Japanese Banks Busy with Debt Moratoriums

About-face under New SME-Aiding Law

By Katsuhiko SAKAI

"They lend us umbrellas on fine days and deprive us of these umbrellas when it rains." So goes a Japanese saying poking fun at banks that forget their financing missions. It means that although banks even force customer companies to borrow funds when these firms enjoy robust earnings, lenders reverse the attitude without scruple and would not provide loans to or even withdraw outstanding loans from borrowers when they are really in need of loans on business deterioration.

Banks for their part have reasons to do so. They cannot lend money from depositors to companies that are not expected to repay loans. It is natural for them to withdraw loans before they turn sour. But such reasons no longer stand. This is because the SME Financial Facilitation Act took effect last December to encourage banks to provide moratoriums on loan repayments by small and medium-sized enterprises (SMEs) and individual borrowers. All Japanese banks ranging from credit cooperatives to megabanks have been racing to leave good track records of debt moratoriums.

Debt Burdens Growing on Deflation

Moves to enact the law against credit squeezing and loan withdrawal surfaced after the Democratic Party of Japan took over the government following its landslide victory in the House of Representatives election last summer. The party formed a policy agreement with its coalition partners – the Social Democratic Party and the People's New Party – calling for legislation to enable debt rescheduling and changes in lending terms. PNP leader Shizuka Kamei, who became financial services minister in the new Cabinet, demanded banks be required to provide up to three years of moratoriums on debt repayments. The banking industry raised strong opposition to his call, triggering a noisy debate.

Behind such a development was a severe economic situation after the September 2008 Lehman credit debacle. Japan's unemployment rate hit a record 5.7% (revised to 5.6% later) in July 2009. Deflation deepened, aggravating SME cash-flow difficulties. Winter bonuses posted the largest-ever declines, indicating growing financial burdens on housing-loan holders.

But it was quite unusual for the government to intervene in private-sector lending contracts to the advantage of borrowers. In modern Japan, the government admitted a debt moratorium twice – just after the Great Kanto Earthquake in 1923 and during the 1927 Great Showa Financial Depression. But such moratoriums lasted for only one month. This was because any easy postponement of debt repayments was expected to have adverse effects, including an increase in the cost of banks disposing of nonperforming loans.

Inspection Focus Shifts to Smoother Finance

Although Financial Services Minister Kamei's remarks caused controversy, the SME Financial Facilitation Act finally became a realistic one, taking into consideration points raised by banks. The law was eventually proposed as a temporary one expiring at the end of March 2011. The debt moratorium was stipulated as a nonbinding obligation of banks. At the same time, however, measures were devised to secure the effectiveness of the debt moratorium scheme.

One measure requires banks to regularly report debt moratorium records to the government and publish them. Any false report would be subjected to up to one year in prison or a fine of up to 3 million yen.

Another measure is an administrative one. The Financial Services Agency (FSA) has fundamentally revised its supervisory guidelines and inspection manuals to prevent debt moratoriums from adversely affecting banks' financial performances by permitting banks to exclude loans subject to repayment moratoriums from nonperforming ones. Earlier, the FSA had focused on banks' financial soundness, prompting banks to dispose of nonperforming loans. Under the revised inspection manuals, however, the inspection focus has shifted to banks' attitude toward the facilitation of financing. Specifically, FSA inspectors are tasked to strictly check whether banks led SMEs to withdraw debt moratorium applications or whether banks turned down debt moratorium requests without justifiable reasons despite other banks' acceptance of similar requests. They now look into whether banks reflect proactive efforts for the acceptance of debt moratoriums in their evaluation of branch and employee business performances.

Under such regulatory mechanisms, banks have enhanced their efforts to support cash flow at SMEs. They have created new offices for consultations with SMEs and increased consultants at call centers. In March, the Big Four Japanese banks – Bank of Tokyo-Mitsubishi UFJ, Mizuho Bank, Sumitomo Mitsui Banking and Resona Bank – published their second debt moratorium records for the period between the implementation of the law on Dec. 4 and the end of January.

Requests Swell for Changes in Lending Terms

According to their announcements of the records, they received 36,940 applications for changes in lending terms, including the extension of debt repayment deadlines, and accepted 11,558 applications. The total included 29,480 applications for SME loan term changes, of which 10,664 were accepted. The remaining 7,460 appli-

cations were for individual housing loans, including 894 cases in which these banks accepted term changes. As the records covered only two months after the law came into force, many of these applications might have been still under screening. The number of accepted applications might have increased substantially later. By the end of January, the four banks turned down only 126 applications for term changes for SME lending or housing loans.

The number of requests for consultation regarding repayment moratoriums for housing loans in December quintupled from the previous month at the three banks other than Resona. Consultation requests regarding SME loans also expanded substantially. These numbers indicated the law was effective and that a large number of borrowers were plagued with growing debt repayment burdens. Behind the suffering of borrowers is the fact that while prices of goods and personal income become lower along with deflation, loan amounts never decline in value.

Photo: Kyodo News

Financial Services Minister Shizuka Kamei addresses a meeting with financial industry representatives in Tokyo.

But debt repayment moratoriums are nothing more than a temporary stopgap for borrowers with cash-flow difficulties. SME managers say they cannot continue business without new loans as well as the postponement of loan repayments. Any decision to provide new loans while accepting the deferment of repayments of existing loans is up to banks. While existing loans are not classified as nonperforming ones even after changes in terms, SME managers say they are uncertain whether they could receive additional loans. Such fears have continued lingering.

A survey by credit research agency Teikoku Databank Ltd. in October last year found that only 25.5% of some 10,000 responding companies supported the new law while 38.3% raised opposition to it. Those planning to apply for debt repayment moratoriums were only 11.1%. Some respondents were cautious toward the use of the new moratorium system as they were concerned that repayment moratoriums could eliminate chances to get new loans.

New Loans Test Banks' Competence

Banks cite limited information disclosure, unreliable financial statements and other shortcomings as reasons when they point to difficulties involving SME loans. Borrower-screening and post-lending monitoring costs for SME loans that are extended in small amounts are less efficient than those for larger loans to big companies. Unless SMEs have sufficient real estate assets as collateral or public loan guarantees, therefore, banks usually refrain from providing loans or toughen lending terms for SMEs with uncertain credit risks.

The revised FSA inspection manuals urge banks to flexibly respond to new SME loan requests. They list as inappropriate action cases in which banks ignore borrowers' technological capabilities or growth potential and depend heavily on collateral or guarantees when screening loan requests. Some regional banks have come to welcome the revised inspection manuals as increasing their freedom in making business decisions on SME loans.

Creditor banks' engagement with borrowers' business management and relevant advice are indispensable for improving business performances at SMEs, on which surveillance by shareholders is difficult, unlike on large companies. "This kind of law may not be required under normal circumstances," Kamei said at a parliamentary meeting on the SME financing facilitation bill. "Lenders and borrowers must pursue coexistence and co-prosperity. Lenders benefit from their sincere support for struggling borrowers. I would like to see them return to this principle." Kamei thus expressed hope for lenders and borrowers to rebuild their mutual confidence.

SMEs account for 99% of companies in Japan and cover 66% of the country's total employment. How to enhance SMEs supporting the Japanese economy is a key challenge testing banks' competence. JS

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