

## Why is JFC the most creditworthy FILP agency?

### Merger effects and institutional differences with other FILP agencies

- Some market participants say that Japan Finance Corporation (JFC) is most creditworthy
- Policy finance institutions ensured market credibility even when Koizumi administration implemented special public corporation reform
- Background factors include institutional gaps such as MOF's overseeing and budget approval by Cabinet and Diet
- Consolidation of policy finance institutions enhanced JFC's presence
- Internal reserve rose vs. pre-merger level

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### Some say that JFC is most creditworthy FILP agency

#### JFC is most creditworthy FILP agency

It is generally said that the bond market calls for gaps among issuers. However, we wonder whether there is a ranking or gap among FILP agency bonds. The existence or non-existence of rating gaps differs by rating agencies. Regarding the issuance spread, there is no difference at the moment if the BIS risk weight is 10%. Although market participants have various valuations, some say that Japan Finance Corporation (JFC) is the most creditworthy.

### High creditworthiness of policy finance institutions and rise in JFC's presence

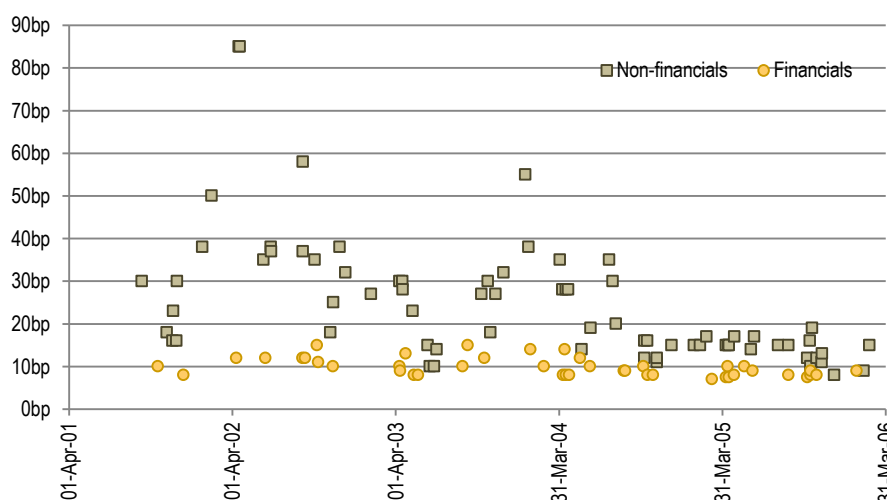
Why? This is because the presence of the JFC was enhanced by the consolidation of policy finance institutions via the reform, on top of high creditworthiness of policy finance institutions. We attribute their high creditworthiness to the institutional difference with other FILP agencies. In this report, we explain these points.

### Gap existed between financials and non-financials when issuance of FILP agency bonds started

#### No change in spreads of financial FILP agency bonds, despite storm caused by reform of special public corporations

Issuance of FILP agency bonds started in FY01. The timing was the worst as such agencies faced the severe storm caused by the reform of special public corporations by the Koizumi administration. However, market valuation was completely divided into that for financials—i.e., policy finance institutions (such as finance corporations and banks) and non-financials—other FILP agencies (e.g., public corporations and business corporations).

Chart: Issuance Spreads of 10-year FILP Agency Bonds



Source: Compiled by Daiwa Securities.

**Issuance spreads of non-financial FILP agency bonds volatile, but those of financial FILP agency bonds stable**

Chart 1 shows issuance spreads of 10-year FILP agency bonds at the time of the start of the issuance of FILP agency bonds. Reflecting media reports and then-Prime Minister Junichiro Koizumi’s remark that “all special public corporations should be liquidated or privatized,” spreads of non-financial FILP agency bonds were volatile, ranging from the 10bp to the 80bp level. The spreads finally tightened with less volatility after mid-FY04 when the law concerning the privatization of four highway-related public corporations was enacted. Meanwhile, spreads of financial FILP agency bonds changed little at the 10-15bp level, indicating that the market relied heavily on financial FILP agency bonds.

**Competent ministries responsible for businesses at ordinary gov’t agencies**

**Institutional endorsement—involvement in MOF, Cabinet, and Diet**

Why did the market rely on them? One possible reason is the difference in the institutional scheme. Ordinary government agencies submit their annual budget plans to competent ministers, and they only have to receive assessment on earnings results from competent ministers. In short, competent ministries are responsible for businesses at ordinary government agencies.

**Not only competent minister but also MOF/Cabinet/Diet responsible for businesses at “gov’t-affiliated agencies”**

However, “government-affiliated agencies” submit the tax-and-spend plan to the finance minister via the competent minister, although they are also government agencies. The plan is submitted to the Diet after receiving approval in a Cabinet meeting, and then a vote is needed for the plan. The earnings results are submitted in the same order. In other words, not only the competent minister but also the Ministry of Finance (MOF), Cabinet, and Diet are responsible for businesses at “government-affiliated agencies.” All financial FILP agencies, whose spreads were not affected by the storm caused by the reform of special public corporations—i.e., policy finance institutions—were “government-affiliated agencies” (Chart 2).

**Chart 2: Transition of “Gov’t-affiliated Agencies”**

(FY)	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
The Okinawa Development Finance Corporation	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
National Life Finance Corporation	○	○	○	○	○	○	○	○										
Agriculture, Forestry and Fisheries Finance Corporation	○	○	○	○	○	○	○	○										
Japan Finance Corporation for Small and Medium Enterprise	○	○	○	○	○	○	○	○										
Japan Small and Medium Enterprise Corporation's credit insurance division	○	○	○	○														
Japan Finance Corporation*								→○	○	○	○	○	○	○	○	○	○	○
Japan Bank for International Cooperation II	○	○	○	○	○	○	○	○				↓○	○	○	○	○	○	○
Japan Bank for International Cooperation*												↓○	○	○	○	○	○	○
JICA loan assistance division**								→○	○	○	○	○	○	○	○	○	○	○
Development Bank of Japan	○	○	○	○	○	○	○	○										
Development Bank of Japan*								↓○	-	-	-	-	-	-	-	-	-	-
Japan Finance Corporation for Municipal Enterprises	○	○	○	○	○	○	○	○										
Japan Finance Organization for Municipal Enterprises								↓○										
Japan Finance Organization for Municipalities									↓○									
Government Housing Loan Corporation	○	○	○	○	○	○												
Japan Housing Finance Agency**							→○	-	-	-	-	-	-	-	-	-	-	-

Source MOF, company materials; compiled by Daiwa Securities.  
 Notes: ○ indicates “government-affiliated agency” and arrows mean organizational change.  
 \*Joint stock company.  
 \*\*Incorporated administrative agency.

**Some appeared to say that policy finance institutions were safe, given support by MOF**

Another reason behind the reliance on policy finance institutions was also the difference in schemes, in our view. The Government Financial Institutions Division in the MOF’s Minister’s Secretariat oversees policy finance institutions jointly with other competent ministers. As most people know, the MOF is called the strongest minister having the authority to compile the budget. Amid the reform, some appeared to say that policy finance institutions were safe, given support by the MOF.

**Koizumi administration reformed policy finance institutions as well**

**JFC established by consolidation of some policy finance institutions**

In the first-half round of the special public corporation reform, the Koizumi administration privatized expressway companies and international airports. In the second-half round, the target was shifted to policy finance institutions, and they were substantially reorganized.

**JHF, JFME, and DBJ no longer “gov’t- affiliated agencies”**

First, the Government Housing Loan Corporation was reorganized to become the Japan Housing Finance Agency (JHF) in FY07, with a drastic review of the business outline. In FY08, Japan Finance Corporation for Municipal Enterprises was reorganized to become the Japan Finance Organization for Municipal Enterprises (JFME), and its ownership was shifted from the central government to local governments. Also in the same year, Development Bank of Japan (DBJ) was converted into a joint stock company as the policy of full privatization was determined. Since the reorganization, these three entities are no longer “government- affiliated agencies.”

**Decline in no. of “gov’t- affiliated agencies” boosted presence of JFC**

Meanwhile, JFC was established through a merger of National Life Finance Corporation (NLFC), Japan Finance Corporation for Small and Medium Enterprise (JASME), Agriculture, Forestry and Fisheries Finance Corporation (AFC), and a part of Japan Bank for International Cooperation (JBIC). Other remaining “government-affiliated agencies” are only (1) Okinawa Development Finance Corporation, whose organization did not change at all, (2) JBIC, which had been integrated with JFC and then it was split off from the organization, and (3) the JICA loan assistance division, which was transferred from a part of JBIC (Chart 2). As mentioned, three organizations were removed from “government-affiliated agencies” due to the reorganization. JFC was then established via a very large merger of remaining organizations involved in domestic operations, which has naturally enhanced its brand recognition in line with an increase in the presence.

**Sufficient risk buffer alongside consolidation of some organizations**

We can point out one more factor. Before the merger, earnings/expenses at NLFC, JASME, and AFC were balanced by governmental subsidies and they had little internal reserves. Via the very large merger, they become a joint stock company, and funding from the government increased. At end-FY16, the ratio of net assets to the total liabilities and net assets stood at 23.3%, indicating a sufficient risk buffer. This also contributes to making the JFC’s brand more reliable.

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- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

\* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

\*\* The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

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