

Operational and Administrative Policies

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1. OPERATIONAL POLICY IN FISCAL YEAR 2004

JBIC is committed to undertaking its mission to live up to the expectations the public has placed on it. In FY2004, it will conduct its operations guided by the following six policy themes, taking current issues into consideration such as domestic and international economic and financial trends, evolving Japanese business, the new ODA Charter, international trends in development theories and practices, and economic and social conditions of developing countries.

- a) Contributing to the stability of international financial order
- b) Supporting economic and social development in developing countries
- c) Securing stable access to natural resources for Japan
- d) Supporting capital- and technology-intensive exports from Japan
- e) Supporting the development and expansion of international operations of Japanese industries
- f) Supporting developing countries in addressing global issues

JBIC is devoted to conducting its operations in line with the Reorganization and Rationalization Plan for Special Public Corporations (cabinet decision, December 19, 2001). At the same time, in view of still difficult economic and financial conditions, JBIC will play its role as a policy-based financing institution to complement and encourage private-sector activities by providing adequate financial resources. This will be done in accordance with On the Reform of 4 Public Corporations on Highways, Core International Airports and Policy-Based Financial Institutions (cabinet decision, December 17, 2002) and the Comprehensive Measures to Fight Deflation (a decision by the Council on Economic and Fiscal Policy, October 30, 2002).

JBIC will also conduct its operations in response to various policy needs and governmental measures. In addition, JBIC will be flexible in meeting the changing business environment and client needs that are hard to predict in advance or will be incorporated in the planning. An effort will also be made to increase the transparency, effectiveness and efficiency in its operations by appropriately managing various risks associated with lending and investment activities, enhancing comprehensive environmental and social considerations, and constantly making operations more client-oriented.

The lending and investment plan for FY2004 is as follows:

Loan and Investment Plan for FY2004		(¥ billion)
IFOs	Export Loans	246
	Import Loans and Overseas Investment Loans	683
	Resource Development	483
	General Investment	200
	Untied Loans	205
	Equity Participation	6
	Sub Total	1,140
OECOs	ODA Loans	697
	Private-Sector Investment Finance	3
	Sub Total	700
Total		1,840

2. COMPLIANCE

JBIC has been devoting its efforts to ensure fair and appropriate operations in compliance with the relevant laws and regulations. The Audit Department, which enjoys a significant degree of independence, conducts periodic on-site inspections at the Head Office, the Osaka Branch and overseas representative offices, while auditors carry out audits on the operations of JBIC in accordance with the Japan Bank for International Cooperation Law (the JBIC Law).

As a policy-based financing institution that operates internationally to execute Japan's external economic policy, JBIC has placed compliance on its major agenda. JBIC recognizes an obligation to deliver effective results to meet social and international expectations. Moreover, JBIC seeks to act with a clear vision and integrity in its effort to enhance

the quality of operations. From this perspective, JBIC does not limit itself to achieve compliance with the relevant laws and regulations but actively strives to achieve compliance in a broader sense that includes socially accepted moral values as well as expectations from the international community.

Specifically, the compliance manual, which compiled laws and regulations that govern JBIC operations, rules for operational practice and social responsibility, was distributed to all the management and staff. In addition, training sessions on compliance issues were held for management and staff based on the compliance program put together by the Compliance Committee, which consists of board members and heads of relevant departments. JBIC is fostering compliance among the management and staff through these activities.

3. DISCLOSURE

JBIC discloses the following operational and financial information to the public in order to increase accountability concerning its current activities.

Document	Access	Scheduled Date of Release
<i>Annual Report</i>	Available at all JBIC offices Distributed free of charge to interested individuals	October
<i>ODA Loan Report</i>	Available at all JBIC offices Distributed free of charge to interested individuals	November
<i>Environmental Report</i>	Available at all JBIC offices Distributed free of charge to interested individuals	February
<i>The Role and Functions of JBIC</i>	Available at all JBIC offices Distributed free of charge to interested individuals	Updated as any change occurs
JBIC website http://www.jbic.go.jp/english	JBIC operations, operational results, financial position, non-performing assets, financial statements based on accounting principles for the private sector, ex-post evaluation reports for ODA projects	Updated frequently

4. RISK MANAGEMENT

In general, the operations of financial institutions involve various risks, including credit risk, market risk (interest rate and exchange rate risks, etc.), liquidity risk, operational risk and computer system risk. As a government agency, JBIC conducts financial operations to achieve policy objectives. Thus, JBIC differs from private financial institutions in terms of the nature as well as the extent of risks involved in its operations and ways to deal with them. Nonetheless, it is essential to have appropriate risk management to ensure sound and efficient operations as a financial institution. In line with the international trend of focusing on risk management as the basis of operations of financial institutions, JBIC is improving its internal risk management system.

More specifically, risk management, together with compliance, was taken to be a managerial issue that needs to be addressed systematically by the entire organization. In April 2002, the Risk Management Division was set up under the Policy Planning and Coordination Department to conduct the integrated management of various risks individual departments are facing.

JBIC manages various risks that policy-based financing institutions are facing. The following are examples of JBIC's major risk management activities.

1. Credit Risk

Credit risk refers to the potential loss from difficulties or failure to recover credit assets due to the declining financial position of a debtor. This risk is inherent in JBIC operations as they primarily consist of lending activities. Credit risks facing JBIC may be classified into sovereign risk which involves financing to foreign governments, corporate risk which involves financing to business firms, and country risk which involves financing to foreign firms (a risk added to pure corporate risk as it arises from the country where the debtor resides). Given the very nature of financial support for external economic transactions and overseas economic cooperation, JBIC frequently extends loans to foreign governments and government agencies as well as foreign companies. Therefore, sovereign and country risk make up a considerable part of the credit risk that accompanies JBIC's operations.

Managing Credit Risk

The cornerstone of credit risk management at JBIC is, in the process leading to credit approval, the evaluation of an individual borrower's creditworthiness. When a new loan application is being processed, the financing departments, the Credit Analysis Department and the Country Economic Analysis Department, collect and analyze information on the borrower. The overseas representative offices also play a

part in collecting information on foreign governments and corporations. A credit appraisal takes place, with checks and balances at work between these different departments throughout the process, leading to the final decision by the management.

For credit provision for foreign governments and corporations, JBIC makes the most use of its unique position as an official institution in that it exchanges views and information with governments and other authorities of recipient countries, such as multilateral institutions as the International Monetary Fund (IMF) and the World Bank, regional development banks, other official export credit agencies and development assistance institutions, as well as with private financial institutions in the industrial countries. Using all these channels, JBIC evaluates sovereign and country risk based on a broad range of information on governments and borrowing governmental agencies as well as political and economic conditions in their countries.

For credit provision for domestic and foreign corporations, there is a need to evaluate their creditworthiness and the appropriateness of the collateral they provide. In particular, for credit provision related to overseas projects, credit evaluation involves checking and examining the sureness of transactions to be financed, feasibility studies of the projects and the industry in which the borrower operates.

Internal Credit Rating

JBIC established the internal credit rating system in FY2001 as part of the bank's operating procedures and to be used to cover all the borrowers in principle. Internal credit ratings are the cornerstone of credit risk management, being used for individual credit appraisals and quantifying credit risks.

Internal Assessment of Asset Portfolio

Japanese private financial institutions undertake the internal assessment of asset portfolios in accordance with the *Financial Inspection Manual* prepared by Japan's Financial Services Agency. JBIC is similarly undertaking the internal assessment of its loan portfolio, based on the *Financial Inspection Manual* and in consultation with an auditing firm to accurately reflect the characteristics of its loan assets to its assessment. In this process, the first-stage assessment is conducted by the relevant financing departments, while the second-stage assessment by the corporate and country economic analysis departments with inspection by the Audit

Department. The results of internal assessment conducted of the asset portfolio are not only used internally for the continuous review of the loan asset portfolio but are also reflected in the disclosure of asset quality to enhance the transparency of JBIC's financial position.

Quantifying Credit Risk

In addition to individual credit risk management, JBIC is working on quantifying credit risks with a view to evaluating the risk of the overall loan portfolio. To quantify credit risks, it is important to take into account the characteristics of JBIC's loan portfolio, which holds a significant proportion of long-term loans and loans involving sovereign risk and country risk. Also to be taken into account is the mechanism of securing assets, such as the Paris Club, a unique framework for debt management by official creditor countries. The initial work to develop a credit risk quantification model incorporating these factors was completed, and currently the model is being tested to assess its effectiveness.

2. Market Risk

Market risk refers to the potential loss from changes in the value of assets and liabilities as a result of fluctuations in interest rates and foreign exchange rates. JBIC addresses specific market risks as follows.

Interest Rate Risk

In IFOs, interest rate risk for foreign currency denominated loans is hedged through interest rate swaps. Thereby, both foreign currency denominated loans and its corresponding funding arrangements are managed on a floating-rate basis. On the other hand, interest rate risk for yen-denominated loans of IFOs is limited since the maturities of loans and their corresponding funding arrangements, both managed on a fixed-rate basis, are more or less matched. In addition, JBIC calculates and analyzes careful projections of its future asset/liability structure and profits and losses.

In OECOs, the capacity to absorb interest rate risk is enhanced by capital injection from the General Account

Budget of the Japanese Government along with borrowings from the FILP. Also, careful projections are conducted of its future asset/liability structure and profits and losses.

Exchange Rate Risk

Foreign currency denominated loans provided in IFOs involve the risk associated with exchange rate fluctuations. JBIC has a consistent policy of hedging the full amount of such exposure through currency swaps and forward exchange transactions. Currently, the OECOs do not involve such exchange rate risk, since none of its outstanding loans are denominated in foreign currencies.

Derivatives Transactions

Basic Policy for Derivatives Transactions

JBIC engages in derivatives transactions exclusively for the purpose of hedging exchange rate and interest rate risks that are involved in its IFO lending and funding operations.

Transactions

Derivatives transactions of JBIC include interest rate and currency swaps and forward exchange contracts. The table below gives a summary of these transactions.

Credit Risk of Derivatives, etc.

(as of the end of March 2004)
(¥ billion)

	Contract Amounts/ Notional Amounts	Credit Risk
Interest Rate Swaps	1,995.0	83.8
Currency Swaps	4,199.7	790.3
Forward Exchange Contracts	1.4	0
Other Derivatives	—	—
Credit Risk Reductions through Netting		(180.7)
Total	6,196.2	693.4

Note: Credit risk was computed based on international standards.

Risks Involved in Derivatives Transactions

Derivatives transactions involve the following risks.

1) Credit Risk

Potential loss from the failure of a counterparty to perform its obligations in accordance with terms and conditions of

the contract governing transactions due to bankruptcy or deteriorating business conditions

2) Market Risk

Potential loss from changes in the market value of financial products due to fluctuations in interest rates or exchange rates

Measures to Address the Risks

1) Credit Risk

JBIC constantly monitors the market value of its derivatives transactions with each counterparty and its credit risk exposure to and creditworthiness of each counterparty in order to ascertain the appropriateness of entering into or maintaining a transaction with each counterparty.

2) Market Risk

JBIC utilizes derivatives transactions exclusively for the purpose of hedging. Therefore, the market risk on derivatives transactions and the risk on hedged (lending or funding) transactions are, in principle, offset against each other.

3. Liquidity Risk

Liquidity risk refers to the risk of cash flows tightening due to worsening fund-raising capability that arises from the deterioration of creditworthiness or mismatches in the maturity of assets and liabilities.

JBIC is minimizing the liquidity risk through effective cash flow management and the diversification of its funding

sources: JBIC makes borrowings under the FILP and issues government-guaranteed bonds in the international capital market and FILP agency bonds in the domestic capital market (from FY2001).

4. Other Risks

Operational Risk

Operational risk refers to the potential loss from negligence of duty or from accidents or misdeeds on the part of JBIC management and staff. JBIC has been minimizing this risk by ensuring accurate operations through checks on the administrative process, creating operational manuals, improving training programs, and streamlining and computerizing the procedures. In addition, the Audit Department, in charge of internal auditing, inspects the administrative practices of the Head Office, the Osaka Branch and overseas representative offices.

Computer System Risk

Computer system risk refers to the potential loss from a breakdown or malfunction in computer systems as well as from their misuse. With greater reliance on information systems, there is an increasing need to make the operations

of JBIC smoother and more effective by exchanging information with Japanese firms as well as foreign governments through information networks. It is thus important to give greater weight to information security through the increased awareness of JBIC management and staff with respect to internal information management and by putting in place measures to block illegal access to JBIC's information systems from external sources by way of information networks. As part of an effort to ensure information security, JBIC drew up the Information Security Policy, and created the Information Security Committee, consisting of heads of the relevant departments.

Apart from operational and computer system risks, JBIC recognizes that its operations involve various direct and indirect risks. JBIC will proactively identify, analyze and manage such risks.

5. PERFORMANCE MEASUREMENT FOR STRATEGIC MANAGEMENT

For Greater Operational Transparency and Results-Focused Operations

In FY2002, JBIC adopted the performance measurement system entitled “Performance Measurement for Strategic Management” (hereinafter referred to as the “System”) in which its business performance is monitored in light of the operational direction and targets set in advance.

The overall framework of the System is as follows (see Figure 1):

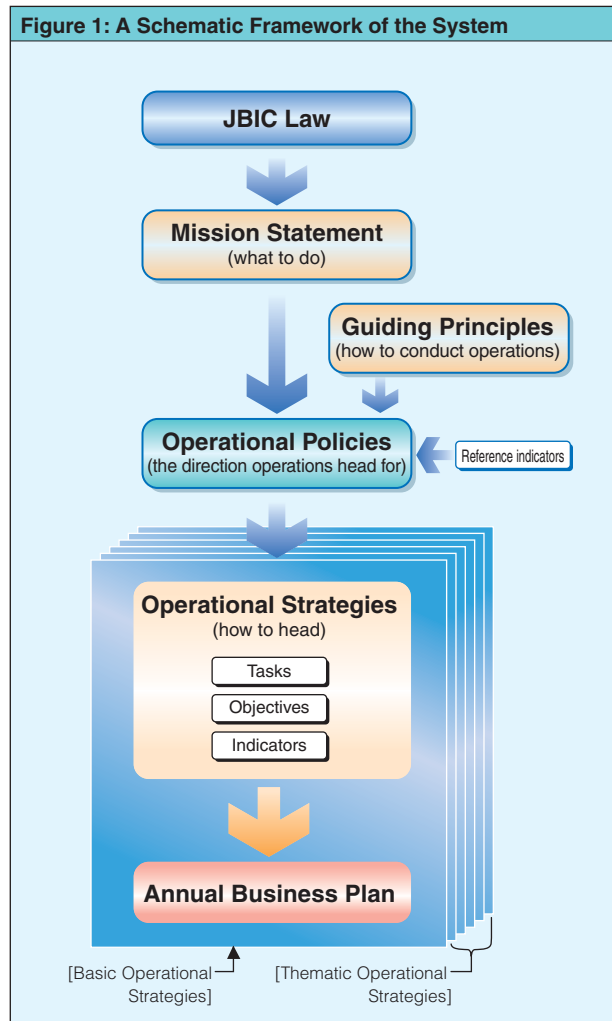
- (1) Operational Policies are set in the context of the Mission Statement, which, in turn, is based on the JBIC Law. As a public corporation engaging in official financing, JBIC also sets the Guiding Principles that explicitly describe “how to conduct operations,” including the emphasis on accountability.
- (2) To conduct operations in adherence to Operational Policies and to ensure operational transparency, Operational Strategies are drawn up, describing specific tasks, objectives and indicators.
- (3) Operational Strategies consist of the Basic Operational Strategies, which refer to the overall operations, finances and organizational capabilities, and the Thematic Operational Strategies, which address strategic business areas to produce results for the public.
- (4) To translate Operational Strategies into specific actions, the Annual Business Plan is prepared for each fiscal year.
- (5) The Annual Business Plan is continuously monitored and assessed periodically to improve the quality of operations.

In this way, JBIC conducts its operations based on the Plan-Do-See (PDS) cycle where JBIC sets targets and reviews the results, while improving its operational performance as well as adjusting targets (see Figure 2).

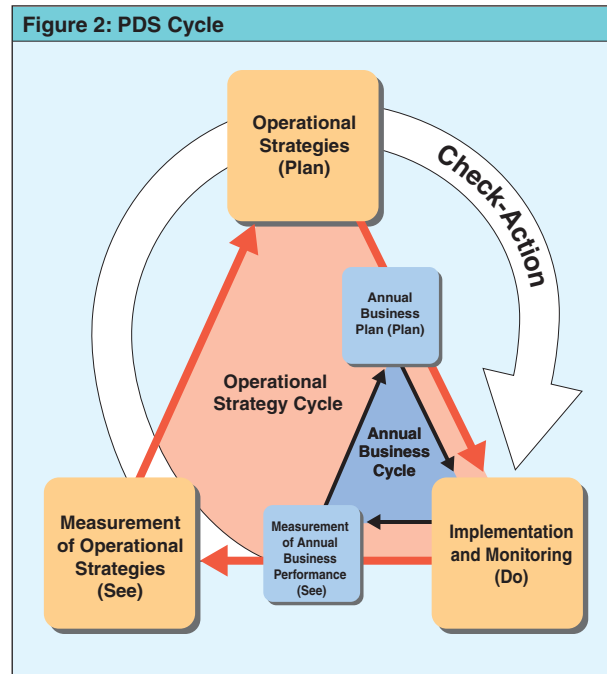
In FY2003, JBIC conducted performance evaluations for FY2002 for the first time since the introduction of this system.

JBIC set up the External Committee for Performance Evaluation (Chair: Yuzo Takagi, Director of the Japanese Institute of Certified Public Accountants (JICPA)) to improve the quality of the evaluation and secure its objectivity. The Committee submitted its opinion concerning the validity of performance measurement and desirable improvements of this system.

The adoption of the System reflects JBIC’s efforts in response to the provision in the Reorganization and Rationalization Plan for Special Public Corporations (Cabinet Decision, December 19, 2001), setting forth that “A study should be undertaken to establish an evaluation method of policy-based financing and a system feeding back the evaluation results into business operations.” It also reflects the policy evaluation activities implemented by the



Japanese Government's department in accordance with the Government Policy Evaluations Act (GPEA), which came into force in April 2002. The System will be modified, as appropriate, based on subsequent discussions on the reform of policy-based financing institutions. In addition, as proposed by the Reorganization and Rationalization Plan for Special Public Corporations, operational readjustment, including the active use of the guarantee facility and appropriate risk management for JBIC's loan portfolio, has been incorporated in Operational Policies and Strategies.



6. OVERSEAS ECONOMIC COOPERATION OPERATIONS MANAGEMENT COUNCIL

JBIC set up the Overseas Economic Cooperation Operations Management Council in accordance with Article 22 of the JBIC Law. Its members are appointed by the Minister of Foreign Affairs and composed of representatives from the

relevant government ministries. The Council discusses important issues pertaining to the management of OECOs in response to a request from the Governor of JBIC. JBIC also reports to the Council the progress of its operations in OECOs.

1. Overseas Economic Cooperation Operations Management Council
Statutory membership: Maximum of 15 members, selected from the relevant government ministries
Appointments: The Minister of Foreign Affairs appoints the members.
Chair: Selected from the members of the Committee by voting among them
2. List of members (as of March 31, 2004)
 - Yukio Takeuchi**
Administrative Vice Minister, Ministry of Foreign Affairs
 - Eiji Kawade**
Administrative Vice Minister, Cabinet Office
 - Michihiro Kayama**
Administrative Vice Minister, Ministry of Public Management, Home Affairs, Posts and Telecommunications
 - Masakazu Hayashi**
Administrative Vice Minister, Ministry of Finance
 - Yasushi Mitarai**
Administrative Vice Minister, Ministry of Education, Culture, Sports, Science and Technology
 - Yoshiharu Otsuka**
Administrative Vice Minister, Ministry of Health, Labour and Welfare

- Mamoru Ishihara**
Administrative Vice Minister, Ministry of Agriculture, Forestry and Fisheries
 - Seiji Murata**
Administrative Vice Minister, Ministry of Economy, Trade and Industry
 - Noriyuki Kazaoka**
Administrative Vice Minister, Ministry of Land, Infrastructure and Transport
 - Shigeru Sumitani**
Administrative Vice Minister, Ministry of the Environment
3. Meetings in FY2003
First meeting (November 11, 2003)
Agenda: a) *Annual Report 2003 and ODA Report 2003*
b) Recent ODA loan commitments
c) Fiscal Year 2004 budget
d) Implementation of new environmental guidelines

7. EFFORTS TO PROMOTE GREEN PROCUREMENT

What Is the Green Procurement Law?

The Law on Promoting Green Purchasing, officially called the Law Concerning the Promotion of Procurement of Eco-Friendly Goods and Services by the State and Other Entities, was enacted in April 2000 and went into effect in April 2001.

The objective of this law is to build a society capable of sustainable development with minimum impact on the environment by requiring the government and its agencies to take the lead role in the purchase of eco-friendly goods and services.

JBIC's Actions

Under the Law on Promoting Green Purchasing, JBIC draws up and makes public a policy to increase the purchase of eco-friendly goods and services for each fiscal year. JBIC purchases goods and services in accordance with this policy, and publishes a summary report on the actual performance at the end of each fiscal year.