

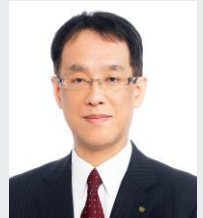
First investments in JASSO bonds

Primarily offers student loans/grants and regularly issues social bonds

- It handles interest-free category 1 scholarship loans and interest-bearing category 2 scholarship loans, both of which must be paid back, as well as grant-style scholarships that do not get repaid. JASSO bonds are a vehicle for funding category 2 scholarship loans
- The percentage of its loans that are past due by at least three months has been declining every year as a result of measures aimed at strengthening collection. Government provides extensional financial support, which puts the organization in the black and stabilizes its financial position
- It began issuing social bonds in FY18 and currently issues Y30 billion of 2-year bonds four times each fiscal year

Credit Memorandum JCRE444
FICC Research Dept.

Senior Credit Analyst
Kouji Hamada
(81) 3 5555-8791
kouji.hamada@daiwa.co.jp



Daiwa Securities Co. Ltd.

JASSO was created through a merger of the Japan Scholarship Foundation with four other entities

Main business is offering student loans/grants

The main business of the Japan Student Services Organization (JASSO) is providing student loans/grants, providing support to exchange students, and providing support for student living costs. One of its predecessor organizations, the Japan Scholarship Foundation, probably had personnel familiar with the student loan/grant business. In FY04, the Japan Scholarship Foundation combined with four other nonprofit entities and a government-operated business to form JASSO.

Scholarship loans and grants-style scholarships, category 1 scholarship loans and category 2 scholarship loans

The student loan/grant business provides scholarship loans that must be paid back as well as grant-style scholarships that do not have to be paid back to students at universities, junior colleges, and other institutions of higher education. It offers two types of scholarship loans, interest-free category 1 scholarship loans and interest-bearing category 2 scholarship loans. Of the 3.48 million students studying at institutions of higher education, 37.2% (1.29 million) of them, or one out of every 2.7, receives funding from JASSO.

The category 1 scholarship loans are primarily funded through interest-free borrowing from the government's general account

Category 1 scholarship loans were first introduced in FY43, and the FY19 budget allows for a total of Y372.4 billion in loans to 570,000 borrowers. The loans are meant for exceptional students that find it particularly difficult to matriculate for financial reasons. The trend away from interest-bearing and toward interest-free has gained momentum in recent years, and since FY17 loans have been awarded to all applicants meeting the lending criteria. JASSO borrows mainly interest-free funds from the government's general account to fund loans to students that are then repaid in installments over a maximum of 20 years following graduation.

Category 2 scholarship loans are primarily funded by JASSO bonds and then converted into FILP loans upon graduation

Category 2 scholarship loans were first introduced in FY84, and the FY19 budget allows for a total of Y676.2 billion in loans to 760,000 borrowers. The selection criteria is looser than for category 1 loans, and once the program was completely overhauled/strengthened in FY99, all applicants meeting the criteria were given a loan. Usage criteria were also relaxed, and the amount of loans grew to a peak around FY12 of about 16x their total amount in FY98, before the overhaul/strengthening was implemented. JASSO uses JASSO bonds to fund its loans to students while they are in school, and once the students have graduated it converts the JASSO bonds into FILP loans from the government, then receives equal repayments of principal and interest for a maximum of 20 years after that.

Grant-style scholarships are a government expenditure on students and do not have to be repaid

Grant-style scholarships were introduced in FY17 and will be awarded to 20,000 students in FY19. These grants were created to support those individuals who have the desire and ability but not the economic means to pursue their education. JASSO provides these funds as a government expenditure and does not need to be repaid by the student.

The enhancement of its scholarship funds has increased JASSO's importance

Scholarships can be used by a greater number of students by combining grants with loans. In addition, many years of continued systems enhancements have raised JASSO's policy importance.

Status of scholarship fund repayment and JASSO's financials

The percentage of loans that were three or more months in arrears was 3.4% at end-FY17

Of JASSO's total loans outstanding at end-FY17, Y7.0498 trillion was lent to students that have already graduated and requires repayment. Of those loans, Y239.8 billion (3.4%) are three or more months in arrears.

That ratio is in a declining trend as result of measures promoting the collection of past due loans

To strengthen the collection of its past due loans, JASSO in principle enrolls all borrowers in an automatic debit program, hires debt collection companies to send out reminders and collect funds on its behalf, has strengthened its consultation mechanisms through call centers, has enhanced legal measures, and makes use of consumer credit reporting agencies. The percentage of its loans past due by at least three months has been declining every year since FY13, when it was 4.6%, to 4.1%, 3.7%, 3.5%, and 3.4%.

Repayment programs take into account the borrower's situation

Additionally, it does not simply promote collection, but offers several programs, including a diminishing repayment plan that reduces the amount of the periodic payment for a specified period and extends the repayment period by up to 15 years, a program that offers a repayment grace period of as long as 10 years when circumstances warrant it, and exemptions from repayments in the case of death or mental/physical disability. It thus pursues collection while taking into account the situations of its borrowers.

It has recorded a profit in 13 of the 14 fiscal years since it was established

Chart 1 shows JASSO's P&L. It receives subsidies from the government in the forms of 1) operational grants to cover personnel costs and administrative costs, 2) interest subsidies to cover the interest-free periods for its category 1 scholarship loans (entire term of the loan) and its category 2 scholarship loans (while the borrower is a student and during grace periods after graduation), and 3) straight subsidies to cover the costs of repayment exemptions and the amortization of un-collectible loans. In 13 of the 14 fiscal years from when JASSO was established in FY04 until FY17, JASSO has recorded positive recurring profit and net profit. It recorded a loss in FY08, but primarily because of a change in how it calculated reserves to ensure proper loan management, and its profit/loss balance has consistently been stable.

JASSO bonds are general security obligations that rank high in seniority

In addition, JASSO bonds are general security obligations. With its stable income and short maturities, there is little need to anticipate unusual events, and even in that case, the amount outstanding in FY17 shown in Chart 2 was Y240 billion as opposed to long-term loans of Y9.2484 trillion, a ratio of 2.5:97.5, giving them high seniority rank.

Chart 1: Income Statement at JASSO (Y bn)

	FY15	16	17
Recurring revenue	103.4	98.9	95.1
Government grants, subsidies, etc.	56.6	52.8	51.0
Interest on student loans	38.7	37.4	35.0
Others	8.0	8.6	9.0
Recurring expenses	99.4	94.5	91.2
Scholarship loan programs	80.9	75.3	72.3
Support for international students	15.9	16.6	16.2
Student support programs	0.3	0.3	0.3
General and administrative expenses	2.3	2.3	2.5
Recurring profit	3.9	4.4	3.8
Net income	7.4	6.3	6.0

Source: JASSO; compiled by Daiwa Securities.

Chart 2: Balance Sheet at JASSO (Y bn)

	FY15	16	17
Assets	9,119.7	9,598.0	9,598.0
Loans	8,751.5	9,207.9	9,207.9
Others	368.2	390.1	390.1
Liabilities	9,052.7	9,521.0	9,521.0
Bonds	350.0	240.0	240.0
Long-term borrowings	8,677.3	9,248.4	9,248.4
Others	25.4	32.6	32.6
Net assets	67.0	76.2	76.2
Common stock	0.1	0.1	0.1
Capital surplus	36.1	33.0	33.0
Retained earnings	30.8	43.0	43.0

Source: JASSO; compiled by Daiwa Securities.

Starting with the bonds that had terms set in August 2018, it has obtained a second opinion on social bonds

Overview of JASSO bonds

The JASSO bonds that had their terms set in August 2018 or later receive a second opinion that they qualify as a social bond as defined by the International Capital Markets Association (ICMA) from Vigeo Eiris, a France-based ESG evaluating institution. The use of the funds, as already described, is to provide category 2 scholarship loans to current students, which contributes to the United Nations' 4th sustainable development goal (SDG):, quality education for all. As of April 2019, 20 investors, both domestic and overseas, have issued investor statements.

Terms are set for Y30 billion of 2-year bonds in May, Aug, Oct, and Jan

Since FY13, terms for JASSO bonds have been set four times a year, in May, August, October, and January, each a Y30 billion issue of 2-year bonds; this gives the timing of the bond's issue a high degree of reliability.

Explanatory Document of Unregistered Credit Ratings

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- 1) Duty of good faith.
- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
- 3) Prohibition of the ratings in cases where Credit Rating Agencies have a close relationship with the issuers of the financial instruments to be rated, etc.
- 4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

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■ Credit Rating Agencies

[Standard & Poor's]

The Name of the Credit Rating Agencies group, etc

The name of the Credit Rating Agencies group: S&P Global Ratings ("Standard & Poor's")

The name and registration number of the Registered Credit Rating Agency in the group: S&P Global Ratings Japan Inc. (FSA commissioner (Rating) No.5)

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The information is posted under "Unregistered Rating Information" (<http://www.standardandpoors.co.jp/unregistered>) in the "Library and Regulations" section on the website of S&P Global Ratings Japan Inc. (<http://www.standardandpoors.co.jp>)

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[Moody's]

The Name of the Credit Rating Agencies Group, etc

The name of the Credit Rating Agencies group: Moody's Investors Service ("MIS")

The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

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The information is posted under "Unregistered Rating explanation" in the section on "The use of Ratings of Unregistered Agencies" on the website of Moody's Japan K.K. (The website can be viewed after clicking on "Credit Rating Business" on the Japanese version of Moody's website (https://www.moody.com/pages/default_ja.aspx))

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[Fitch]

The Name of the Credit Rating Agencies group, etc

The name of the Credit Rating Agencies group: Fitch Ratings ("Fitch")

The name and registration number of the Registered Credit Rating Agency in the group: Fitch Ratings Japan Limited (FSA commissioner (Rating) No.7)

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Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥ 2 million (including tax) per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- 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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