credit supplement system in the private sector became substantial by virtue of creation of housing loan insurance by non-life insurance companies, and inauguration of guarantee companies by private financial institutions. The housing loan insurance system as a public credit supplement system has the following characteristics:

- Insurance premium is low. For example, in case of individual loan, it is about 40% lower than guarantee fee of private guarantee institution.
- Underwriting standard is looser than that of private ones. For example, it is available to bridging loan, unsecured loan, reservation loan in case of impossibility of effecting group credit life insurance contract, etc.
- Underwriting scope is wide. For example, enterprise loan, etc. that are not covered by some private guarantee institutions may be covered.

Advantageous in terms of BIS restrictions. Since the housing loan insurance is a government insurance, risk weight becomes 10%, as a result of which housing loans can be expanded without relatively lowering self-owned capital ratio.

2) Summary of Housing Loan Insurance:

Table 5-8 Summary of Housing Loan Insurance

Governing law and regulation, etc.	Housing Loan Insurance Law (Law No. 63 of 1955) Ministerial Ordinance Determining Insurance Premium Rates of Housing Loan Insurance (Ministerial Ordinance No.132 of 1955) Terms and Conditions of Housing Loan Insurance [Approved by competent ministers (Construction and Finance Ministers)]
Accounting	Housing loan insurance business should be separately journalized in special account (the Government Housing Loan Corporation Law, Article 26-2) Housing Loan Insurance Funds ¥15.5 billion
Purpose	With respect to financing by financial institutions in the private sector (hereinafter called "financial institutions") for construction, purchase, etc. of houses, to smoothen such finance by the Government Housing Loan Corporation's underwriting and to <u>promote construction of houses</u>.
Applicable loans and premium rates	Loan term: <u>6 months or more</u> (No restriction on bridging loans) Loan amount: <u>¥300 million or less (or ¥2 billion or less in case of special loans for houses for sale)</u> Requirement for security/guarantee and insurance premium rate Requirement for security/guarantee by kind of loans Insurance premium per annum by kind of loans Requirement of Security and/or Guarantee Annual Insurance Premium Rate Individual loan Security or guarantee 0.18% (Note 1) Individual bridging loan (Loan term 1 year or less) Security (Registration reserved) 0.32% (Note 2) Rental house loan Security 0.45% Loan for houses for sale, land reclamation, etc. Security and guarantee 0.50%

Insured amount, etc.	Insurance benefit 90% of the outstanding debt (= remaining balance) to be repaid to the financial institution (Note 1) Collection after payment of insurance benefit As the Government Housing Loan Corporation would not be subrogated, the financial institution should continue to manage and collect its claim on the loan and pay 90% of the collected fund to the Government Housing Loan Corporation. (Notes 1 & 3)
Characteristics	Procedure is simple. Underwriting scope is wide. Insurance premium is cheap. Advantageous in raising the self-owned capital ratio. Advantageous in asset evaluation.

Source: The Government Housing Loan Company

Note 1. Raise of repletion ratio in a loan by a private financial institution, which is used jointly with an individual-related loan by the Government Housing Loan Corporation:

For a private financial institution's loan that may satisfy certain requirements, and is used jointly with an individual-related loan by the Government Housing Loan Corporation, repletion ratio is raised to 100% and subrogation is available.

The Government Housing Loan Corporation shall request the financial institution that has paid insurance premium to collect the subrogated claim and pay a commission to the institution.

[Summary of the system]

Requirements:

a. That it is a private financial institution's loan used jointly with an individual-related loan by the Government Housing Loan Corporation.

b. That it is a loan executed by the same financial institution as an agent of the Government Housing Loan Corporation.

c. That the loan executed by the Government Housing Loan Corporation uses guarantee by the Government Housing Loan Guarantee Corporation.

d. That the loan satisfies the same examination requirement for finance as that applied when insurance is not effected.

e. That the borrower's burden to repay all debts including a loan from the Government Housing Loan Corporation is 20% or less.

f. That the borrower has sufficient security.

※ Prior to execution of the loan, the Government Housing Loan Corporation will make an examination for effecting insurance contract.

Note 2: Premium rate: 0.28% per annum

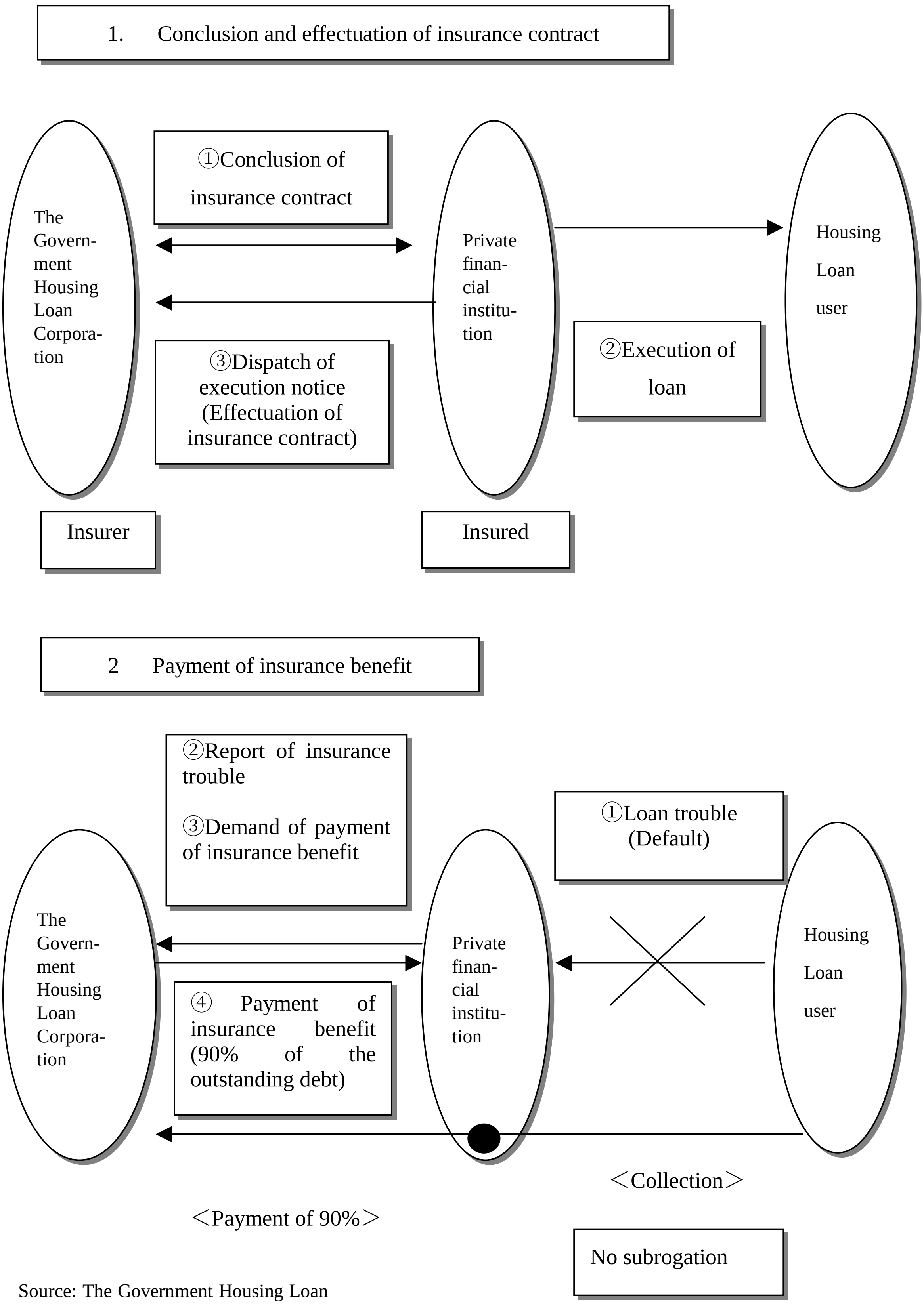
Note 3: Commission for collection service: Same amount as the commission to be paid for lending service rendered by the financial institution on behalf of the Government Housing Loan Corporation.

3) Mechanism of the System:

Housing loan insurance is an insurance to be contracted by and between the Government Housing Loan Corporation and a private financial institution, but is as directly contracted by the Government Housing Loan Corporation and a housing loan user. This relation is as illustrated in the following table.

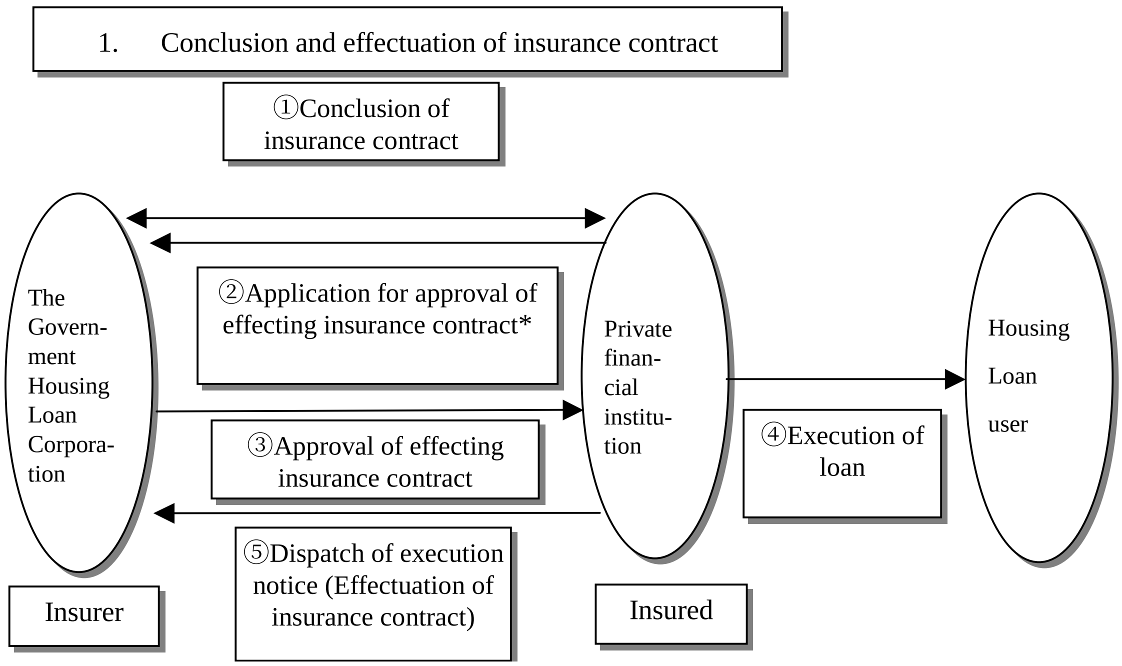
The housing loan insurance of the Government Housing Loan Corporation, compared with the one offered by casualty insurance companies, differs in that the contractant is the creditor and not the loanee. Housing loan insurance is categorized as a type of personal loan credit insurance.

Figure 5-4 Mechanism of Housing Loan Insurance

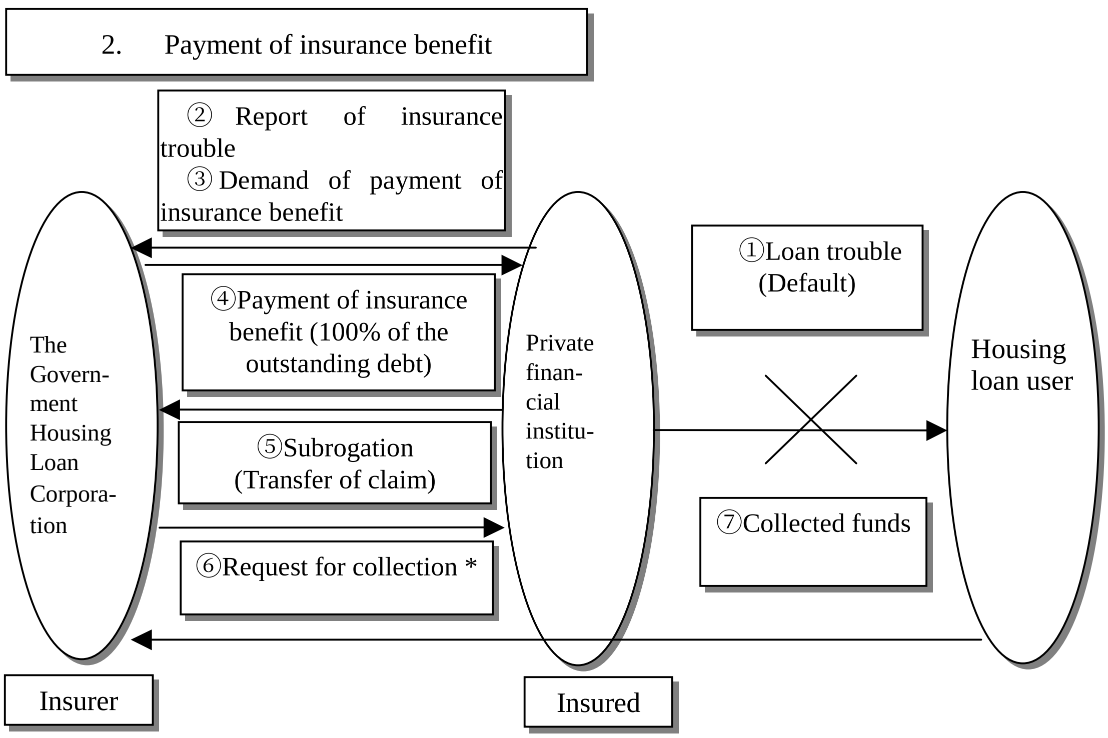


Source: The Government Housing Loan

Figure 5-5 Insurance having 100% Repletion Ratio for Loans Jointly Executed by Private Financial Institution and the Government Housing Loan Corporation



* Application for approval of effecting insurance contract shall be filed after prearrangement of the loan by the Government Housing Loan Corporation.



* The Government Housing Loan Corporation shall pay a commission to the private financial institution for its collection service.

Source: The Government Housing Loan Company

Table 5-9 Performance of Housing Loan Insurance (Units: Number of cases; In million yen)

Year	Limit of sum insured	Insurance contract		Insurance relations established			Insurance relations maintained		Troubles		Insurance benefits paid		Collected funds	Premium revenues	Net income	Funds + Reserves (Initial balance)
		No. of institutions	Amount	No. of institutions	No. of relations	Amount	No. of relations	Amount	No. of troubles	Amount	No. of claims	Amount				
2	240,000	1,164	239,747	516	10,992	144,207	67,894	656,140	91	629	88	375	399	1,260	998	11,379
3	240,000	595	239,950	559	16,607	231,109	75,006	800,246	92	2,064	72	610	234	1,790	10	12,376
4	430,000	1,175	429,968	608	21,532	300,395	82,611	969,187	153	3,826	110	2,681	345	2,239	-1,622	12,386
5	430,000	1,198	426,614	614	24,669	382,045	92,052	1,160,260	240	6,325	169	3,780	696	2,726	-2,624	10,764
6	650,000	1,188	641,892	631	31,053	474,078	101,868	1,339,174	233	5,741	176	3,345	944	2,664	-836	8,140
7	650,000	1,199	637,488	635	31,676	477,394	107,462	1,470,751	270	6,503	171	3,647	1,230	3,130	-1,211	7,304
8	650,000	1,126	646,611	633	34,596	520,047	116,500	1,639,696	305	6,699	245	4,245	1,223	3,505	-1,199	6,093
9	650,000	1,031	634,304	617	24,910	363,434	118,012	1,700,115	399	8,156	210	4,832	1,898	4,460	-1,360	4,894
10	1,000,000	1,034	910,689	585	17,609	277,527	118,114	1,761,743	417	7,698	296	4,268	1,141	4,100	-1,593	3,534
11	1,000,000	988	657,367	519	15,460	220,278	117,978	1,791,146	523	9,658	299	4,605	2,499	3,476	-183	16,941(Note

¥16,758 million at the beginning of 2000

(Note) In a package of the government's economic measures of April 1998, there was an additional contribution amounting to ¥15 billion from the general account. (Funds after the contribution registered ¥15.5 billion.)

Source: The Government Housing Loan Company

(2) Guarantee by the Government Housing Loan Guarantee Corporation

1) History up to Creation of the System:

The Government Housing Loan Corporation makes it a condition of its finance to obtain a joint guarantor designated by the borrower, as well as a mortgage settled on the property. However, it became a heavy burden for the borrowers to find the guarantors due to the concentration of population in large cities and increases of nuclear families since 1965. Meanwhile, on the side of the Government Housing Loan Corporation, the guarantee by joint guarantors showed its limits when the lending amount increases, and the term of repayment becomes longer. Additionally, there has been an attempt to create a housing loan insurance system. To lighten burdens of debtors and to secure claims of the Government Housing Loan Corporation, the Government Housing Loan Guarantee Corporation was established in 1972 as a guarantee institution of the Government Housing Loan Corporation.

2) Outline of the Guarantee:

These funds cover for construction, purchase, improvement, etc. of individuals' houses that are financed by the Government Housing Loan Corporation, and the mortgage is settled for the benefit of the Corporation, in principle. This guarantee is also available to other loans executed in conjunction with loan by Annuity Welfare Business Corporation through the Government Housing Loan Corporation, and loans to individual persons by Okinawa Development Finance Corporation. The Government Housing Loan Guarantee Corporation does not attach any special condition on qualifications of the parties that request for this guarantee. In other words, the qualifications are the same as those of borrowers of housing loans from the Government Housing Loan Corporation.

The mechanism of the guarantee is shown in the table. A guarantee service agreement is concluded and a guarantee fee is paid. If the Government Housing Loan Corporation, etc. should become unable to receive repayment from a borrower, the Government Housing Loan Guarantee Corporation will fulfill its guarantee obligation to the Government Housing Loan Corporation, etc. and manage and collect its claimable rights. Actual guarantee business and collection businesses are handled by financial institutions that deal with loans of the Government Housing Loan Corporation.

Guarantee fee is determined according to loan amount, loan term and method of repayment, and should be paid in a lump sum.

3) Development of Guarantee Contracts:

Among users of housing loans executed by the Government Housing Loan

Corporation, those who have requested the Government Housing Loan Guarantee Corporation to guarantee their debts account for about 97%. Since the Government Housing Loan Guarantee Corporation was established, the number of guarantee consignment contracts signed by the organization has reached approximately 13,040,000, and the total value of the contracts has amounted ¥139,301.6 billion as of the end of the year 2001.

(3) Other Public Measures

1) Guarantee of rental house loans by the Government Housing Loan Corporation through House Improvement Development Corporation and Megalopolis Noninflammable Construction Corporation.

In case of use of a rental house loan from the Government Housing Loan Corporation, two individual guarantors and physical security are required in principle. However, as it was difficult to find such guarantors who may guarantee said loan of a great amount, etc., an institutional guarantee system in place of individual guarantors was established in November 1988. This system means that Megalopolis Noninflammable Construction Corporation or House Improvement Corporation (hereinafter called the "Corporation") becomes a guarantor, when the borrower pays guarantee fee that is cheaper than that to be paid to a private guarantee institution.

Rate of guarantee fee depends on the term of guarantee, that is, in case of a loan for 20 years or less, 1.36% of the loan amount, 21 ~ 25 years 1.6%, 26 ~ 30 yeas 1.82%, 31~ 35 years 2.0%, respectively. Real Estate Credit Guarantee K.K. re-guarantees the Corporation's guarantee (second guarantee). Percentage of the applicants for rental house loans executed by the Government Housing Loan Corporation (who use the Corporation's guarantee) has come higher, and at present almost all applicants use the Corporation's guarantee. Since the foundation of these organizations, approximately 32,828 guarantee consignment contracts have been singed, and the total value of the contracts has amounted ¥6,407.6 billion as of the end of the year 2000.

2) Apartment Houses Management Center's guarantee of loans for improvement of common spaces of apartment houses:

When an apartment house's management union uses a remodeling loan (for common spaces) financed by the Government Housing Loan Corporation, Apartment Houses Management Center may be a joint guarantor of the loan. To prevent degradation of the apartment house due to passage of time, and to maintain its asset value and functions for a long time, it is essential to execute appropriate large-scaled repairs from time to time. However, in executing such repairs, several problems including shortage of funds reserved for repair purposes, poor finance system available to the management union, and issue of security may come out. Then, this system was established in September 1986 with an aim of promotion of smooth repair of apartment houses (through institutional guarantee) at lower guarantee fee by Apartment Houses Management Center with no security. Guarantee fee varies according to the guaranteed amount and the term of guarantee (maximum 7 years).

(4) Credit Guarantee Institutions in the Private Sector

In Japan there are a number of credit guarantee systems similar to that of the Government Housing Loan Guarantee Corporation. They include systems for specific industries, those involving the nation or local public entities such as prefectures, and those under special laws. Most of these systems have applicability defined by specific industries or districts.

From a viewpoint of founder type, these credit guarantee institutions may be classified into two groups, namely: public institutions and private ones. Public institutions have been established solely or jointly by the national government, local public entities, industrial circles, etc. in the fields where specific purpose, need of development or strengthening of industry is or can be recognized.

These public guarantee institutions may be classified by their guarantee purposes as follows:

1) One which aims at promotion of export;
2) One which aims at development of mining and manufacturing industries;
3) One which aims at development of smaller businesses;
4) One which aims at development of the construction industry; or
5) One which aims at acquisition of housing loans.

Further, private guarantee institutions engaged in the guarantee business take the form of stock company (*Kabushiki Kaisha*), and reportedly there exists 150 or more private guarantee institutions at present.

Figure 5-6 Guarantee Institutions in the Private Sector

Private guarantee institutions (in the form of stock company)

- Bank-affiliated
  - City bank-affiliated (11 companies)
  - Local bank-affiliated (58 companies)
  - Secondary local bank-affiliated (35 companies)
  - Trust bank-affiliated (8 companies)
  - Credit association-affiliated (17 companies)
  - Laborers' credit cooperative-affiliated (1 company)
- Life insurance-affiliated
  - Life insurance-affiliated (12 companies)
- Real estate/Construction business-affiliated
  - Real estate business-affiliated
  - Construction business-affiliated
- Non-life insurance-affiliated
  - Non-life insurance-affiliated (19 companies)
- Others
  - Credit companies
  - Finance companies
  - Credit card companies

Source: JICA Study Team

Among those, credit guarantee companies are classified into the following groups:

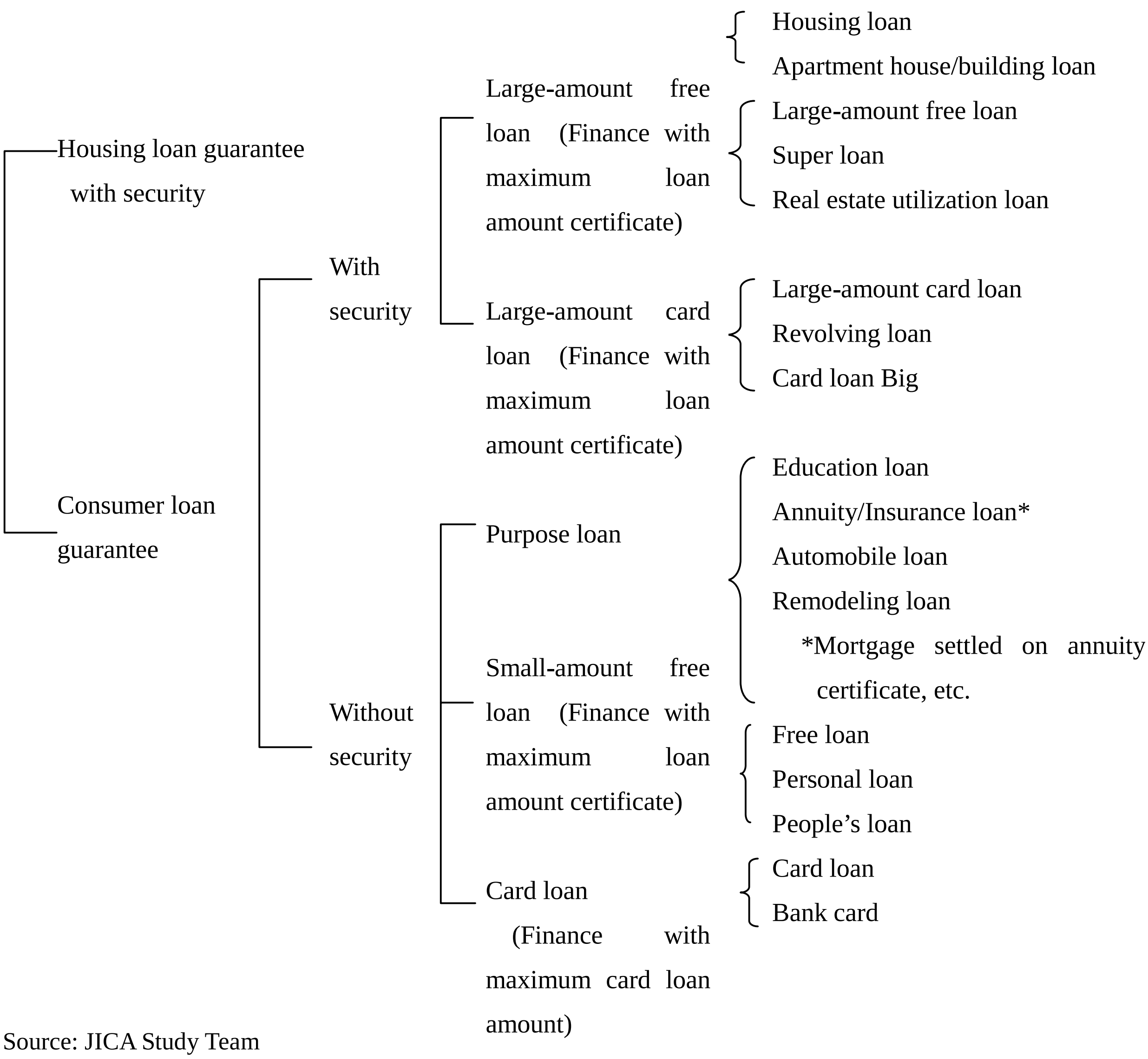
1) Bank-affiliated;
2) Life insurance-affiliated;
3) Real estate/Construction business-affiliated;
4) Non-life insurance-affiliated; and
5) Credit card companies, etc.

Furthermore, bank-affiliated credit guarantee companies mentioned in 1) above are classified into 5 groups, namely: city bank-affiliated, local bank-affiliated, secondary local bank-affiliated, trust bank-affiliated and credit association-affiliated.

These guarantee companies are classified by their guarantee purposes into two groups, namely: 1. housing loan guarantee (with security) and 2. consumer loan (with or without security).

Guarantee supplied by private institutions covers a variety of subjects and details of this guarantee may be greatly classified as shown in the figure below.

Figure 5-7 Private Guarantee Products



Source: JICA Study Team

Main guarantee products handled by private guarantee companies are as follows:

1) City bank-affiliated, local bank-affiliated, and trust bank-affiliated guarantee companies:
   They mainly handle housing loan guarantee (with security) and consumer loan guarantee (with security).
2) Secondary local bank-affiliated guarantee companies:
   They handle a variety of products mentioned in Table 3.
3) Credit association-affiliated guarantee companies:
   They mainly handle housing loan guarantee (with security).
4) Life insurance-affiliated guarantee companies:
   They mainly handle housing loan guarantee (with security) and consumer loan guarantee (with security).
5) Non-life insurance-affiliated guarantee companies:

They mainly handle insurance for housing loans and consumer loans (with security) executed by financial institutions.

According to the result of a research of housing loan credit supplement services in 2000 by the Government Housing Loan Corporation, performance and state of use of institutional guarantee of housing loans, etc. by private guarantee companies are as shown below.

Table 5-10 Use of Housing Loans by Private Guarantee Companies by Business Status (Average)

	Guarantee by affiliated company	Guarantee by other bank	Credit company	Guarantee by non-life insurance company	Other guarantee by company	Finance insurance	Without institutional guarantee
City bank	90.8	0.0	0.7	0.1	3.8	0.5	3.6
Trust bank/ Long-term credit bank	51.5	0.0	0.9	2.3	28.1	0.0	17.2
Local bank	72.8	4.1	9.6	1.4	1.5	3.0	7.6
Secondary local bank	73.7	1.8	6.3	2.5	0.4	4.5	10.9
Credit association	29.0	6.4	3.5	4.3	0.9	17.8	38.1
Credit union	3.3	2.7	4.6	2.7	3.1	34.1	49.5
Laborers' credit cooperative	86.4	0.0	0.5	0.0	0.2	0.3	12.7
Federation of Agriculture Credit Associations	43.2	0.0	0.0	4.9	0.3	28.1	23.5
Federation of Fishery Credit Associations	2.1	0.0	2.6	7.6	0.0	34.0	53.6
Life insurance company	65.0	5.0	25.0	0.0	5.0	0.0	0.0
Central Finance Corporation	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Total	32.7	4.1	4.2	3.5	1.6	19.3	34.5

Source: The Government Housing Loan Corporation, Claims Control Div.

Table 5-11 Private Guarantee Companies' Underwriting of Guarantee of Housing Loans

Amount: In million yen

	April 1998 to March 1999		April 1999 to March 2000	
	No. of cases	Amount	No of cases	Amount
City bank-affiliated	207,600	4,021,622	192,825	3,711,011
Local bank-affiliated	186,700	2,377,112	189,958	2,456,194
Secondary local bank-affiliated	53,201	633,632	49,180	632,743
Trust bank-affiliated	38,347	719,685	54,647	993,840
Credit association-affiliated	39,823	576,050	36,127	536,906
Laborers' credit cooperative-affiliated	59,048	749,471	50,371	639,175
Life insurance-affiliated	11,064	161,367	6,718	108,498
Credit card companies affiliated	-	133,560	-	259,919
Non-life insurance-affiliated	33,478	256,974	27,206	230,808
Total	629,261	9,629,473	607,032	9,629,094

Source: The Government Housing Loan Corporation, Claims Control Div.

Table 5-12　Housing Loan Subrogation by Private Guarantee Companies

Amount: In million yen

	April 1998 to March 1999		April 1999 to March 2000	
	No. of cases	Amount	No of cases	Amount
City bank-affiliated	1,943	66,268	1,829	50,602
Local bank-affiliated	3,720	20,019	4,060	22,170
Secondary local bank-affiliated	1,013	14,304	1,142	15,673
Trust bank-affiliated	64	1,237	87	1,495
Credit association-affiliated	136	2,221	174	2,902
Laborers' credit cooperative-affiliated	430	3,985	519	4,254
Life insurance-affiliated	1,333	19,408	1,276	16,751
Credit card companies affiliated	-	-	-	-
Non-life insurance-affiliated	10,044	14,332	9,956	15,057
Total	18,683	141,774	19,043	128,904

Source: The Government Housing Loan Corporation, Claims Control Div.

<Factors that have caused troubles>　(Respondents were asked to select up to three factors.)

		1998 study	2000 study
1)	Excessive debts	79.5%	66.4%
2)	Bankruptcy of debtor's company, etc.	56.1%	45.1%
3)	Decreased income due to change of occupation or retirement	49.2%	45.1%
4)	Poor performance of debtor's company, etc.	44.7%	29.5%
5)	Bankruptcy of employer company	21.2%	15.6%
6)	Poor performance of employer company	14.4%	10.7%
7)	Spendthrift	5.3%	3.3%
8)	Disease, injury or death	3.8%	4.9%

Table 5-13　Collection of Housing Loans by Subrogation in Private Guarantee Companies

Amount: In million yen

	April 1998 to March 1999		April 1999 to March 2000	
	No. of cases	Amount	No of cases	Amount
City bank-affiliated	4,827	70,768	4,393	55,459
Local bank-affiliated	3,834	10,426	4,283	12,479
Secondary local bank-affiliated	384	10,060	380	10,555
Trust bank-affiliated	35	442	65	954
Credit association-affiliated	48	809	71	1,190
Laborers' credit cooperative-affiliated	40	722	45	773
Life insurance-affiliated	476	12,283	356	9,885
Credit card companies affiliated	-	-	-	-
Non-life insurance-affiliated	681	3,005	681	3,786
Total	10,325	108,515	10,274	95,081

Source: Government Housing Loan Corporation, Claims Control Div.

<Method of collection>

		1998 study	2000 study
1)	Collection by the guarantee company solely	68.9%	65.6%
2)	To request a financial institution to make collection	3.0%	1.6%
3)	Collection by the guarantee company jointly with a financial institution	19.7%	23.0%
4)	To request a third party institution to make collection	5.3%	6.6%

Data 1.3. Credit Supplement System by Private Institutions

(1) System of Housing Loan Guarantee Insurance

1) History of the System:

From about 1965 when the construction of houses was progressing under the government's 5-year house construction plan, and financial institutions in the private sector were shifting their business to the general public: A system of housing loan guarantee insurance was established in 1971 aiming at utilizing certain know-how owned by non-life insurance companies and supplementing creditability of housing loans.

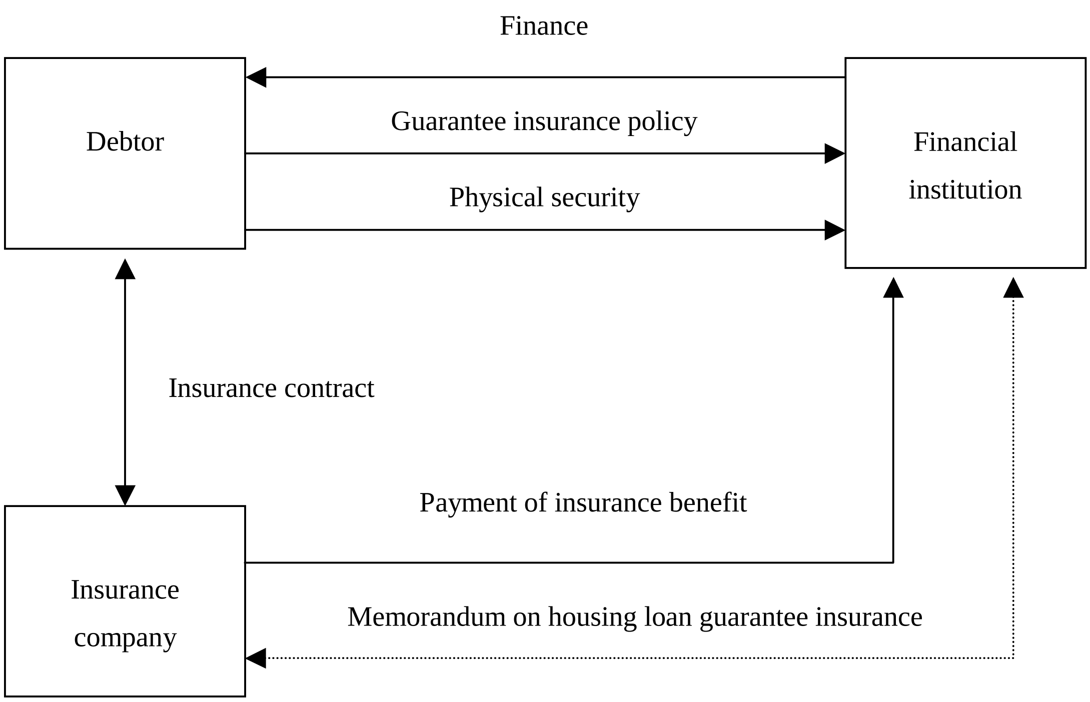
2) Outline and Characteristics of the System

Purpose of housing loan guarantee insurance is to guarantee housing loan claims of financial institutions, and under this system insurance company plays as insurer, debtor as insurer and financial institution as insured, respectively. For contracting housing loan guarantee insurance, there are several conditions including 1. indemnity ratio should be 100% of the damage, 2. subrogation be applied to collection of claims after payment of insurance benefit, and 3. housing loan borrower cannot be an enterprise. The last condition imposed as a qualification for housing loan borrowers, is different from insurance for housing finance.

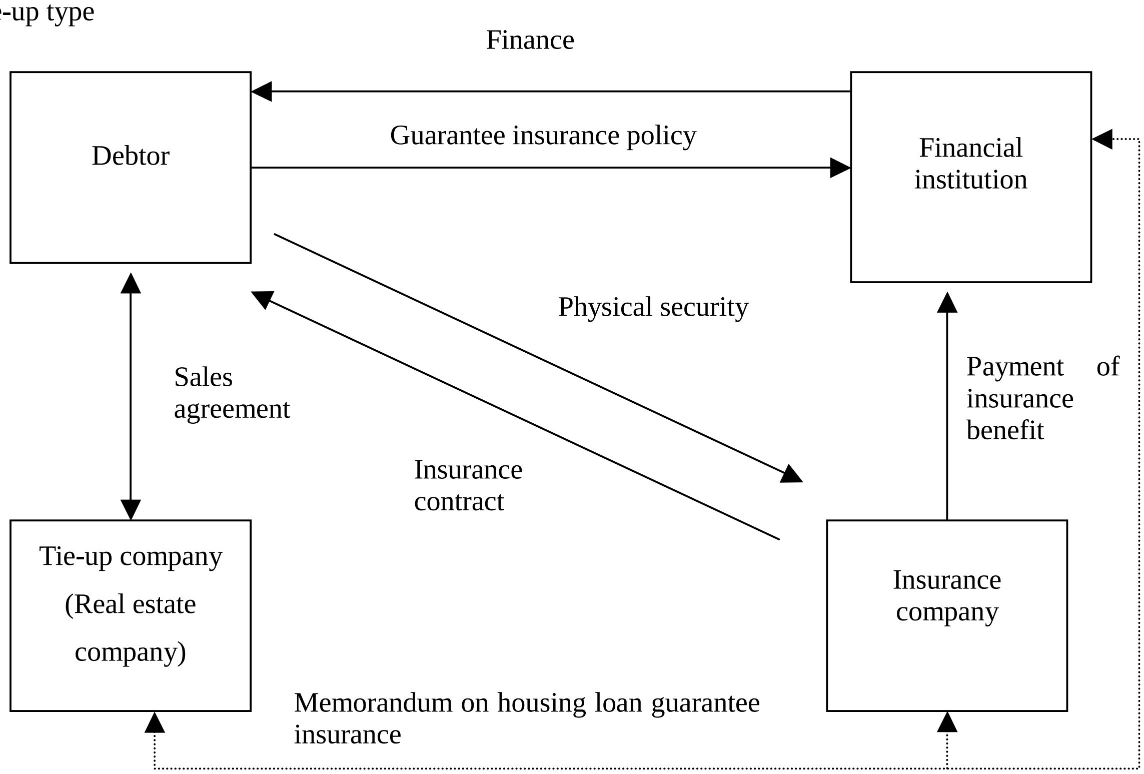
Housing loan guarantee insurance constitutes one insurance contract, and from the provisions, are classified by type into two groups, namely: non tie-up type and tie-up type.

Figure 5-8　Mechanism of Housing Loan Guarantee Insurance

Non tie-up type



Tie-up type



Source: The Housing Loan Progress Association

3) Guarantee by Guarantee Institution-Affiliated Guarantee Companies

[Background for inauguration of these guarantee companies]

Before or after the creation of housing loan guarantee insurance system in 1971, many housing loan guarantee companies affiliated to financial institution were inaugurated. They appeared in the context of social and economic needs for institutional guarantee in place of individual guarantee for non tie-up housing loans, and general guarantee by tie-up companies in tie-up housing loans, because financial institutions had to strengthen preservation of their claims to cope with expansion of housing loans, and to improve efficiency of clerical works. The opening of guarantee companies became more active around 1975 and it was basically and generally accepted that a guarantee company affiliated to a lender bank supplemented creditworthiness of borrower of housing loan.

The guarantee companies' status as an incidental business of financial institutions was authorized by a notice of 1975 issued by the Director of Banking Bureau, Ministry of Finance. (In general, a guarantee company can be formally established when it is registered with the relevant prefecture governor under the Money Lending Business Law.)

Characteristics of housing loan guarantee companies are as follows:

- To guarantee its parent bank's housing loans as an affiliated company of financial institution.
- To completely take over its parent bank's security business.
- To also guarantee defaults caused by earthquake or other casualty.
- Able to do flexible operation in collecting claims, etc. by effectively using the relation between parent bank and subsidiary.

4) Installment Sale Companies

An installment sale company is a corporation registered as installment purchase mediator under the Installment Sale Law, and represents one business style of consumer credit industry of which main business is comprehensive mediator, credit guarantee, finance, etc. Installment sale companies effectively use their ability of credit examination of prospective borrowers, and collection of claims as a pioneer of consumer finance, and furnish guarantee to local financial institutions' loans that are out of standards, etc., centering on housing loans by life or non-life insurance companies having no windows. As they cover some portions not underwritten by financial institution-affiliated guarantee companies, guarantee fee is higher than that charged by such financial institution-affiliated guarantee companies.

5) Tie-up method and non tie-up method

(Background)

Private financing institutions started to be fully involved in the housing loan market since 1965. This was a time when social and economic effects on the environment, such as the dramatic increase in population and soaring land prices, caused housing costs to suddenly rise, and made it necessary for people to borrow money to buy a house. On the other hand, with the demand for industrial funds decreasing, private financing institutions needed to create a foothold in the retail market. They began to promote housing loans as a means of integrating household economy, from payment of salary and automatic payment of public charges, to settling of credit card accounts.

There are two kinds of housing loans: tie-up housing loans and non tie-up housing loans.

In tie-up housing loans, a financing institution joins hands with a specific company, and offers loans through the good offices of that company. Tie-up loans are usually offered to buyers of houses sold by real estate agents and the like.

Non tie-up loans, on the other hand, are offered by the financing institution directly to the people building or buying a house.

The percentage of tie-up loans to non tie-up loans is unknown, as there are no disclosed references. But it is said to vary according to the financing institution and its business conditions. Long-term credit banks and trust banks with relatively few branches usually have a high rate of tie-up loans, whereas city banks with branches nationwide and local banks, secondary local banks, and credit associations whose activities are rooted in the local region, have a high rate of non tie-up loans.

i) Tie-up housing loans

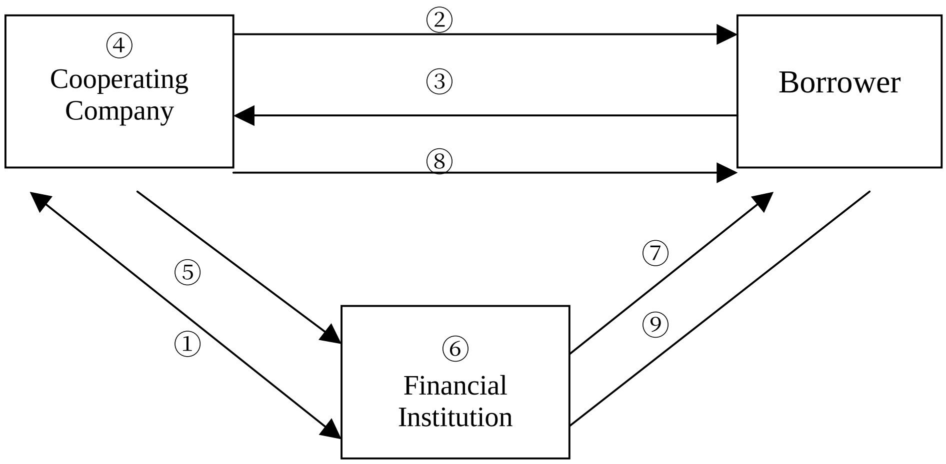
Tie-up loans generally refer to loans that are offered by financing institutions to buyers of real estate sold by a cooperating company. However, there are cases in which a tie-up loan is offered to employees of a cooperating company, who are building or buying a house. The difference with non tie-up loans is that the cooperating company receives the loan application, organizes it, and carries out part of the loan evaluation and credit preserving measures rather than the financing institution.

The mechanism of tie-ups can be classified as follows according to how credit is preserved.

- Tie-ups in which the cooperating company guarantees the loan in full.
- Tie-ups in which the cooperating company guarantees the loan in full, and the financing institutions impose their own guarantees
- Tie-ups that are guaranteed by a securing company

Tie-ups based on full guarantees are limited to a handful of large companies only, as future outlook is insecure (bankruptcy, etc.). Tie-up loans guaranteed by a securing company are widely used.

Figure 5-9 Tie-up loans



①Conclusion of contract for full guarantee

②Sales of houses

③Application for loan guarantee trust

④Evaluation of guarantee acceptance/rejection

⑤Notification of loan applicant

⑥Evaluation, formalities for loan

⑦Offering of tie-up loan

⑧Payment by loan

⑨Loan payment in divided installments

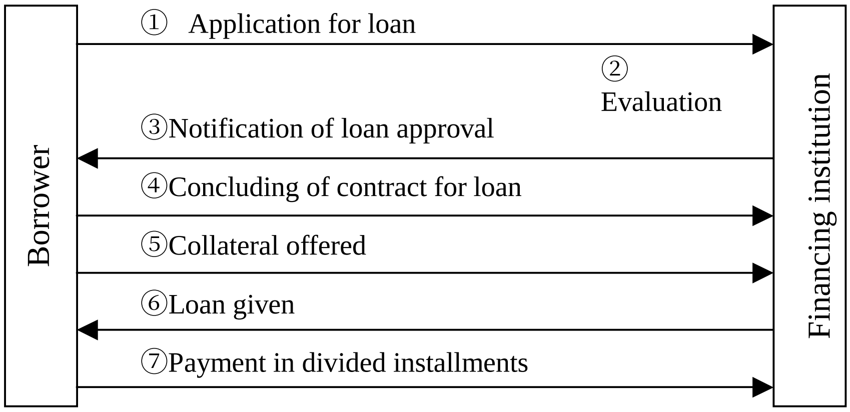
Source: Financial Affairs Society

ii) Non tie-up housing loans

Non tie-up housing loans refer to loans that people who are building or buying a house, receive directly by signing a contract with a financing institution. Previously, a “saving up” style of loan existed, in which people set aside some money regularly for a certain period of time, and received a loan based on a specified multiple of this reserve (usually up to three times), but presently, “instant” loans that have no conditions based on savings are more common.

The mechanism of a non tie-up housing loan is shown in the following figure. Depending on the style of credit preservation, there are cases where the financing institution that is offering the loan collects (as collateral) the property for which the loan is offered, and cases where the securing company or insurance company imposes a collateral.

Figure 5-10 Non tie-up housing loans



Source: Financial Affairs Society

iii) Recent developments

In recent times, non tie-up housing loans are offered more than tie-up housing loans for the reasons listed below.

1. Buyers can select houses from a wide range of selections without being binded only to houses offered by certain cooperation companies (real estate agents) that offer loans only for their properties.
2. With tie-up loans, there are many cases in which cooperation companies burden its borrowers with ostensible brokerage fees and other fees besides the housing loan itself. This does not occur with non tie-up loans. Moreover, the practical interest rate is relatively low at the time of the loaning.
3. Previously, the evaluation for non tie-up loans was stricter than it was for tie-up loans, and borrowing money was difficult, but recently, with private financing institutions' emphasis on the retail market, the difference between the two has lessened.

Data 2. Public Loan Security and Guarantee System in Japan

The Government Housing Loan Guarantee Corporation as an Example

Data 2.1. System and its Mechanism

The Government Housing Loan Guarantee Corporation (hereinafter called the "Guarantee Association") is a public service corporation established in 1972 aiming at promoting the housing loans executed by the Government Housing Loan Corporation, etc. and therefore promoting the construction and acquisition of houses. The competent authorities are the Ministry of Finance and the Ministry of Land, Infrastructure and Transport. Its basic property at the initial time amounted to ¥22 million (¥4.5 billion as of 2001). Contributors of the initial property were Housing Finance Promotion Association and National Federation of House Supply Corporations, etc. Working funds of the Guarantee Association have been provided by guarantee fees paid by the users of housing loans and executed by the Government Housing Loan Corporation. The Guarantee Association has not received any subsidy or financial support from the state.

The Guarantee Association's services include 1. guarantee business concerning housing loans of individual borrowers financed by the Government Housing Loan Corporation, Okinawa Development Finance Corporation and Annuity Welfare Business Corporation (hereinafter called "the Government Housing Loan Corporation, etc."), and 2. group credit life insurance guarantee business of repayment of debts to the Government Housing Loan Corporation, etc. on behalf of the insured (when the insured who has borrowed a housing loan from the Government Housing Loan Corporation, etc.), and effected a group credit life insurance contract (mutual aid) (hereinafter called "group credit insurance") dies or becomes disabled (sequela).

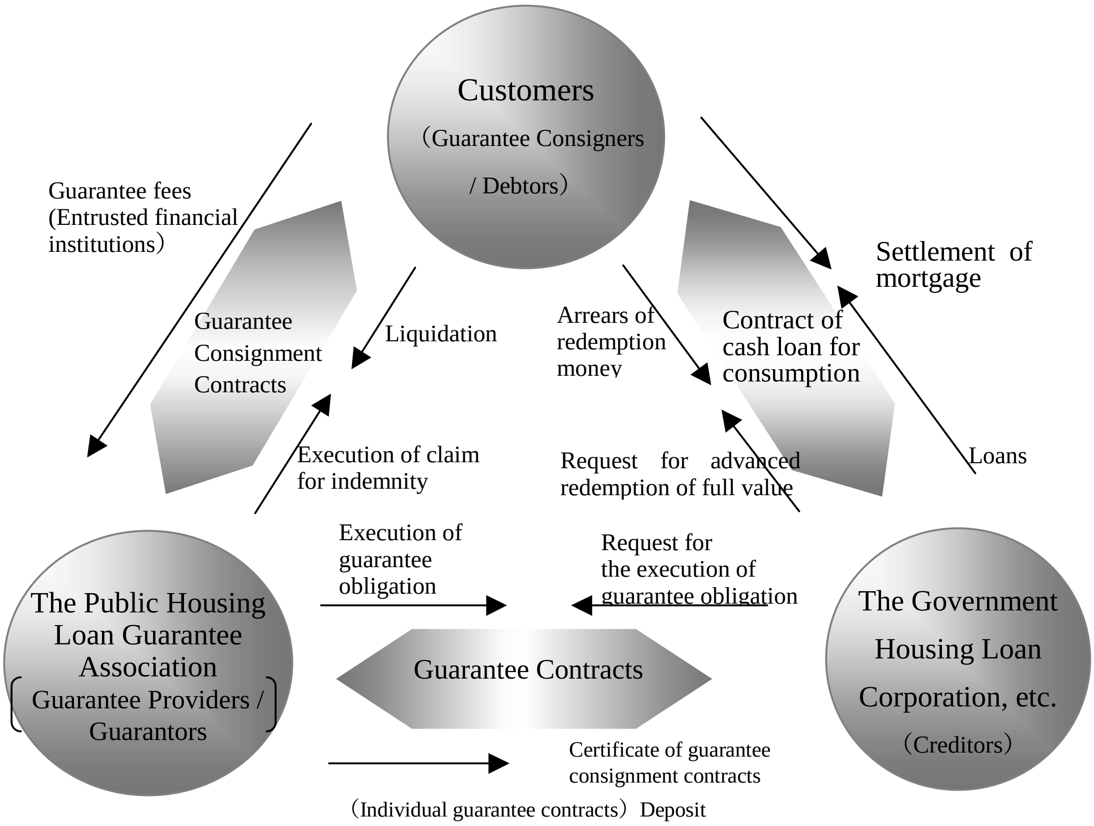
Data 2.2. Guarantee Business

Guarantee by the Guarantee Association means that the Association plays a role of joint guarantor for the benefit of borrowers of individual loans from the Government Housing Loan Corporation, etc.

Loans covered by this guarantee are, among housing loans executed by the Government Housing Loan Corporation, etc. to "the people who acquire a house for their own or relative's dwelling purpose", those on which mortgage is settled. Guarantee fee varies according to the loan amount and the term of loan and is on a low level of about 60% of that charged by private guarantee institutions.

Under this system, when the Government Housing Loan Corporation, etc. is unable to receive repayment from a debtor, the Guarantee Association as joint guarantor, repays the debt to Government Housing Loan Corporation, etc. on behalf of the debtor and manages claimable rights obtained through such repayment and collects the claim.

Figure 5-11 Guarantee Service: Workflow



Source: Housing Guarantee Corporation

In case where a user (debtor) of the Government Housing Loan Corporation, etc. has contracted a guarantee service agreement with the Guarantee Association, and if the debtor becomes unable to repay the debt, upon request for subrogation from the Government Housing Loan Corporation, etc., the Guarantee Association repays the debt on behalf of the debtor.

After repayment by the Guarantee Association, the claim is vested to the Association and the mortgage of the Government Housing Loan Corporation, etc. is transferred to the Association. The debtor repays to the Association the debt refunded by the Association for the debtor.

Table 5-14 Current Condition of Guarantee Consignment Contracts and Group Credit Debt Liquidation Consignment Contracts

As of the end of March 2001

Classification	April 2000～March 2001		Total sum since the commencement of service	
	Number of Contracts	Total Value	Number of Contracts	Total Value
Guarantee Consignment Contracts	445,816	8,869,785	13,042,681	139,301,646
Group Credit Debt Liquidation Consignment Contracts	438,716	8,749,284	9,689,291	124,157,734
Guarantee Consignment Contracts for private rental housing, etc.	2,649	464,614	32,828	6,407,640

*Total values are in JPY000,000's.

Source: Monthly Housing Finance Report

Note: 1. The figures of guarantee consignment contracts and group credit debt liquidation consignment contracts, listed above, are for the contracts signed by the Housing Loan Guarantee Corporation.

2. Guarantee Consignment Contracts for private rental housing, etc, listed above is a total of contracts signed by Government Corporation for Improvement & Development of Housing and Megalopolis Noninflammable Construction Corporation.

Table 5-15 Development of Performance of Guarantee Obligations (Subrogation)

Classification	No. of cases (in 1,000)	Amount (in 100 million yen)
‘95.4～’96.3	9.8	1,148
‘96.4～’97.3	11.0	1,430
‘97.4～’98.3	11.2	1,554
‘98.4～’99.3	16.3	2,227
‘99.4～’00.3	17.8	2,476
‘00.4～’01.3	20.6	2,914

Source: The Government Housing Loan Guarantee Corporation

Table 5-16 Causes for Arrears (Subrogation during the period from ‘99/4 to ‘00/3)

Causes for arrears	Ratio	
	Subrogation during the period from ‘99/4 to ‘00/3	Subrogation during the period from ‘00/4 to ‘01/3
Dismal sales performance	23.0	24.1
Difficulty in living	17.8	16.3
Bankruptcy	11.9	10.6
Excessive debts	11.0	9.8
Disease	7.1	5.9
Unemployment	5.4	6.6
Death	1.2	1.3
Others	22.7	25.5

Source: The Government Housing Loan Guarantee Corporation

Table 5-17 Development of Collection of Claimable Rights

Classification	Collected amount (in 100 million yen)
‘95.4～’96.3	529
‘96.4～’97.3	656
‘97.4～’98.3	787
‘98.4～’99.3	802
‘99.4～’00.3	1,278
‘00.4～’01.3	1,548

Source: The Government Housing Loan Guarantee Corporation

(1) Group Credit Life Insurance System

The group credit life insurance system of the Government Housing Loan Corporation means that, when a borrower of individual housing loan from the Government Housing Loan Corporation, etc. has concluded a “repayment service agreement under group credit life insurance contract” with the Guarantee Association, and later confronted with an unexpected accident such as death or becoming disable, the burden to repay the debt which is to be borne by the bereaved family may be released. Under this system, the Guarantee Association becomes the insurer and beneficiary, and concludes a group credit life insurance contract ("group credit contract") with a life insurance company, by designating the debtor of the Government Housing Loan Corporation, etc. as the insured ("insured"), and the Guarantee Association repays the outstanding debt in a lump sum to the Government Housing Loan Corporation, etc. with insurance benefit paid by the life insurance company.

1) Purpose of the system:

   Purpose of the system is that when a debtor is confronted with an unexpected accident such as death or becoming disable, the outstanding debt is fully repaid with insurance benefit so that both of the debtor's house and the Government Housing Loan Corporation's claim may be preserved.

2) Operation of the system:

   This system was created in 1980 and has been operated by debtors' voluntary participation in the system on the basis of group credit life insurance contract executed by and between the Government Housing Loan Guarantee Corporation and insurance companies.

   Insurance is jointly underwritten by 37 life insurance companies and clerical affairs are handled by the following 8 local managing companies by regions:

   Nihon Life Insurance, Daiichi Life Insurance, Sumitomo Life Insurance, Meiji Life Insurance, Asahi Life Insurance, Yasuda Life Insurance, Mitsui Life Insurance and Chiyoda Life Insurance

3) Eligible insured:

   Those whose age is full 15 year or more but less than 70 years as of the day of application. (Withdrawal age is full 80 years old.)

4) Contracting fee:

   Contracting fee to be paid by a debtor for the first year is ¥28,100 per ¥10 million of loan amount (Level monthly payment of principal and interest; repayment term – 30 years or less)

   As the contracting fee is determined according to the outstanding debt, it becomes lower year by year in and after the second year.

5) Development:

   Development of group credit life insurance is as shown in the table below.

Table 5-18 Performance of Group Credit Life Insurance

1.Contracts by year (Units: No. of contracts; In million yen)

1997		1998		1999	
No. of contracts	Contracted amount	No. of contracts	Contracted amount	No. of contracts	Contracted amount
571,545	9,648,179	445,090	7,779,936	517,859	10,260,202

2.Contracts in effect (Units: No. of contracts, Million yen)

1997		1998		1999	
No. of contracts	Contracted amount	No. of contracts	Contracted amount	No. of contracts	Contracted amount
4,827,953	58,218,231	4,705,117	58,378,918	4,678,305	60,988,170

3.Repayment (Units: No. of contracts; In million yen)

1997		1998		1999	
No. of cases	Amount	No. of cases	Amount	No. of cases	Amount
12,583	115,186	13,335	125,862	13,555	133,274

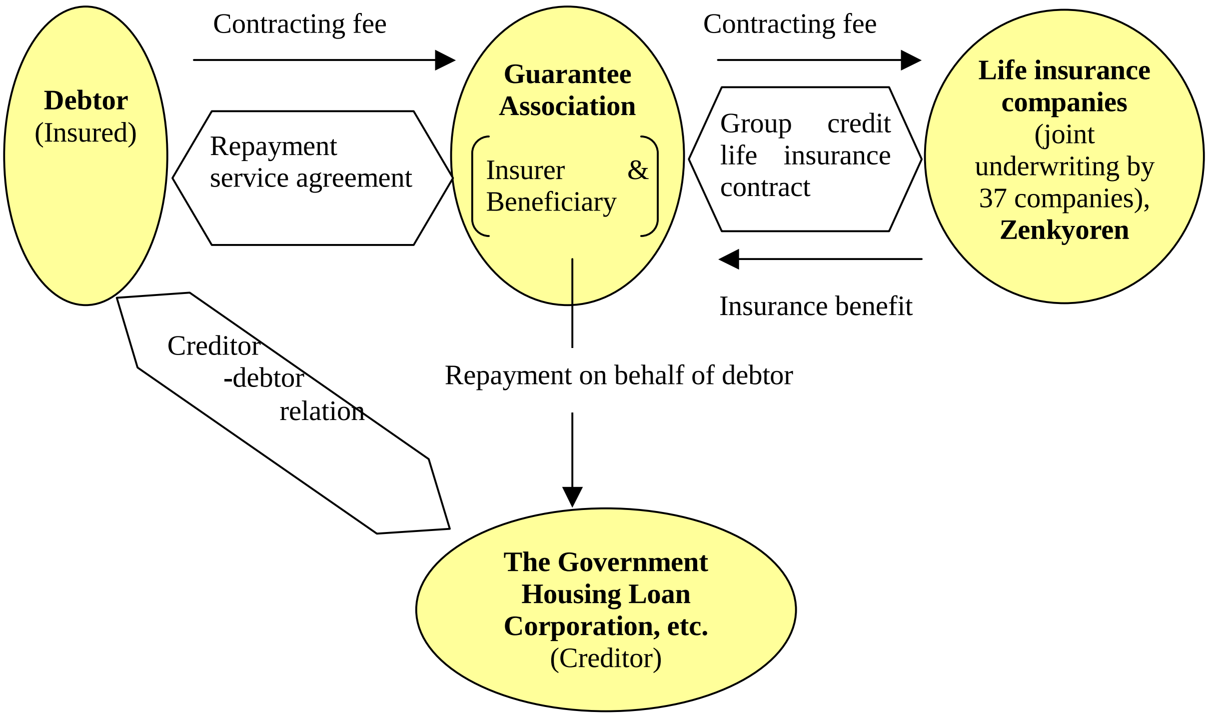
4.New contracts ratio (on quantitative basis) (Unit: %)

1997	1998	1999
95.54	95.83	95.75

*Figures include those financed together with annuity loans.

Source: The Government Housing Loan Corporation Yearly Report

Figure 5-12 Mechanism of Group Credit Life Insurance System of the Government Housing Loan Corporation

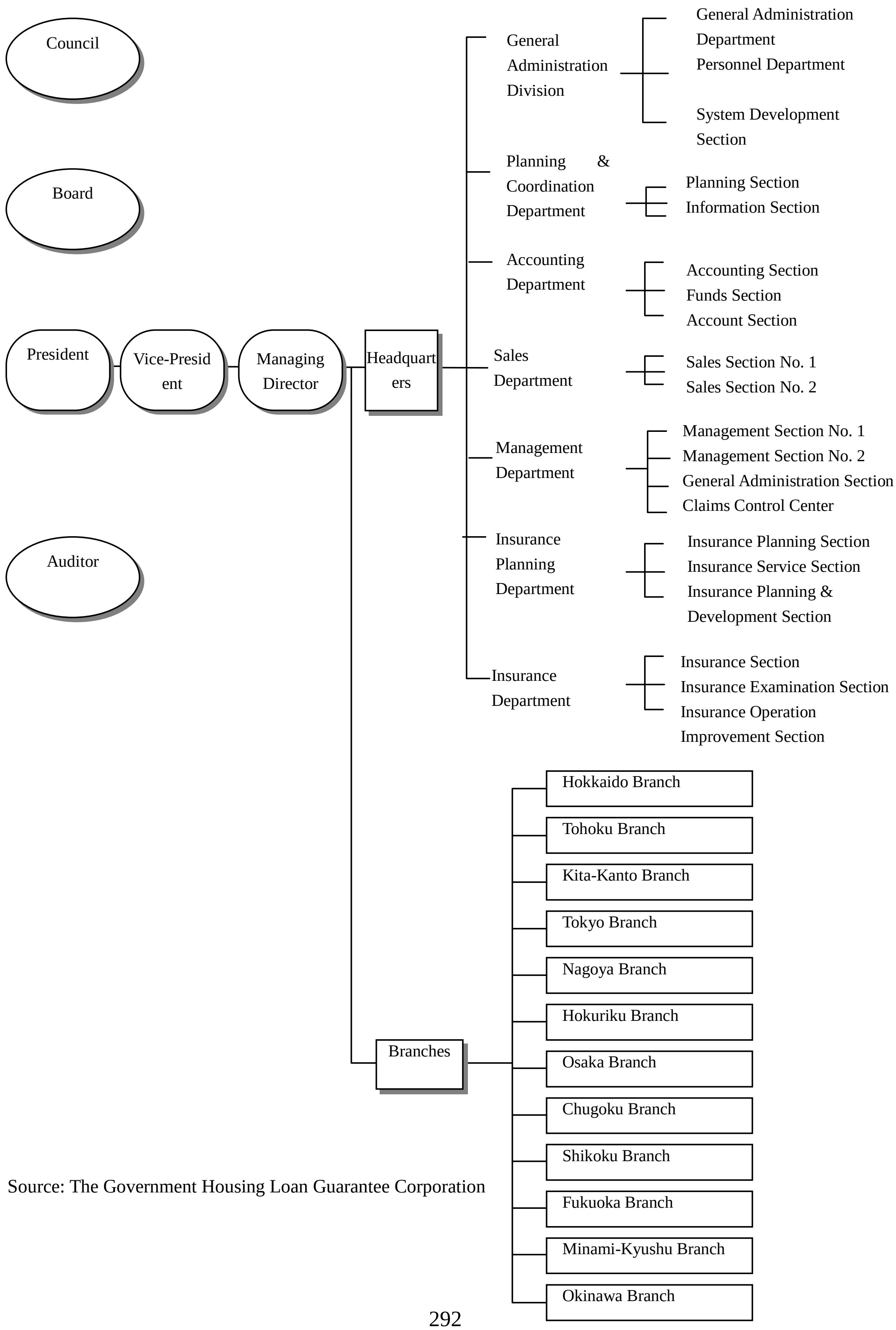


Source: The Government Housing Loan Guarantee Corporation

(2) Organization of the Guarantee Association

Figure 5-13 Organization of the Guarantee Association

Organization (as of April 1, 2001)



Source: The Government Housing Loan Guarantee Corporation

(3) Business Plan and Budget/Settled Accounts of the Guarantee Association

Business plan and budget of the Guarantee Association are drafted by the President, and decided by a resolution of not less than two-thirds of all Directors of the Board with consent of the Council prior to commencement of each accounting year, and reported to the Ministers of Finance and Land, Infrastructure & Transport within 3 months after commencement of each accounting year.

With respect to the Guarantee Association's activities and settled accounts, the President prepares Business Report, Statement of Income and Expenditure, Statement of Increase/Decrease of Net Worth, Balance Sheet, Inventory, etc. after the end of each accounting year. These financial statements should be audited by the Association's Auditor within 70 days after the end of each accounting year, and through a resolution of not less than two-thirds of all Directors of the Board with consent of the Council, be reported to the Ministers of Finance and Land, Infrastructure & Transport within 3 months after the end of each accounting year.

The latest Statement of Income and Expenditure, and Balance Sheet of the Guarantee Association are as shown in the table below. Disclosure of the Association's financial position is useful to elevate transparency of its business activities, and to substantiate its reliability as a judicial person for public interest. This fact has contributed to elevation of the Association's reliability and raise of guarantee users' ratio, and such high ratio has led to lowering of guarantee fee and finally to users' interests.

Table 5-19 Statement of Income and Expenditure

(From April 1, 1999 to March 31, 2000) (Yen in 100 millions)

Income				Expenditure			
Item	Housing Loan Guarantee	Group Credit	Total	Item	Housing Loan Guarantee	Group Credit	Total
Operating income	879	3,279	4,158	Operating expenses	299	2,881	3,181
				Administrative expenses	11	8	20
Profit on sale of marketable securities	1,057	698	1,755	Expenses for purchasing marketable securities	3	918	922
Profit on collection of claim for indemnity	1,548	-	1,548	Expenses for purchasing claim for indemnity	2,914	-	2,914
Others	16	0	17	Others	0	0	1
Total	3,501	3,977	7,479	Total	3,230	3,809	7,039

Source: The Government Housing Loan Guarantee Corporation

Table 5-20 Balance Sheets

(Fiscal year ended March 31, 2000) (Yen in 100 millions)

Assets				Liabilities and Shareholders' Equity			
Item	Housing Loan Guarantee	Group Credit	Total	Item	Housing Loan Guarantee	Group Credit	Total
Current assets	807	367	1,174	Current liabilities	3	1,231	1,234
Fundamental property	45	-	45	Reserves	2,495	1	2,497
Fixed assets	113	75	189	Liability reserve for guarantee contracts	5,422	-	5,422
Investment securities	2,023	5,503	7,527	Liability reserve for group credit contracts	-	4,713	4,713
Claim for indemnity	4,976	-	4,976				
Customers' acceptance liability	675,951	-	675,951	Guarantee liabilities	675,951	-	675,951
				Net assets	45	-	45
Total	683,917	5,946	689,863	Total	683,917	5,946	689,863

Source: The Government Housing Loan Guarantee Corporation

Table 5-21 Statement of Changes in Net Assets

(April 1, 1999 to March 31, 2000) (Yen in 100 millions)

Increase				Decrease			
Item	Housing Loan Guarantee	Group Credit	Total	Item	Housing Loan Guarantee	Group Credit	Total
Operating income	879	3,279	4,158	Operating expenses	299	2,881	3,181
Marginal profit on sale of marketable securities	105	137	242	Administrative expenses	11	8	20
				Amortized claim for indemnity	915	-	915
				Backlog depreciation	1	1	3
Refunds from amortization reserves for claim for indemnity	2,268	-	2,268	Transfer to amortization reserves for claim for indemnity	2,493	-	2,493
Refunds from liability reserve for guarantee contracts	5,878	-	5,878	Transfer to liability reserve for guarantee contracts	5,422	-	5,422
Refunds from liability reserve for group credit contracts	-	4,220	4,220	Transfer to liability reserve for group credit contracts	-	4,713	4,713
Refunds from unearned special contract charge	-	945	945	Transfer to unearned special contract charge	-	973	973
Others	17	0	17	Others	4	3	7
Total	9,149	8,582	17,731	Total	9,149	8,582	17,731
				Net asset increase for this year	0	0	0
				Net asset carried forward to the next year	45	0	45
				Total assets for the year	45	0	45

＊Total values shown in the table above might not match since figures smaller than 100 million yen were rounded off.

Source: Housing Guarantee Corporation

Data 2.3. Requesting Financial Institutions to Render Guarantee Services on Behalf of the Guarantee Association

The Guarantee Association requests financial institutions that have been requested to do business (including the business of Annuity Welfare Business Corporation to be done on its behalf by the Government Housing Loan Corporation or Okinawa Development Finance Corporation) on behalf of the Government Housing Loan Corporation, or Okinawa Development Finance Corporation upon their request, to render guarantee services on behalf of the Guarantee Association in exchange for commissions.

Window of the services for the Government Housing Loan Corporation, etc. is the same as that of the Guarantee Association, and the window carries out not only credit examination of prospective borrowers, but also carries out management and collection of claimable rights.

Commissions to be paid by the Guarantee Association to these financial institutions are shown in the schedule below.

Table 5-22 Schedule of Commissions

	Cost	Amount including consumption tax
(Guarantee business)		
Commission for contracting	900	945
Commission for subrogation (with security)	34,900	36,645
Commission for subrogation (without security)	17,500	18,375
Commission for contracting installment repayment (non-notarial deed)	5,000	5,250
Commission for contracting installment repayment (notarial deed)	15,000	15,750
Commission for management and collection of claims	252	265
Commission for collection by partial payment or installment	390	410
Commission for filing application for auction, etc.	50,000	52,500
Commission for receipt of voluntary repayment	5,000	5,250

	Cost	Amount including consumption tax
Commission for receipt of dividend	5,000	5,250
Commission for procedure for collection by partial payment	7,500	7,875
Commission for receipt of dividend of depreciated claims, etc.	5,000	5,250
Commission for election of manager of inherited property	15,000	15,750
(Group credit business)		
Commission for acceptance of application	1,262	1,326
Commission for management	126	133
Figure in parenthesis means postal book-transfer amount.	(87)	(92)
Commission for demand of insurance benefit (mutual aid)	3,495	3,670
Figure in parenthesis shows commission under two interest rates.	(3,980)	(4,179)

Source: The Government Housing Loan Guarantee Corporation

Data 3. Credit Supplement System in the United States

Data 3.1. Credit Supplement System (Mortgage Insurance, Guarantee) in the First Market

The US government's policies for supporting housing loans, and its credit supplement system occupies an important position, as well as its policy for promoting liquidation of housing loan claims. This credit supplement system means that government-related institutions carry out insurance or guarantee for housing loans executed by financial institutions in the private sector. These insurance and guarantee are FHA insurance and VA guarantee.

(1) The FHA (Federal Housing Administration) was a government-related institution established under the National Housing Act in 1934 in times of great economic crisis in the world and is currently under the control of HUD (Department of Housing and Urban Development). The FHA has several programs to supplement housing loans. Among them, the most important program is mortgage insurance (the so-called FHA insurance; Section 203 (b) of the National Housing Act).

This FHA insurance means such guarantee that if a borrower becomes unable to perform the obligations, the government (FHA) shall indemnify the lender's loss. This is a system to give people who don't have sufficient credit or fund an opportunity to use housing finance. In the past, there were restrictions on interest rate, loan amount, etc. to be covered by the insurance for reducing borrowers' burden to repay their debts, but such restriction on interest rate was abolished in 1983.

Before the introduction of this FHA insurance, as general conditions of private housing loans, finance ratio was about 40 ~ 50% of needed fund, term of repayment was about 5 years, and only interest had to be paid every year but principal repaid in a lump at maturity. Therefore it was very difficult for the people whose ability to raise fund was poor, to have their house. However, by virtue of introduction of the FHA insurance, finance conditions imposed by financial institutions were significantly improved, and finance ratio has reached 97% at highest, and the term of repayment is usually 30 years now. In addition, introduction of installment repayment, etc. have greatly contributed to improvement of especially lower income earners' ability to obtain their house.

The FHA insurance has many systems. The core of them has been a mortgage finance insurance system under Section 203 (b). This system has its legal base on the National Housing Act, and its purpose is to support the people who want to have their own house. The system is outlined as follows:

1) Application filed to:

Financial institution authorized by the HUD. Application document is examined in the HUD's relevant local office.

2) Applicability:

Acquisition of housing, which is at the stage of designing or construction, and of existing house, or conversion of existing housing loan.

3) Limit of finance amount to be covered by the insurance:

In case of house for a single family, the limit amount is $115,200 in principle, but some districts have higher limits taking into account higher price of houses in the districts.

4) Limit of finance ratio:

In case where the price of house covered by the insurance is not more than $50,000, the ratio is 98.75% at highest in principle, and if the price exceeds $50,000, 97.75% at highest.

In addition, highest finance ratio is set for each level of financed amount. In general, up to $25,000 of financed amount, 97% of appraised value (including a certain fixed contracting expense), more than $25,000 but not more than $125,000, 95%, and more than $125,000, 90%, respectively.

5) Longest term of repayment:

30 years.

6) Insurance premium:

Insurance premium equal to 2.25% of the financed amount should be paid at the time of execution of the finance. In addition, an amount obtained by multiplying the average outstanding debt of each repayment year by a certain fixed rate should be paid as insurance premium for the year. Insurance premium to be paid at the time of execution of the finance can be included in the finance.

Table 5-23 Insurance Premium of FHA (Section 203 (b))

Finance ratio	Insurance premium	Repayment years
Less than 90%	0.5% of the average outstanding debt	11 years
90% or more but not more than 95%	0.5% of the average outstanding debt	30 years
More than 95%	0.55% of the average outstanding debt	30 years

Source: FHA data

7) Performance:

Finance insured under this system in 1998 numbered 1,091,289.

Data 3.2. VA Guarantee

In the United States there had been a system to support veterans since the age of a colony. In 1930, the Veterans Administration (VA) was established by unification of various support institutions. The VA commenced a certain guarantee service in connection with housing loans under the Military Personnel Re-Adjustment Act of 1944, which has come to the present as the so-called VA guarantee. In 1944, the VA was promoted to a higher status to the Department of Veterans Affairs.

The VA handles clerical affairs concerning housing loans in its 48 local offices. Concretely, a document relating to a housing loan contracted by a financial institution is forwarded to the competent local branch which in turn checks the document and issues a guarantee deed.

Those who are eligible to use the VA guarantee are veterans who may satisfy certain requirements in the aspect of military service and their spouses. As for finance amount to be covered by this guarantee, there is a limit of 4 times of the guaranteed amount at maximum. Interest rate has a similar limit but may vary according to fluctuations in interest rates in the money market. Term of repayment is not more than 30 years (exactly 30 years and 32 days) and redemption prior to maturity is available without penalty. As to price of house, it should be purchase price, or not more than reasonable price decided by the Department of Veterans Affairs but concrete price is not decided. Characteristics of the VA guarantee include that dawn payment is unnecessary, and that substantial finance ratio exceeds 100% of the purchase price because VA guarantee fee can be included in the financed amount.

At present, the VA guarantee is handled by the VA Loan Guaranty Service of Veterans Benefits Administration, Department of Veterans Affairs. Purpose of the guarantee is, for rewarding veterans and military personnel in active service for their contributions to the nation, to support them to obtain and retain their own house. The Veterans Benefits Administration also carries out direct finance to borrowers, but those who are eligible to use this finance are limited to the veterans Native Americans under certain fixed conditions or who have been injured while on military service.

(1) Finance to be covered by the VA guarantee:

Finance by the VA guarantee should cover the purchase, construction or improvement of house or for conversion of existing housing loan. Finance conditions are as follows:

1) Purpose of finance:

Purchase, construction or improvement of house and conversion of existing housing loan.

2) Term of repayment:

30 years and 32 days at longest. However, the term may not exceed the remaining economic life of the house seeing from a viewpoint of immovable appraisal.

3) Finance amount:

Finance is available up to the price of house appraised by the Veterans Benefits Administration or acquisition price, whichever is the lower. However, as in many cases financial institutions sell their claims in the second market, it is usual financial institution set the limit at $203,000 on the basis of their standard for such sale in the second market.

4) Borrower's fund on hand:

If the price of house to be purchased is not more than the price appraised by the Veterans Benefits Administration, the borrower's fund on hand is unnecessary. Otherwise the borrower should pay from the fund on hand a difference between the purchase price and the appraised value. Differently from this, a financial institution that executes finance may request the borrower to have a certain amount of fund on hand.

5) Interest rate:

Interest rate is decided between the financial institution and the borrower on the basis of interest rates in the market. Limit on this interest rate was set in the past but in 1992 finance at interest rate currently in effect in the market was allowed on a trial basis and in 1996 such interest rate was allowed on an eternal basis.

(2) Those who are eligible to apply for the VA guarantee:

Those who are eligible to apply for the VA guarantee, finance amount to be covered by the guarantee, guarantee fee are as follows:

1) Those who are eligible to apply for the VA guarantee:

Eligible persons are military personnel in active service and veterans who may satisfy certain fixed requirements and their spouses. It is necessary to obtain a certificate of eligibility from the Department of Veterans Affairs prior to filing this application.

2) Finance amount to be covered by the guarantee:

Finance amount to be covered by the guarantee is decided for each level of financed amount as shown in the table below.

Table 5-24 Finance Amount Covered by VA Guarantee

Finance amount	Limit of guarantee amount
Not more than $45,000	60% of finance amount
More than $45,000 but not more than $144,000	40 % of finance amount or $36,000, whichever is the lower (Minimum guarantee - $22,500)
More than $144,000	25 % of finance amount or $50,750, whichever is the lower

Note: Limit of guarantee amount per applicant is decided. Total guarantee amount shall not exceed this limit.

Source: Department of Veterans Administration data

3) Guarantee fee:

Guarantee fee (funding fee) is paid only at the time of executing the contract and there is no subsequent payment. Amount of such guarantee fee is computed by multiplying the finance amount by a rate decided, based upon the ratio of dawn payment to the purchase price of house. Fee rates are shown in the table II-3-11.

Guarantee fee can be included in the finance amount.

Table 5-25 Fees for VA Guarantee

Percentage of cash	Guarantee fee
Less than 5%	2% of finance amount
Not less than 5% but less than 10%	1.5% of finance amount
Not less than 10%	1.25% of finance fee

Source: Department of Veterans Administration data

4) Performance:

Finance with the VA guarantee in 1998 numbered 368,791.

(3) Private Mortgage Insurance (PMI)

Mortgage insurance by private companies collapsed due to frequent occurrence of insurance troubles in the age of grave economic crisis in 1930s. For many years, housing loan insurance was underwritten by government-related institutions (Federal Housing Administration and Veterans Administration). However, since 1957 when MGIG (Mortgage Guaranty Insurance Corporation) in Milwaukee advanced into the housing loan insurance market as private institution, insurance services for housing loans by private companies have expanded, and at present many mortgage insurance companies are engaged in this insurance business. Moreover, “mortgage bankers” that render total service including servicing business, resale of houses, etc. in addition to insurance service, have entered into this market.

A housing loan without FHA insurance and VA guarantee that are government-related ones is called conventional loan. Conventional loan has meant only housing loan without insurance, but today also means housing loan with private mortgage insurance. Users of such conventional loan are mainly higher income earners. Further, as it is insurance furnished by private companies, there is no restriction on housing loan contracts to be covered by the insurance, and all conditions including applicable insurance fee rates, limit of underwriting are decided by individual insurance companies at their discretion.

II-6.

Construction of Infrastructure to Support Innovation of Housing Finance System

6. Construction of Infrastructure to Support Innovation of Housing Finance System

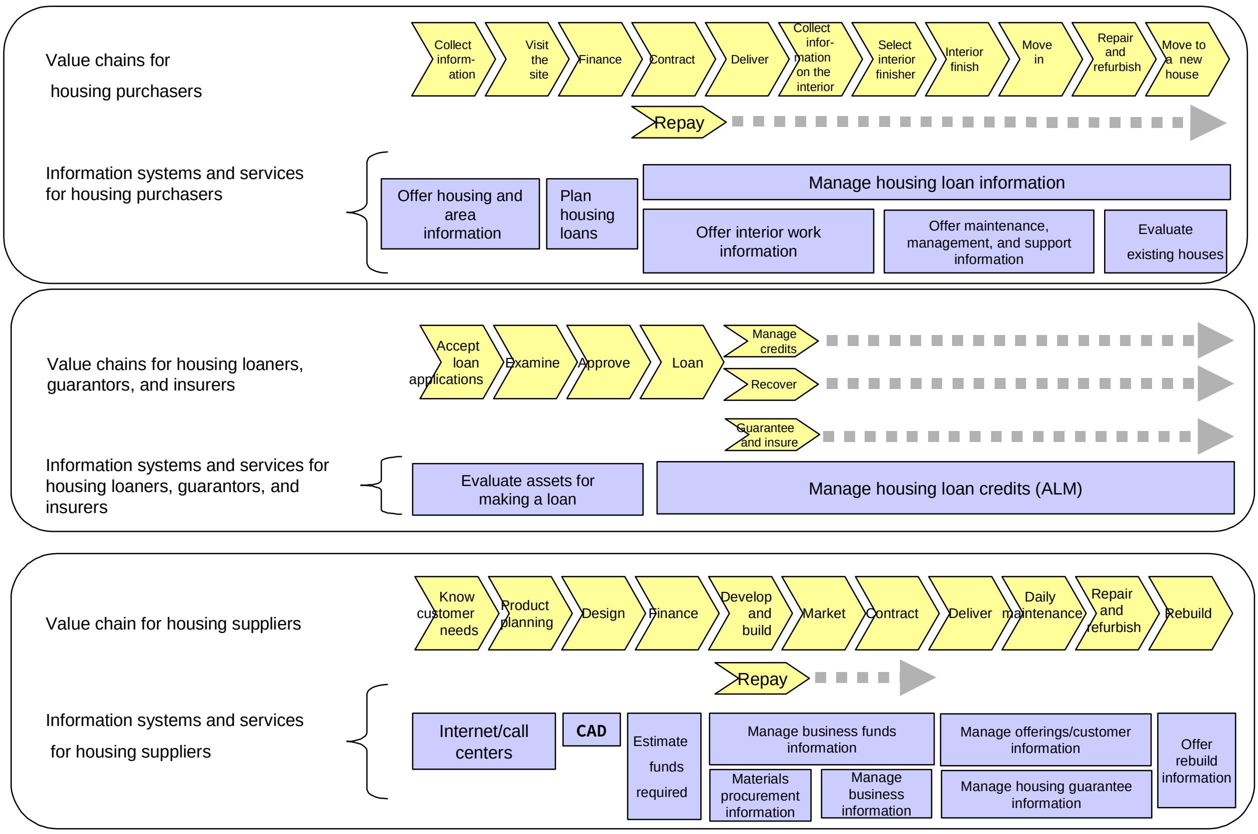
6.1. Construction of Housing Information System

6.1.1. Importance of Housing Information System

(1) Information Systems Required for the Activities of Various Housing-related Entities

In line with the development of the housing industry, information systems must be established to support the activities of three major housing-related players of housing purchasers, housing loaners, guarantors, and insurers, and housing suppliers. The following figures show the information systems, and services by value chain to serve the three market players.

Figure 6-1 Information Systems Used in Housing Activities

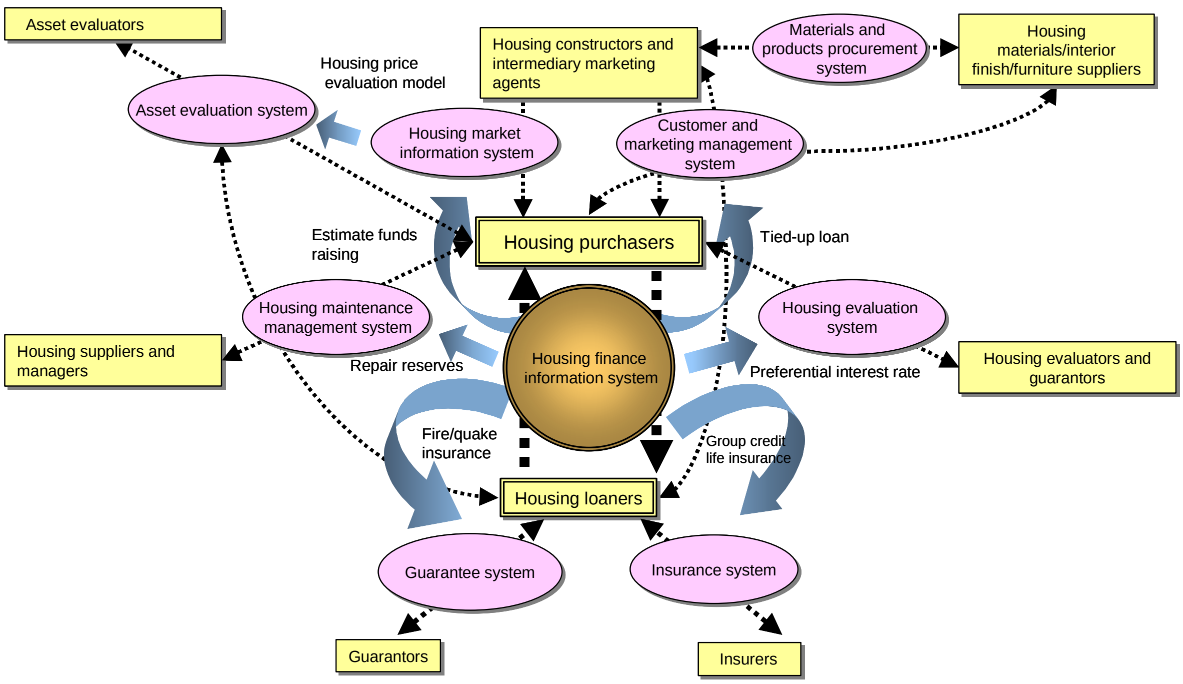


Source: JICA Study Team

(2) Construction of Housing Finance Information System Triggers Increased Setup of Housing Information Systems through Chain Reaction

Financing and services between housing purchasers, and housing loaners trigger setup of various housing information systems in the private sector through chain reaction in terms of both enhanced, and expanded functions, and business opportunities.

Figure 6-2 Construction of Housing Finance Information System Triggers Increased Setup of Housing Information Systems through Chain Reaction

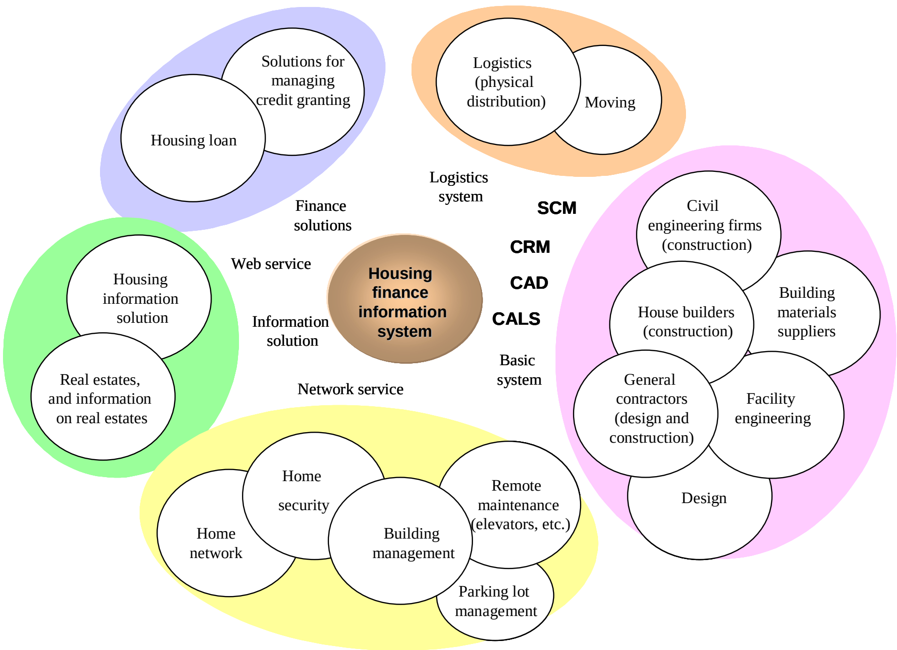


Source: JICA Study Team

(3) "Housing" Stimulates Development of Basic and Information-oriented Solution Providing Businesses in the Related Industries

Construction of a housing finance information system will entail development of various solution providing businesses who supply, for example, finance and information solutions, networking services, basic solutions, and logistics systems in a wide variety of industries including finance, housing agency, housing management, housing construction, logistics, and moving industry.

Figure 6-3 "Housing" Stimulates Development of Basic and Information-oriented Solution Providing Businesses in the Related Industries



Source: JICA Study Team

The three major housing information systems (housing finance, personal credit, and housing distribution information system) are discussed below.

6.1.2. Construction of Housing Finance Information System

(1) Role and Necessity of Construction of Information System in Innovation of Housing Finance System

As discussed in paragraph I-3, “Innovation of Housing Fund System,” innovation and development of the housing finance system require standardization of the housing finance formalities. In addition, many other tasks must be achieved including among others, construction of national and regional business management systems, training of expert staffs for housing finance, construction of training systems, restructuring of the public housing finance system to enhance efficiency, reinforcement of political loan functions, establishment of means to raise funds directly in the market, establishment of diverse fund raising means and cross-region accommodation, increased investments, and reinforced inspection and supervision by the central government. To achieve these tasks, one need to standardize business procedures, reorganize and cooperate across the boundary of regions, promote ALM management using IT (information and communication technology), train experts and enrich training programs, tie-up with the market, etc. All these require introduction of the housing information system. That is, construction of the housing information system is a prerequisite for innovating the public housing finance system.

According to the information gained in the hearings, etc., information systems are being introduced at Provident Fund Centers in Shanghai and Chengdu, but approximately 50% of all Provident Fund Centers in China do not have an information system. In Shanghai and Chengdu, Provident Fund Center introduces their own information system individually, and these are not standardized. If the situation is left unattended, all local Provident Fund Centers may introduce their own information system, making it difficult to integrate the entire provident fund systems, and the efforts of innovating the public housing finance system will be in vain.

(2) Functions Required for the Housing Finance Information System

The functions of the housing finance information system will be reinforced in line with the forthcoming phase-in of the new housing finance system.

The following summarizes the housing finance functions required to be realized in the three respective stages of progressive system innovation. The housing finance information system must fully exhibit these functions.

1) Transition from Present to Management Mechanism Type

Approximately 2,300 provident fund centers will be merged with provincial centers then with Central Provident Fund Center. The functions of Central Provident Fund Center are unification of City Provident Funds, and assigning right men to right positions. These must be realized also from the viewpoint of construction of effective information systems.

2) Transition from Management Mechanism to System Finance Type

Central Housing Finance Mechanism will issue bonds to raise funds in the financial market on its own initiative. The new loanees will include suppliers of housing including ready-built houses for sale and rental houses. Increased loanees require that a new system be in place to examine loans, evaluate collaterals, and guarantee and recover credits. Provincial Housing Finance Mechanisms should be authorized to integrate the funds of the provincial provident fund, and accommodate them across regions as required. This must be realized also from the viewpoint of construction of information systems.

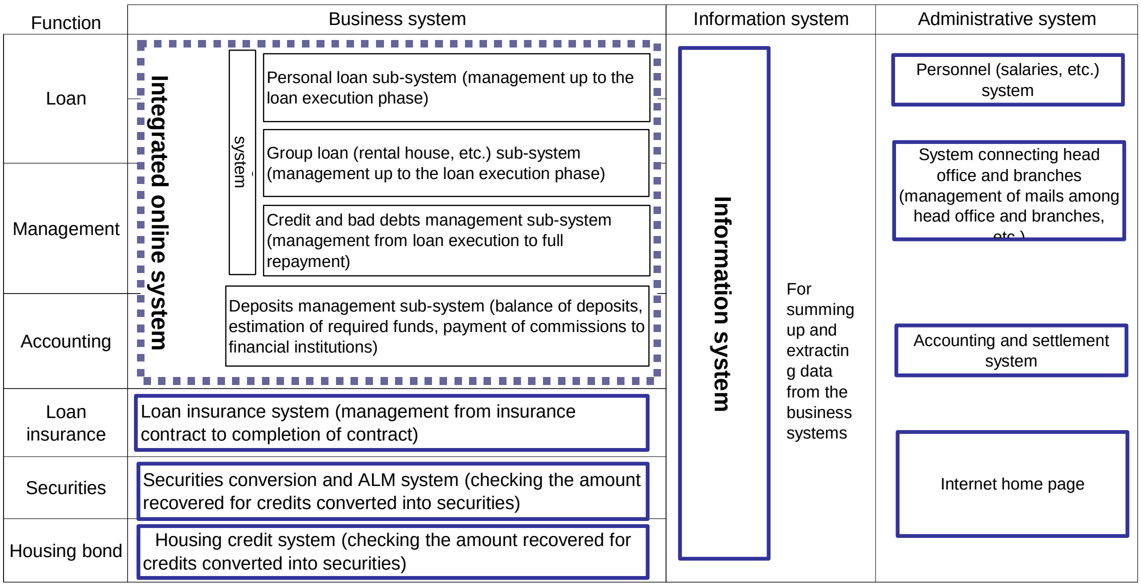
3) Transition from System Finance to Political Finance Type

China Housing Central Bank (provisional) should drive activities to eliminate the sense of unfairness held by the user layer who "is unable to purchase a house," which is expected to increase in the future. The Bank should build rental houses, pay the maintenance and management cost, and pool repair reserves for the common use spaces of an apartment. Typically, it should actively raise funds and invest including deposit of funds of Provincial Housing Finance Mechanisms, funds investment, aggregation of voluntary reserves and purpose taxes, and issuance of MBS and bonds in the capital market. These should be realized also from the viewpoint of facilitating construction of information systems.

4) Functions Required for Housing Finance Information System (summary)

Housing finance is a cooperative operation between public housing finance system with the provident fund at the center and the private housing finance system with commercial banks at the center at any phase described in paragraph 3. The housing finance information system should be constructed on the integrated online systems of both public and private housing finance organizations. The functions required for the housing finance information system characterized above are summarized in the figure below.

Figure 6-4 Functions Required for Housing Finance Information System (summary)



Source: JICA Study Team; based on the materials from The Government Housing Loan Corporation, Japan

(3) Images of Housing Finance Information System (referring to The Government Housing Loan Corporation, Japan)

1) Outline of Integrated Online System of The Government Housing Loan Corporation

The integrated online system of The Government Housing Loan Corporation is outlined below.

a. Operation Shape

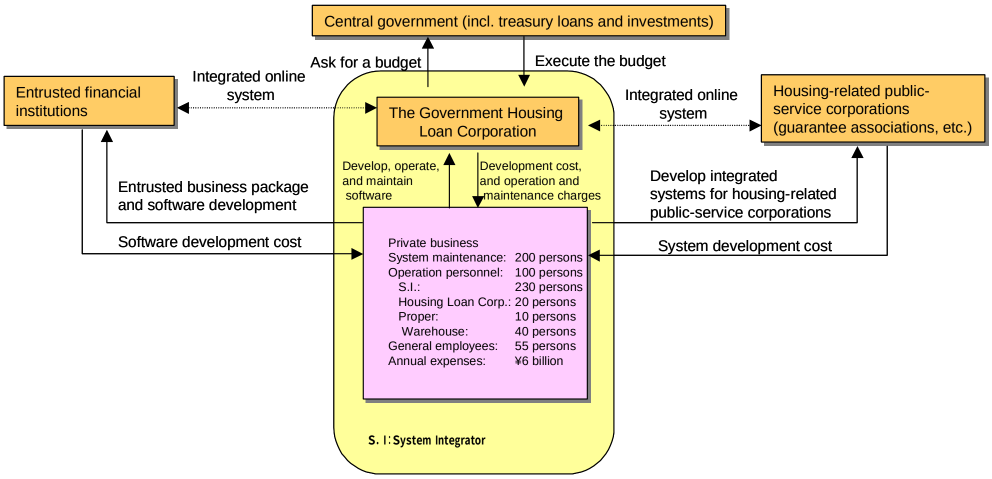
The Government Housing Loan Corporation and entrust private businesses with the development and operation of the integrated online system.

b. Business Models

The business model for development and operation of the housing finance information system in Japan is illustrated below.

Figure 6-5　Business Model for Construction, Operation, and Maintenance of Housing Finance Information System

The housing finance information system of The Government Housing Loan Corporation is developed, operated, and maintained by private businesses consisting mainly of system integrators.



Source: JICA Study Team; based on various materials

c.　System at The Government Housing Loan Corporation

Information System Department is responsible for the operation.　Related sections are Operation Section 1 (development and maintenance; 11 persons), and Operation Section 2 (operation; 5 persons)

d.　System at the Entrusted Party

Integrated Online System Headquarters (approximately 70 persons) is responsible for the operation.

Business: Planning and operation, support center, operation management, and development and maintenance.　Operator business and other functions are contracted out to private businesses.

e.　Number of Entrusting Financial Institutions

766 financial institutions as of April 1, 2001 including city and local banks, second local banks, credit associations, credit unions, laborers' credit cooperatives, credit federation of agricultural cooperatives, credit federation of fishery cooperatives, etc.

f.　Number of Credits Managed

Approximately 5,450,000 credits (as of April 1, 2001)

Reference: Daily throughput = Approximately 2,000,000 ledgers are updated in a peak day.

g.　Host Computer

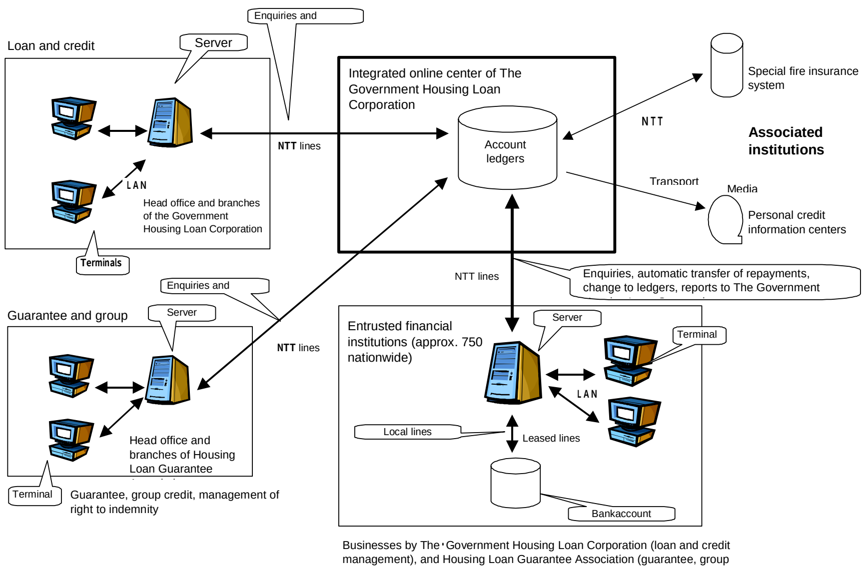
Fujitsu GS8800/200 and GS8400/30 (duplex operation in the real operating environment)

2) An Image of the Integrated Online System Network

The following figures illustrate the network of the integrated online system of The Government Housing Loan Corporation.

Loans of The Government Housing Loan Corporation are political loans. The integrated online system requires system change in accordance with organizational change. System change includes not only change of the program version used in the host but also an upgrade of application software installed on the terminals. Functional enhancement also occurs in addition to organizational changes. In a functional enhancement, the host programs must also be changed and the terminal software upgraded. Using the remote maintenance technique, the changes at The Government Housing Loan Corporation are automatically transmitted to the entrusted financial institutions to overwrite an upgrade the affected software applications.

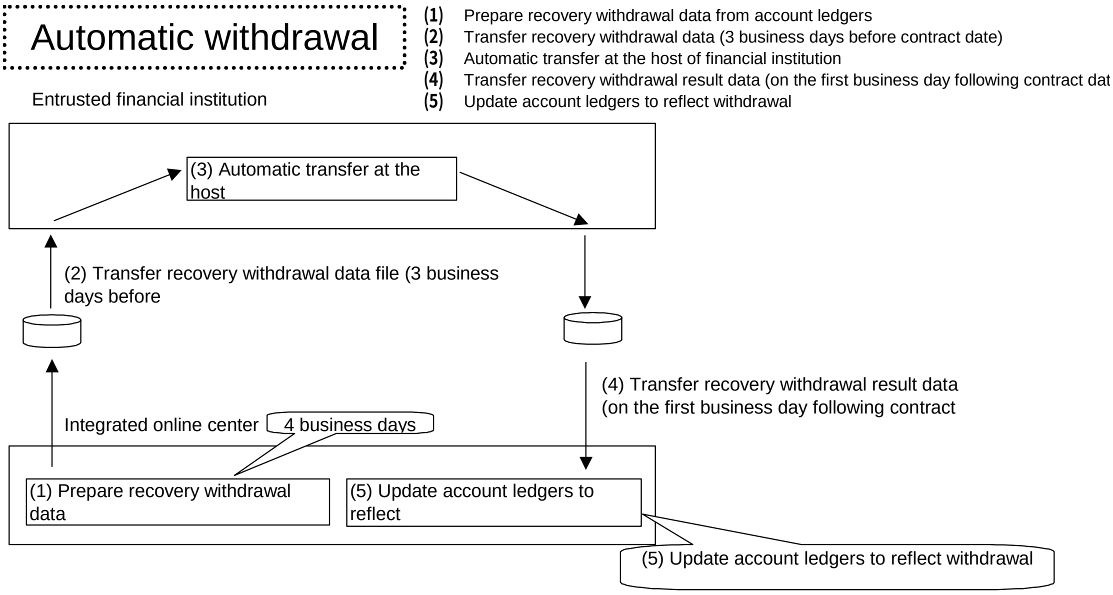
Figure 6-6 Integrated Online System Network of The Government Housing Loan Corporation (1)



Source: JICA Study Team; based on the materials from The Government Housing Loan Corporation

Figure 6-7 Integrated Online System Network of The Government Housing Loan Corporation (2)

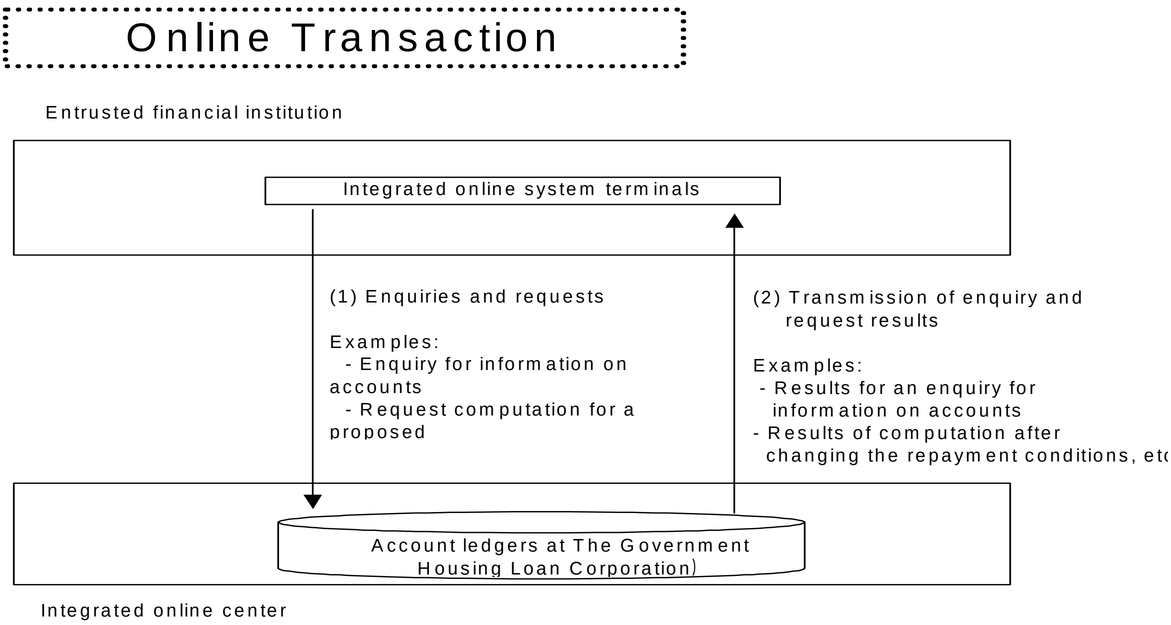
The network is used for transmission of automatic withdrawal data (file transfer) and for online transactions (two functions).



Source: JICA Study Team; based on the materials from The Government Housing Loan Corporation

Figure 6-8 Integrated Online System Network of The Government Housing Loan Corporation (3)

The network is used for transmission of automatic withdrawal data (file transfer) and online transactions (two functions).



Source: JICA Study Team; based on the materials from The Government Housing Loan Corporation

Table 6-1 Integrated Online System Network of The Government Housing Loan Corporation (4)

Role of Integrated Online System Sub-systems

The integrated online system consists of a certain number of sub-systems serving different businesses.

Sub-system		Major role	Examples of online transactions
Common	Account management	Manage account name, address, and telephone number.	Manage account enquiries, address change, and time limit (absence management, etc.).
The Government Housing Loan Corporation	Personal loan	Expedite personal loans	Process application information, design and site examination information, debit and credit information・account information, and funds granting information.
	Group loan	Expedite group loans (rent, re-development, etc.).	Enquire loan ledgers, and process payment information.
	Credit management and bad debts	Manage ledgers after loan on deeds, prepare recovery withdrawal data, and manage arrears.	Process payments received, advanced repayments, and changes to redemption conditions, enquire for credit information, prepare arrears cards, and request, approve, and apply for full advance repayments.
	Accounting (deposits management)	Manage deposits,manage money pool set reserved for bank-to-bank acommodation and housing loan corporation to bank, and bill and pay commissions.	Daily collate, report expected amounts recovered, bill business entrust fees, and receive interests on deposits.
Guarantee Association	Guarantee and group credit	Manage payments and receipts of guarantee and special contract fees, and accounts information.	Receive and pay guarantee and group credit special contract insurance premium, and bill, apply, and register group credit repayments.
	Management of right to indemnity	Manage information on right to indemnity.	Receive payments from the indemnitor, and expedite and register auction, etc.
	Accounting (management of payments and receipts)	Manage payments and receipts of the Guarantee Association	Daily collate, and remit to the Guarantee Association

Source: JICA Study Team; based on the materials from The Government Housing Loan Corporation

(4) Road Map for Constructing Housing Finance Information System

1) Articulation of the Attitude of the Administrative Organs

First of all, the responsible administrative organ for construction of the housing finance information system must be specified as soon as possible (People's Bank of China or the Ministry of Construction? Which department or bureau? etc.).

An urgent study is then required on the means to construct the housing finance information system (use the national financial budget or private finance initiatives including BOT? In the latter case, to which extent is the private sector allowed to do in constructing and operating the system? Are the Japanese and other foreign private capitals allowed to participate in the construction and operation of the system (including partnering with local businesses)?

2) Road Map for Constructing Housing Finance Information System

The discussions on a road map for constructing the housing finance information system below are only possible when 1) the attitude of the administrative organ is articulated.

a. Understanding Actual State of Housing Finance Information Systems in Various Areas

As stated above, local Provident Fund Centers are independently constructing information systems in Shanghai, Chengdu, and other cities. It is necessary to understand the actual state of local housing finance information system before constructing a national standard top-down type housing finance information system.

b. Case Studies of Shanghai and Chengdu as the Leading Cases
Shanghai reportedly has the most advanced information system. In Chengdu, a top-down type housing finance information system is being constructed as a local closed system. It is necessary to scrutinize the construction and operation of the housing finance information systems in these two cities in line with the tasks mentioned in paragraph 1.

c. Summary of Tasks Related to Present Housing Finance Information System
The tasks related to the present housing finance information system are summarized based on the discussions in paragraphs 1 and 2.

d. Outline of the Preferred Housing Finance Information System
The outline of the preferred housing finance information system will be clarified in terms of size/grade, functions, construction schedule, etc. through work described in paragraphs 1 through 3. An interview survey will also be scheduled with People's Bank of China, Ministry of Construction, and other related organs.

e. Case Study of Japan (The Government Housing Loan Corporation hearing)
Your system is compared with the housing finance information system operated by The Government Housing Loan Corporation, Japan. This will assist you to prepare for cost benefit analysis, paragraph 6, and provide you a concrete image of basic units of initial cost, operation cost, gross profits, interest and the like.

f. Cost Benefit Analysis
Cost benefit analysis of the housing finance system to be constructed in China is made using the information enumerated in paragraph 5.

g. Summary of Conditions for Private Businesses to Participate in the System
We will discuss the conditions under which private businesses will participate in the system construction and operation (by hold hearings, or having the business submit a prospect).

h. Evaluation of Business Opportunity for Private Businesses
Business opportunity for private businesses is evaluated based on the processes 1 through 7.

i. Preparation of Detailed Road Map for Construction of Information System

When the evaluation affirms business opportunities for private businesses in paragraph 8, a detailed road map (partnering, etc.) will be prepared for construction of the information system.

6.1.3. Construction of Personal Credit Information System

(1) Role and Necessity of Information System in Personal Credit Risk Management

Risk management backed by personal credit investigation is indispensable for the sound development of the housing finance system. In many areas excluding Shanghai, the financial institutions do not have an enquiry system supported by a personal credit database so that they must actually visit the person to investigate credit conditions.

Table 6-2 Present Method of Personal Credit Investigation (cited again)

Contents	Means	Reliability
- Status of debtor	- Enquire at public offices	High
- Credibility of documents rendered	- Enquire at public offices	Slightly high
- Use of the funds	- Site visit	Slightly low
- Solvency of the debtor	- Collect individual information	Low
- Confirmation of collaterals and guarantees	- Site visit and enquiries at public offices	Slightly high

Source: JICA Study Team; from hearings held at the branches of local banks.

Since China is a WTO member country now, the financial institutions must pursue managerial strategies that anticipate participation of foreign-affiliated financial institutions in the housing finance market and the resultant severe competition. A system of speedy and accurate personal credit investigation to facilitate housing loan decision-making is urgently required. It is very much important to construct a personal credit information system.

(2) Functions Required for Personal Credit Information System

The personal credit information system collects and manages personal credit information for loan, credit card, and other transactions. It also provides reference information for granting credit and managing transactions after concluding a contract.

- Collect personal credit information
- Manage personal credit information
- Prepare and provide reference information for granting credit and managing transactions after concluding a contract

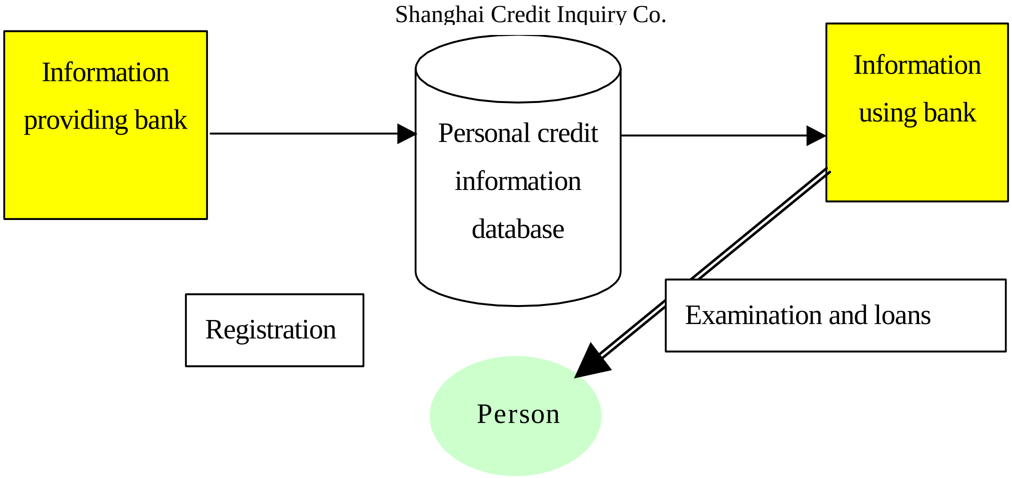
(3) An Image of Personal Credit Information System

1) Shanghai Credit Inquiry Corporation (China)

Shanghai Credit Inquiry Corporation (personal credit enquiry company; hereafter called Shanghai Credit Co.) operates the first personal credit enquiry system in China. The company was established in summer of 1999 based on the "Opinion on Expanded Personal Consumption Loans" of the Head Office of People's Bank of China proclaimed in May 1999. The objective of the system is to alleviate credit risk of banks offering personal loans. Shanghai Credit Co. opened an inter-bank personal credit enquiry system connecting banks in the Shanghai area in June 2000. (An integrated personal credit evaluation system will be completed by the year of year 2001.) When the system started in June 2000, the company owned 1.8 million personal credit enquiry data (680,000 personal consumption accounts held by the banks, and 1.18 million debit card account opening data. (A debit card holder is entitled to automatic loans from the deposit account with the bank.)

Shanghai Credit Co. pays RMB0.2 per data source to the bank providing the information, and collects an information providing fee of RMB10 per search from the bank who uses the database.

Figure 6-9 Personal Credit Enquiry System in Shanghai (cited again)



Note: Arrows (→) indicate the flow of information.

Source: JICA Study Team; based on the materials from Shanghai Credit Inquiry Corporation .

(Reference: Contents of personal credit information database of Shanghai Credit Co.)

- Information on personal status: ID No. (personal certificate No.), name, date of birth, sex, matrimony, family register, employment, educational background, etc.
- Credit information: Balance of loans, lending bank, terms and amount of loan, guarantees, repayments made, delays, re-contract (re-scheduling), etc.
- Credit card information: Number of accounts held at banks, bank names, usage, repayment information, balance of credit, misuse record, usage by card, etc.

- Social information: Lawsuit cases, criminal record, jail sentence, description of punishments, etc.
- Special records: Monetary fraud, credit card fraud, etc.
- Number of enquiries to the same information: Enquiries within 6 months, reason thereof, contents of enquiry, etc.

2) Personal Credit Information Center Managed by Japanese Bankers Association, Japan

Personal Credit Information Center managed by Japanese Bankers Association, Japan, is a personal credit information institution established and operated by Japanese Bankers Association to smoothen consumer loans. It collects personal information pieces from the transactions made by the loan and credit card users, and provides these information pieces to the members to assist in their judgment of granting credit and managing a series of transactions after contracting. The members comprise financial institutions (banks, credit associations, credit unions, laborers' credit cooperatives, agricultural cooperatives, governmental financial institutions, etc.), credit card companies, consumer loan businesses, guarantee companies, guarantee associations, and other corporations related to the personal credit business. The membership is 1,670 as of end of September 2001.

The following information is registered:

(Loans)

Date, amount, and limit of borrowings, intended use of the funds, mortgage, balance of borrowings, final repayment date, monthly repayments, and other details of transactions and the condition of repayment.

(Credit cards)

Date, amount, limit and balance of borrowings (use), final repayment date, monthly billing and payments, and other details of transactions and the condition of payment.

(Guarantee)

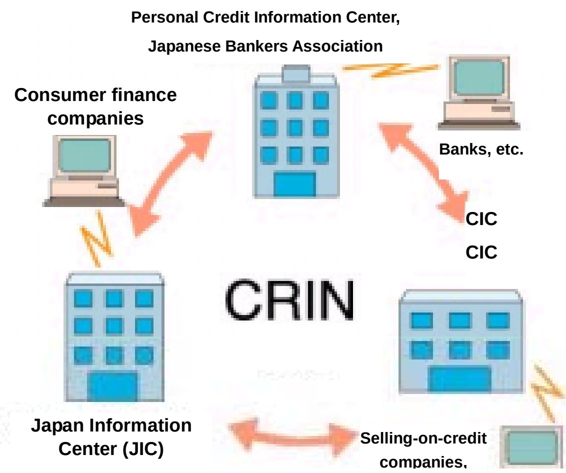
Guarantee set date, amount guaranteed, guarantee period, and other details of guarantee transactions.

Personal Credit Information Center, Japanese Bankers Association, exchanges information with the following personal credit information organs (CRIN [Credit Information Network]):

Japan Information Center (JIC):	The major members are consumer finance businesses.
CIC:	The major members include selling-on-credit companies, home electric appliances and car makers' credit companies, department stores, volume sellers, bank card companies, specialty stores associations, lease companies, guarantee companies, etc.

The members to the Personal Credit Information Center, Japanese Bankers Association, and the above tied-up personal credit information institutions mutually use the following registered information owned by respective organs to exchange information:

Figure 6-10 Information Exchange among Personal Credit Information Organs



Source: Personal Credit Information Center, Japanese Bankers Association

(4) Road Map for Constructing a Personal Credit Information System

The first step recommended in the construction of the personal credit information system is establishment of local personal credit information system operating companies like Shanghai Credit Co.

To be specific, a system integrator to integrate businesses related to computer hardware and software should be established inviting participation by consumer loan businesses, selling-on-credit companies, home electric appliances and car makers' credit companies, department stores, volume sellers, bank card companies, specialty stores associations, lease companies, and guarantee companies. Depending on conditions, joint setup with local administrative organs may also be possible.

The next step would be construction of an information exchange network (Credit Information Network – CRIN) involving two or more personal credit information system constructing and operating companies across areas with the aim of expanding the scope of activities. Personal Credit Information Center managed by Japanese Bankers Association provides an ideal model in this respect.

Japan, Europe, and America have many years' experience in the construction of housing finance information systems and personal credit information systems. Information systems should be constructed at the initiative of the private sector. It is also important to assume and expect that sooner or later, foreign-affiliated businesses will participate in the construction and operation of information systems.

6.1.4. Construction of Housing Distribution Information System

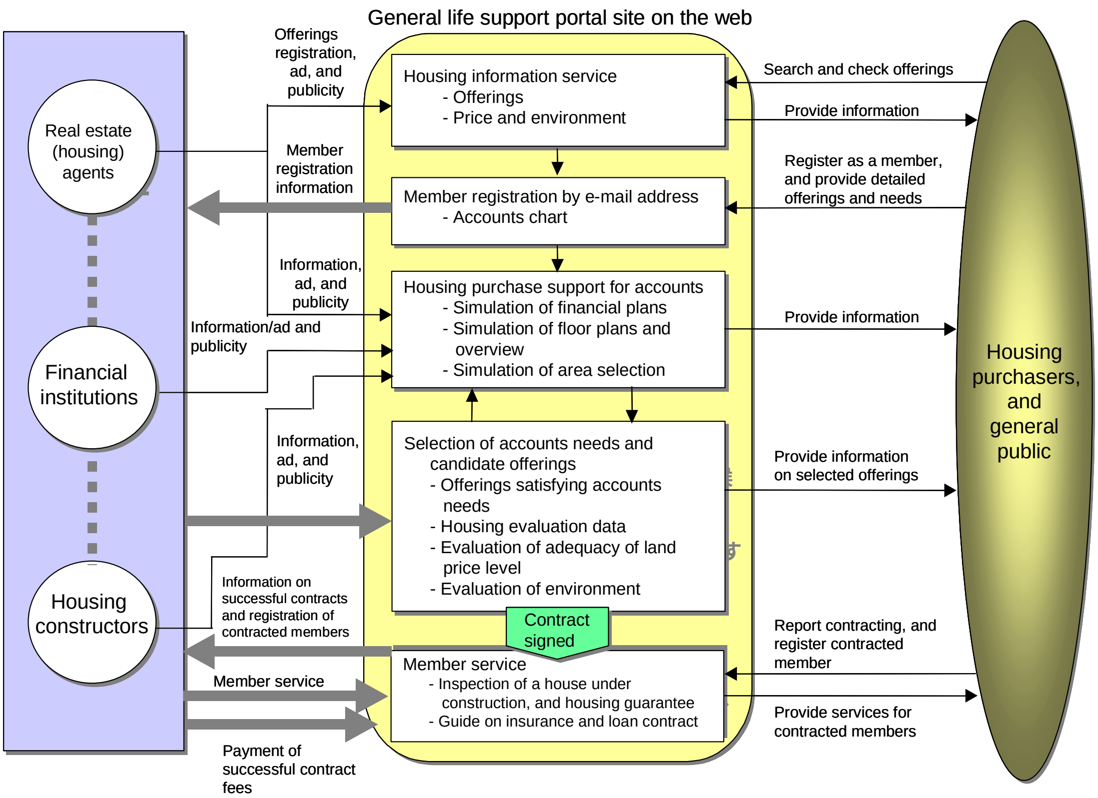
(1) Role and Necessity of Housing Distribution Information System in Development and Activation of Housing Market

To assist in the voluntary growth and development of the housing distribution and rental market, the three market players of housing demander, supplier (constructor), and information and service provider should actively access and utilize high-quality information in their housing selling and buying activities, rental transactions, and provision of brokerage, and information service. This requires organization of information on the existing housing stock and on the rapidly growing new merchandise housing and other housing assets, together with establishment of a system to effectively use the information organized. It is possible for the housing distribution information system, over the popular and widespread Internet, to bring housing purchasers and suppliers together despite distance and time. That is, the housing distribution information system is an indispensable infrastructure for developing and vitalizing the housing market.

(2) Functions Required for Housing Distribution Information System

The scheme of a typical housing distribution information system is described below using a business model.

Figure 6-11 A Business Model of Housing Distribution Information System



Source: JICA Study Team

The important point is who should construct and operate the housing distribution information system, and who bears the funds required.

Let us first consider who bears the funds. Transfer of the cost of the housing distribution information system to end users (housing purchasers) is not recommended because the cost transferred will eventually be lost and gone in the course of continuing price competition. The housing development, construction, and intermediary marketing companies, and banks, and other housing purchase funds lending entities may be able to bear the funds. The housing development, construction, and intermediary marketing companies can find (latent) customers, and hopefully increase marketing routes by providing services to end users using the housing distribution information system. The banks may wish to use the housing distribution information system to offer value-added services to end users, to increase the sale of personal housing loans while controlling the relevant marketing expenses at a reasonable level. Both categories of business entities therefore may find a way to bear the funds in the form of fees for carrying offerings in publicity media, introduction or intermediation of business items (latent customers), and remuneration for successful contracts.

Who then would operate the housing distribution information system? The answer is an Internet portal site. Portal sites possess a huge amount of information on (latent) customers, and exchange various types of information with the general public day after day. The “entrance” to information exchange for general public, or portal site, is the right place to construct the housing distribution information system and provide services effectively. One can also entrust the housing developers, constructors, and marketing agents, and/or banks to update the local housing distribution information to offset the above funds bearing, at least partially.

Assume a business model for the above housing distribution information system, and you will surely know that the following functions should be available:

- Offerings registering, posting, and advertising function
- Offerings intermediating function
- Offerings searching function
- Financial plan setup function to support housing purchasers
- Posted offerings examination function

(3) An Image of Housing Distribution Information System

To help you understand what actually a housing distribution information system is, the activities of Recruit Co., Ltd., Japan, are described below as an example.

1) Outline of Recruit Co., Ltd.

Established: March 31, 1960

Capital: ¥3,002.64 million

Sales: ¥326,547 million (year ended March 2001)

Employees: 4,254 (including 2,800 regular employees)

Head office: Recruit Ginza 8 Building, 4-17, Ginza 8-chome, Chuo-ku, Tokyo

Business lines

a. Human resource services

(Recruit of human resources, education, career development support, human resource systems, business incubation)

b. Matching services via journals, Internet, etc.

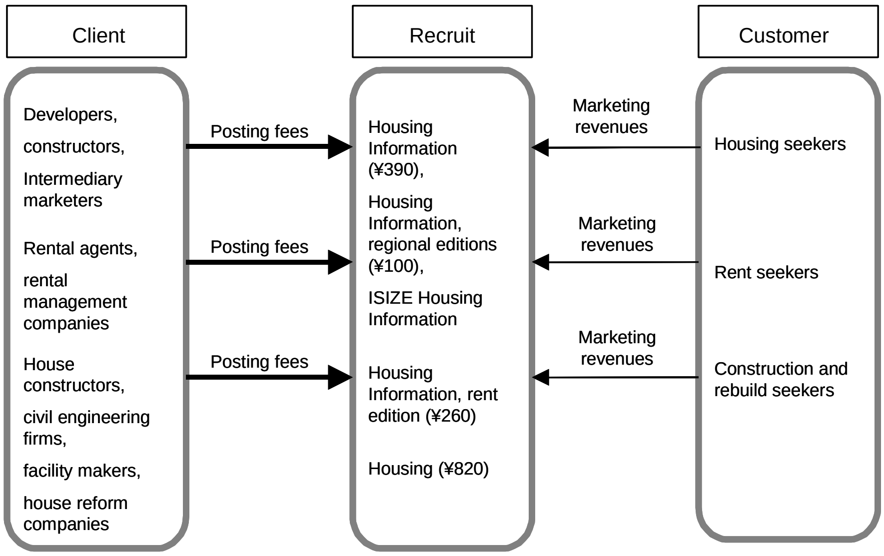
(Topics and categories include housing, travel, automobiles, wedding, learning, finance, etc.)

c. Local area vitalization support

(Publication of regional journals, promotion of moving to and staying in local areas, promotion of local industries)

2) Business Model of Matching Service via Journals, Internet, etc.

Figure 6-12 Business Model



■ **Weekly Housing Information, metropolitan area edition**

Two report pages at ¥2 million/week

Total offerings information **classified** by available railroad: ¥10,000/week

Source: Recruit Co., Ltd.

Recruit uses journals and Internet web sites as the distribution information media. They rely on posting fees paid by the advertisers. The total annual circulation of the journals is 20,980,000 (including both national and regional editions). The journals cover all areas in Japan. The number of households covered is 28 million (60.4% of all households in Japan). No significant competitors exist. The January 10, 1990 issue with 1,940 pages and over 50 mm in thickness was registered on the Guinness World Records as the world's largest information magazine. The number of offerings appearing in the journals per year is 1.12 million.

3) Internet Portal Site: ISIZE Housing Information

ISIZE Housing Information started in January 1999 as an integrated web site covering anything about housing. The Internet portal site provides all necessary purchasing functions including Purchase, Sell, Rent, Build, Resorts, Moving, Housing Loans, etc.

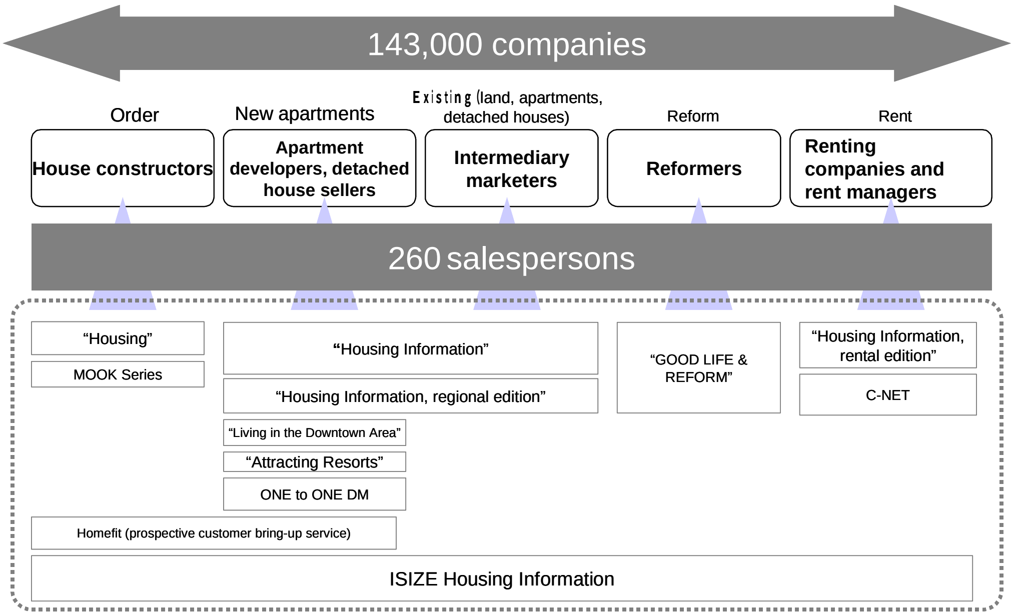
Figure 6-13 ISIZE Housing Information

Source: Recruit Co., Ltd.

4) Finding the Clients (Customers)

The types of clients (or types of offerings handled) are quite diverse, and cover virtually all businesses in the housing industry. Typical clients include developers, constructors, agents, rental managers, house constructors, and house reformers. Two hundred and sixty-eight salespersons make it a rule to personally visit the clients for face-to-face discussion and confirmation of the offerings to be posed. Recruit deals with a total of 14,300 companies.

Figure 6-14 Finding the Clients (Customers)

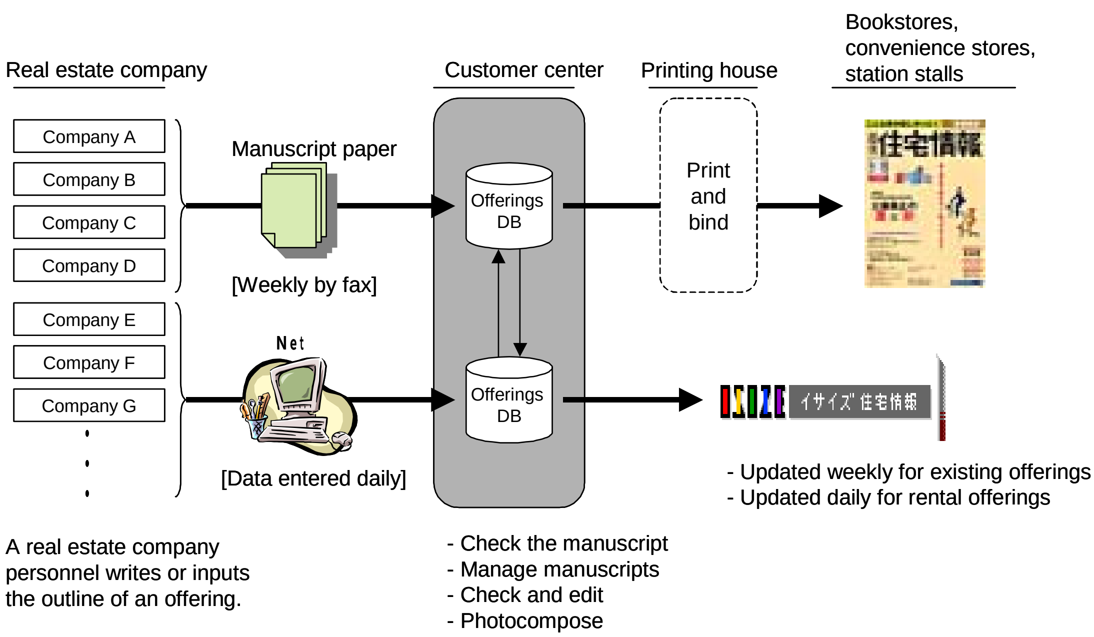


Source: Recruit Co., Ltd.

5) Contents of Information to Be Posted (existing houses and rental offerings)

Basically, the personnel at the real estate company writes down on manuscript paper or inputs into computer the information on an offering, and Recruit edits the manuscript. This is a low-cost operation.

Figure 6-15 Contents of Information to Be Posted (existing houses and rental offerings)

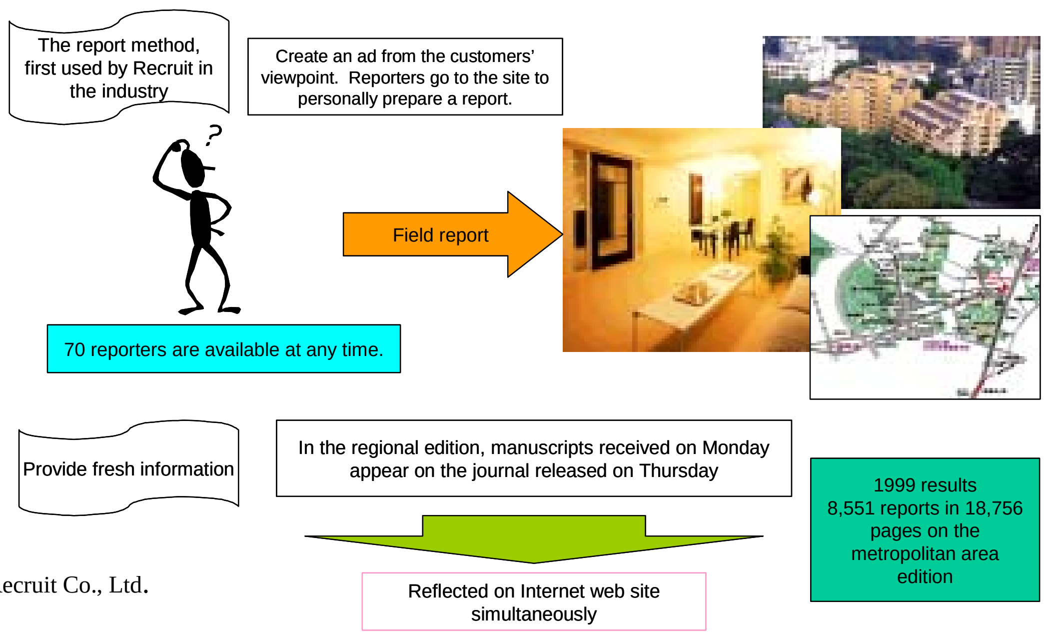


Source: Recruit Co., Ltd.

6) Contents of Information Appearing on the Web Site (new houses)

Recruit samples new house offerings and sends reporters to the site, to evaluate and introduce the offering from the site. Overall, 171 report ads appear weekly on the average. These are edited using a system unique to Recruit. To appeal to the consumers, individual offerings in particular are reported. In addition to salespersons, Recruit hires 70 exclusive reporters who are familiar with the industry. The entire process is increasingly systematized. With the closing date set at Thursday every week, the books with the reports are distributed to the bookstores, shops, and convenience stores on Wednesday in the next week but one. Updates are immediately reflected on the Internet the web pages.

Figure 6-16 Contents of Information to Be Posted (new houses) Source: Recruit Co., Ltd.

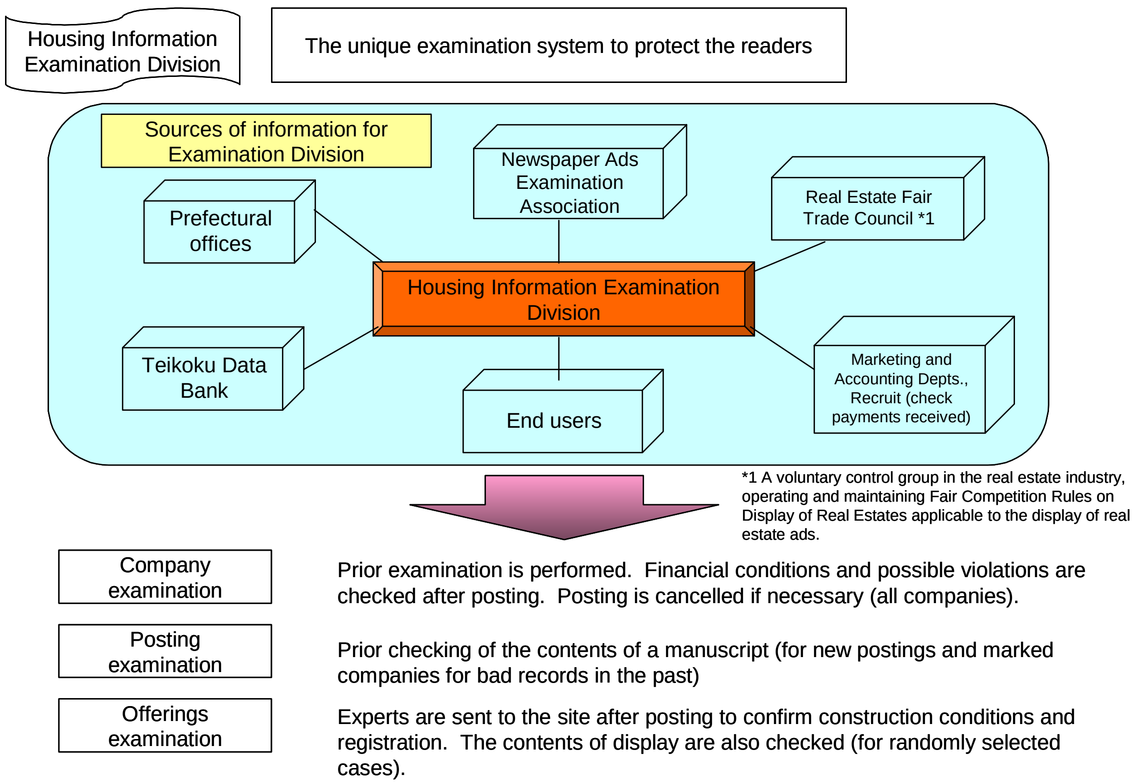


Source: Recruit Co., Ltd.

7) Examination of Information

Recruit operates the unique information examination system to ensure that correct information be given to the consumers. Correctness of information is warranted by prior examination, post-examination of offerings that are randomly picked up, and by operating an exclusive customer claim window.

Figure 6-17 Examination of Information



Source: Recruit Co., Ltd.

(4) Road Map for Construction of Housing Distribution Information System

Housing information construction and continual operation should eventually be performed by private businesses. At the start, however, a certain size must be secured to make the business profitable for private companies. In addition, initial investment risk always exists in the construction of an information system. In China where old company dormitories constructed during the planned economy periods exist and form a substantial housing stock, national financial funds should be used to some extent to stimulate construction of a scheme of effective utilization, maintenance, and renewal of these social capitals. From this viewpoint, one of the alternatives is for Housing Bureau of a local government to take the initiative and set up and operate its own system to introduce the basic functions. For example, Housing Real Estate Exchange Center may introduce the functions. A certain private business in China already carries housing information over the Internet and is going to deploy more than 1,000 housing agent chain shops (for introducing not only its own but also other companies' offerings) throughout China by the end of next year. These shops may compete with public sector organizations including Housing Real Estate Exchange Center. Eventually, however, the information providing developers and house constructors have the right of selection, so that what is good will survive and thrive while what is not good goes out of business.

The housing distribution information should be supplied through not only intermediary marketing stores but also paper media, including weekly journals so that those who have no PCs and non-Internet users can equally have the opportunity to access the information.

6.2. People Development and Qualification System for Housing Finance

6.2.1. Necessity of People Development Systems

(1) Organizations' Viewpoint

Two focal points in the reform of the housing finance system in China are (1) construction of a housing political finance scheme to support housing development, and (2) establishment of risk management system to support a sound housing finance system. As China is now a regular WTO member, both housing and finance industry will soon face severe international competition. Foreign companies will invest in the private housing and finance business five years later. That is, commercial banks in China will then have the opportunity to compete with foreign commercial banks on equal terms relying on their own physical strength (scale), and the level of total service they can offer to the general customers. One may say that the quality of services rendered will decide the winner.

Excellent human resources are indispensable for the administration to develop and provide efficient guidance to businesses, and for the businesses (banks) to offer enhanced services to the customers. Improvement of staffs' ability at this time and on a long-term basis is very important for both Ministry of Construction (MOC) (responsible for housing promotion) and People's Bank of China (PBC) (responsible for finance supervision).

PBC recognizes the importance of people development. Educational and training programs are being prepared and the facilities under construction. Major commercial banks also educate and train their staffs on a continual base, more or less. Foreign-affiliated banks accepted staffs from Chinese financial institutions to train them in international exchange programs. All these instances, however, are basically short-termed and individual, with a limited number of participants. A comprehensive development plan backed by sophisticated human resource strategies is missing in China. People development programs specialized in housing finance do not exist either.

Provident Fund Management Center (PFMC) lacks human resources partly because of difference in size of organizations in general. In spite of government assistance, PFMC entrusts not only loan examination, but also fund operation to commercial banks because the responsible department lacks people, and the persons in charge lack business ability. This is the reason why a large amount of deposits and many loan applications flow into certain leading commercial banks, where the funds are arbitrarily operated. This is a problem from the viewpoint of safety and public interests held for the housing provident funds. As is well known, these funds are of public nature, being collected from urban workers and enterprises as forced savings. The spirit of housing policy is not well permeated to the general public through the provident fund system against expectation.

(2) Individuals' Viewpoint

In China as well as in any other country, an expert vocational ability is necessary if one wishes to be able to voluntarily select one's career, and seek a position that suits for the value and vocational belief of one's own, whether one is in or outside the administration or a financial institution. You need to acquire expert vocational ability and technology that are useful in other fields of activities, if you want to be successfully changed in job assignment within the organization or transferred, or the job switched rather than losing your job.

Organizations facing severe competition tend to recruit the required labor (human resources) of adequate quality, when it is required, by the required number, rather than generously holding an affluent amount of labor at all times. This is the reason why workers assert in recent years the right of developing vocational ability. It is important for organizations wishing to recruit and keep excellent human resources, to assist in furtherance of the ability of the individuals to advance their career, and fuse the efforts of the organization and individuals together. This may seem contradictory, but attests to the fact that enhancement of individuals' business ability and expert technology are inseparably associated with the growth (or extinction) of an organization.

Individuals engaged in the housing finance business must have knowledge, skill and technology, on finance and construction industry, and also cross-industry complex knowledge. It is necessary to develop people for the sake of individual organizations and at the same time to develop generally able people.

6.2.2. Construction of People Development System

(1) Training System

1) Training Should Be Emphasized

Three basic means of people development are basic education, training, and lifelong learning for self-development.

Expert staffs in housing finance must be university graduates (basic education) in the first place. Self-development is personal responsibility to accumulate culture throughout life. Individuals should voluntarily learn and practice according to their own needs, and any organization should not be expected to do this on behalf of individuals.

The basic idea of people development in the housing finance system to be established, is to utilize the level of the basic education of individuals, and provide training to assist in self-development of individuals. Establishment and maintenance of a training system in workplace is most important.

2) Development of Expert Knowledge and Ability Should Be Emphasized

The purpose of training is not enhancement of personal culture and acquisition of general knowledge, but should be development of expert knowledge and ability related to the associated industry or organization.

Excepting high-level expert knowledge and sophisticated technology, the basic expert knowledge and ability would cover the topics of personnel, labor, ability development (management and supervision), accounting and finance, sales and marketing, production control, law and general affairs, publicity and advertisement, logistics, information and business control, management planning, and international business. The basic items are listed below.

Table 6-3 The Basic Items of the Expert Knowledge and Ability

Ability	Minimum required level
Knowledge, skill, and culture regarding special field	Basic and the lowest required contents studied at the university
Communication	Presentation ability, writing logical sentences, use of foreign language, self-expression skill, etc.
Basic information processing and operation of Office Automation (OA) equipment	Technical skill
Basic management	Skill for basic management of daily work
Problems identification, analysis, and solution	Conceptual skill
Adjustment of human relations	Conflict between individuals and between individual and organization, social human skill

Source: JICA Study Team; based on materials from Japan Labor Study Mechanism

Business career systems are generally used to develop basic vocational ability in Japan. The systems are designed to assist the white colors and other people to acquire expert knowledge and ability required for execution of duties systematically and step by step. The central government does not directly provide training but private training organs operate official courses, and completion tests are conducted to objectively evaluate the achievements. Those who prove a certain level in the final examination will receive a completion certificate. The certificate may be used as a means to evaluate vocational ability of employees in the personnel treatment system.

Housing finance requires high-level expert vocational ability. In addition to the above developmental and basic training, two other common training themes are appropriate: (1) real estate (housing in particular) business related to construction industry, and (2) housing loan, mortgage and guarantee, and insurance business related to financial business.

3) Development of Generally Able Persons Should Be Emphasized

Public institutions needing an administrative reform, and private businesses facing severe competitions no longer rely on conventional long-term stock type employment. Education and training cost is curtailed to the minimum, and they are eager to recruit immediately usable people.

This can be an effective means of organizational or personnel reform for an organization (ex: commercial banks). Importantly, these immediately usable persons will sooner or later be short supplied when the demand and supply balance is lost. Moreover, distribution is unbalanced due to the market mechanism. To break through this situation, the administration should take the initiative in making a top-down adjustment. That is, a human resource development infrastructure must be established in cooperation with the responsible organs for developing finance and housing (PBC and MOC).

When constructing the basic human resource development infrastructure, one should set up a common level of expected knowledge and ability required for the associated industry, and use it as the platform for developing people. One should not try to look into detailed training programs to be used at individual organizations, or to comply with the objectives of human resource development sought by individual institutions. The true objective is to develop generally able persons who are not limited to particular organizations or businesses, but are ready to work in a moving and changing environment. These people will surely support the level of industry in the future in this country.

(2) Vocational Ability Evaluation System

1) Use of Qualification System

A fair yardstick is necessary to objectively evaluate vocational ability and the level of generally able persons. Qualification systems are generally used to show the index of vocational ability. Existing qualifications such as doctor, lawyer, licensed tax accountant, certified construction consultant, etc. are based on the social vocational ability evaluation systems.

In Germany, even industrial and handicraft qualifications are used. Any person who graduates from a professional school and practices at an enterprise (systematic vocational training), will acquire the qualification of Facharbeiter by vocation or Geselle on passing the final examination. In Britain, National Vocational Qualification (NVQ) system is universally used. The qualifications in the system cover approximately 90% of all types of businesses in U.K. Qualification is given in five different levels of competence. Banking Diploma of Institute of Bankers has a long history, and the contents are constantly updated to meet the contemporary requirements. The bank staffs in U.K. attend the training course and night classes of a college to acquire qualifications. In Japan, various qualification systems, which might be said too much complex in a sense, do exist at the national, industrial and corporate level.

2) Relation between Training and Qualification System

To make training effective and attractive for both organizations and individuals, training should be interconnected with acquisition of qualification. That is, simultaneous construction of training and qualification system is important.

The merits of qualification in an organization are described below.

a. Satisfy the legal and business requirements (establishment of business infrastructure and enhancement of the competitive power)
b. Promote learning of vocational knowledge, skill, and expert technology by staffs (development of vocational ability of human resources)
c. Appeal the human resources and ability of the organization to outer world (enhancement of presence of the organization)
d. Complement evaluation of working ability within the organization (enhancement of transparency and soundness of personnel system)

3) Linkage between External Qualification System and In-house Vocational Ability Evaluation System

Growth of an organization depends on whether excellent human resources are recruited or not in this age when people are changing occupation frequently. It is important for organizations to enhance employees' affection for business and organization by proposing organizational potentials, and giving incentives appropriate to excellent employees.

Qualification systems not only improve organizational power through enhanced expert ability of employees but also favorably affect employee motivation, morale improvement, attachment to organization, and sincerity in doing business. With this in mind, training, qualification, and personnel systems should be operated in combination. That is, the results of training should be reflected in the qualification system, and the personnel system connected to in-house vocational ability evaluation system that considers qualification achieved.

It is important for China (the government and the private sector alike) to construct a scheme to link vocational ability evaluation systems with personnel, treatment, and vocational ability development system.

6.2.3. Development of Housing Finance-related Human Resources and Qualification System

(1) Comprehensive Training System

Housing finance business varies with region, loan execution financial organs, and the character of the organization (public or private). Different know-how is required for the staffs if these conditions are different. In spite of these different situations, however, common requirements, stemming from the basic housing finance, exist for both principal and general staffs: minimum level of expert knowledge on housing and financial transactions, development of high-level ability for management and marketing, loan examination, fund operation, and credit management, and enhancement of the relevant business processing ability.

For an integrated overall housing finance system to function effectively, people with a certain level of knowledge, skill, technology, and know-how must work together in harmony. This common work is certainly sustainable because the related personnel may already have a certain level of general basic education before employment, but a vocational training infrastructure is very important to keep the standard for the common work.

Legislation and administrative intervention with laws, notifications, and instructions are not sufficient to fully transplant the essence of the state's financial, housing, and industrial policy, and industrial technology into the level of respective organizations and individuals. Flexible permeation through jobsite training is most effective.

With this in view, the overall training system for housing finance should be constructed as an entire system from the very beginning of conceptual design. The following points should be considered when designing an integrated training system:

1) Integrated Training Organization

A vertical streamlined training organization covering both financial and housing industry should be established, such as: Central Housing Finance Training Center (tentative).

Before starting on this, some preparations and training know-how are required such as construction of facilities, start-up of training programs, and recruit of teachers. The recommended and practical first step is reinforcement of the existing training systems at PBC and MOC, and establishment of new training programs focused on housing finance. The human resources development-related departments at both organizations should lead the project, and make necessary adjustments with the related departments at commercial banks and local construction departments.

The overall steps are described below.

a. PBC and MOC adjust the training systems within their own organization, integrate them into a vertical training system, and develop housing finance-related training programs.

b. PBC and MOC tie up to share housing finance-related training programs, mutually use their training facilities, and set up a network of common instructors, eventually constructing a common system for some training entities.

c. PBC and MOC jointly construct a common housing finance-related training facility and start up common training programs.

d. Central Housing Finance Training Center (tentative) and its local centers are established when necessary to construct a nationwide training system network. Central Housing Finance Training Center (tentative) will have the secretariat and various functional departments responsible for training operation, teaching materials, training facility management, etc. Depending on the overall size, an instructor development and procurement department will be required.

2) Use of Existing Facilities and Information Networks

PBC currently operates Beijing Training Center (mainly for middle and upper class principal staffs including managers and above) and Zhengzhou Training Center (general principal staffs including sub-managers and below, and technical staffs), although these are not particularly specialized in housing finance. Some local branches operate small-sized training centers. All major commercial banks operate training centers (also used for other purposes) of variable sizes.[1] MOC is more or less in the similar situation except that the shape is somewhat different.

Construction of an integrated training system is actually integration of supervising organizations, and of the contents of training programs. Existing facilities such as training centers operated by commercial banks should be used to the extent possible. Facilities attached to university may also be used.

(2) Complex Training Programs and Diverse Training Shapes

1) Complex Training Programs

Housing finance concerns long-term and small personal loans, in principle, unlike corporate loans. Different know-how from conventional corporate loans is required. Housing finance is sometimes asked to contribute to housing promotion through guidance policy finance and reflect the government's finance policy. The housing finance staffs, senior ones in particular, must have interdisciplinary knowledge and vocational ability. With this in mind, the contents of a training program should be cross-functional. Note that individual trainees need not necessarily be well versed in all business fields, but learning the basic knowledge about the related industries is very beneficial in executing the daily business.

When developing a housing finance training program, be sure to purposefully develop a complex one. To be specific, each program should be developed after defining the level of target trainees, purpose of training, expert area emphasized, type of vocational ability to be developed, and the associated qualifications obtainable.

The principal staff training courses should be divided into primary (chief section members and section chiefs), intermediate (managers and superintendents), and advanced course (above managers). General staffs may attend the primary (new employees), intermediate (experienced), or advanced course (careers). Expert training should be divided into finance and housing course, each possibly including topics on related fields.

Typical topics are tabulated below.

[1] From the hearings of graduate students at Beijing Training School, PBC

Table 6-4 Typical Topics of the Expert Training

Field	Contents
Finance	Loan examination, guarantee and insurance, credit management, credit recovery, resolution of bad loans, etc.
Housing	Appraisal, transaction, mortgage, guarantee, and registration of real estate, etc.
Related topics	Computer system, accounting, treasury, audit, legal, information processing, etc.

Source: JICA Study Team

Something like a “communication bridge” should be built between creditor and debtor to successfully recover the credit claimed for compensation. Then counseling is provided in the hope of enabling the debtor to pay. It is important to establish human reliability between the parties concerned. Considering this point, the training programs should emphasize on not only acquisition of professional knowledge but also learning of communication know-how to survive in this industry.

2) Diverse Training Shapes

The above discussion is focused mainly on the training of staffs at PBC and MOC. Considering the balance among training needs, preparation of training facilities, and program start-up, a variety of training shapes should be available at least in the initial period.

One of the alternatives would be to open associated expert courses or dedicated lectures at universities. Recommended time zones would be nighttime for a relatively long-term continuous training, and winter and/or summer vacation periods for short-term intensive training. Instructors may be recruited and educated smoothly if the university is willing to cooperate.

Other possible means to be taken in the initial stage of the project include to open cable television training courses using communication means connected to the existing information network, and remote Internet training courses. Note that these means are suitable for the introductory courses, and not for high-level training.

(3) Qualification Obtained Step by Step

1) Use of Existing Qualifications and Support of Acquisition

The table below shows the business fields, the contents of the business, and official qualifications acquired by staffs at banks engaged in housing finance business in Japan.

Table 6-5 The Fields, the Contents and the Official Qualifications acquired by Staffs at Banks Engaged in Housing Finance Business in Japan

Field	Contents		Official qualifications (incl. state qualification)
Finance	Personal	Knowledge of loans, fund operation, and tax for individuals	PF class 1, PF class 2 (personal), licensed tax account, certified public accountant, social insurance consultant
	Corporate	Knowledge of loans, fund procurement, tax and law for corporations	PF classes 1 & 2, licensed tax account, certified public accountant, social insurance consultant, securities analyst, smaller enterprise consultant
Credit management and recovery	Laws on credit management and recovery, practical knowledge, know-how of credit recovery		-
Insurance	Knowledge of insurance merchandise, tax and legal knowledge required for marketing (sales)		Actuary, PF class 1, PF class 2 (life insurance), PF class 2 (nonlife insurance)
Tax and laws	Expert staffs on tax and laws		Licensed tax accountant, certified public accountant, patent attorney, judicial scrivener, those who passed the second legal examination, bookkeeping license classes 1 & 2
Real estate	General marketing		Residential land and building transaction superintendent, land and building surveyor, real estate appraiser
	Appraisal		Real estate appraiser
	Development		Construction consultant
	Property management		Building management consultant
System	Expert knowledge of system development		Information processing engineer classes 1 & 2, junior & senior system administrator, system operation & management engineer, database specialist, network specialist, application engineer, system audit engineer, system analyst, database search engineer, etc.
Miscellaneous	Qualifications useful for the entire organization		Clerical specialist, consumer life adviser, etc.

Source: JICA Study Team; based on the materials from Bank Labor Study Association

Many state qualifications exist in China and people can obtain them by efforts. The first step in construction of housing finance-related qualification system is to effectively use existing qualifications related to housing finance. That is, organizations should actively assist the housing finance staffs to acquire qualifications relevant to their respective work type and career (assuming voluntary efforts of individuals at the same time). Training programs to be used at this time would preferably include certain qualification acquisition courses.

2) Qualification Systems at Three Levels

Qualification systems should be constructed to allow gradual progress of the learners. The purpose of the qualification system for organizations is not just acquisition of qualifications by the employees, but gradual advancement of their business doing ability and performance through continued efforts aiming at acquiring a qualification. Different levels of qualification systems should be established.

Qualification systems are generally set up at three different levels as shown in the table below.

Table 6-6 Qualification Systems of Three Different Levels

Level	Scope of application (Official scope)	Contribution to organizations (Possibilities)
State qualification State-level approval and license	Nationwide (some are internationally accepted)	- Contribute to promotion in state of an organization - Contribute to enhancement of human resource level for the entire organization - Contribute to enhancement of performance of the entire organization - Appeal to the external world with greater impact
Qualification, approval, and license used in a particular industry Qualification, approval, and license commonly used in more than one industry	Within the industry(ies)	- Contribute to enhancement of human resource level for the entire organization - Affect enhancement of the performance of organization
Qualifications used in respective organizations (business ability assessment standard)	Within the organization (ex. within a bank or a group of banks)	- Contribute to enhancement of basic human resource level - Affect enhancement of the performance of organization - Contribute to transparent and objective personnel evaluation

Source: JICA Study Team

The most limitative qualification within an organization is the in-house qualification that is based on the ability of employees, contents of work, educational background, years of continuous service, and other standards irrespective of promotion in the line (this is usually considered separately). In-house systems should naturally respect common qualifications such as state and industry qualifications acquired by employees, but remember, in-house systems are by nature different from state systems.

(4) Future-oriented Housing Finance Qualifications

The relation among real right, credit, mortgage, and other rights associated with housing can be very complex in China because the civil codes are not sufficiently established. Generally, real estate transactions frequently involve problems, and this is not limited to China.

Escrow (third-party guarantee of a transaction) is a means to make real estate transactions safe and to establish a sound and efficient housing finance system. With this method, a third party having no interest with seller, purchaser, and agent conducts property-related business on their behalf to ensure safety and certainty of the housing transaction.

To be specific, the escrow agent holds the housing (real estate) that is effectively contracted, and performs the following business on behalf of the contracting parties:

1) Survey right to the property, and its contents
2) Pay the housing loan equivalent amount temporarily on behalf of the contractor
3) Confirm delivery of the right of payment of contract amount
4) Confirm delivery of right, etc.

Various existing state qualifications must be fully used, and a comprehensive range of housing finance-related qualifications must be introduced to affirm business performing ability and reliability of the third party.

We recommend introducing the “Housing finance administrator” (tentative) qualification to certify that the person so qualified has sufficient knowledge of loan business (loan examination and execution, credit management, recovery, etc.), and a minimum required level of knowledge of escrow that is designed to assure rightful execution of a housing (loaned property) contract by entrusting it to a reliable third party.

The housing finance administrator (tentative) qualification should be included in the housing finance training system as an integral part of it. The staffs of financial institutions should take a training course which aim is to give them knowledge of loan business (loan examination and execution, credit management, recovery, etc.), including the latest information on public housing finance system, and knowledge of escrow. The trainees then take the examination for housing finance administrator on completing the course. MOC, PBC and other responsible organs will contract out the examination questions to suitable vocational ability evaluation institutions, and approve the qualification for those who pass the examination.

When actually practicing this system, coordination with and distinction from the existing qualifications (real estate, land, and public land appraiser) is necessary. Importanlty, training should not be just once but should be periodically performed, this being a condition for renewal of the qualification.