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Local Government Bond System and Market in Japan

**Ministry of Internal Affairs
and Communications**

November 2013

I Safety of JLGB

II Attractiveness of JLGB

III Topics

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I Safety of JLGB (Japanese Local Government Bond)

- 1. Solid support by the central government on redemption**
- 2. Check and control system by the central government, etc.**
- 3. Control of fiscal discipline**



Principal and interest of JLGB have been fully paid without default (similar to JGB).



The risk-weight of JLGB is regarded as 0% in Basel Capital Accord (Basel III, domestic standard, standardized approach).



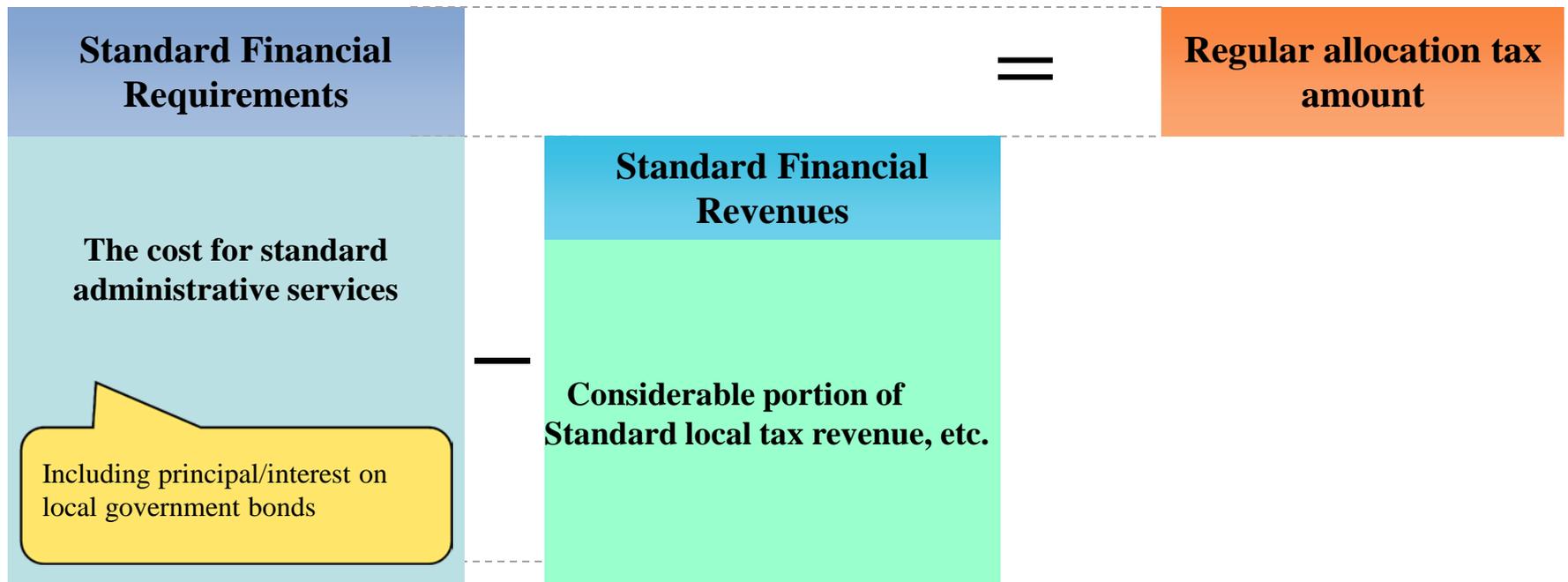
MIC I-1 Solid support by the central government on redemption

The central government secures revenue sources required for principal/interest payment on local government bonds through the local public finance system.

In particular, it is secured through local allocation tax each local government receives from the central government to provide basic social capital and standard administrative services to citizens.

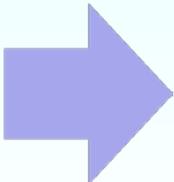
The principal / interest on JLGB is included in the standard fiscal demand amount when calculating local allocation tax.

The local allocation tax system has functioned for about 60 years since 1954. The amount of the local allocation tax is around 17 trillion yen.

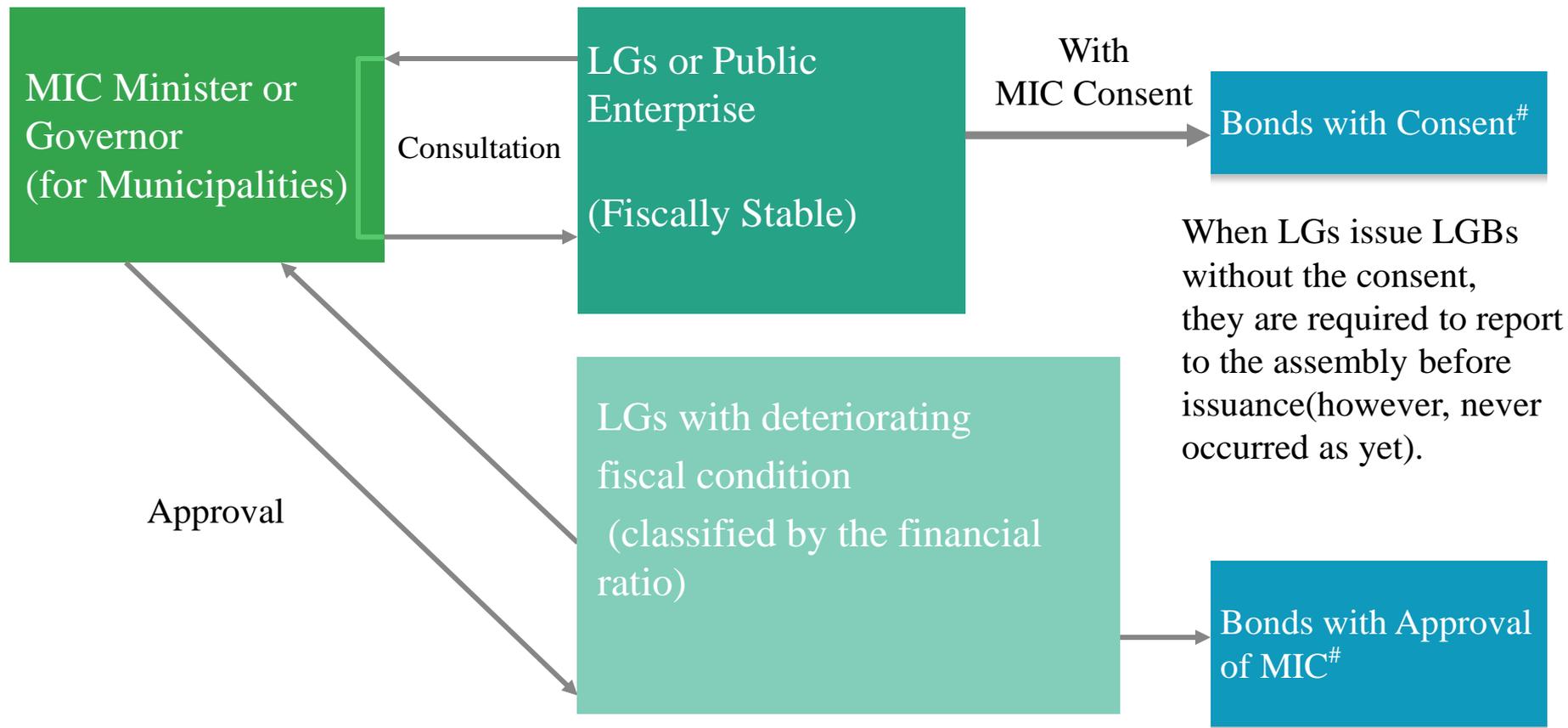


I-2 Check and control system by the central government, etc. (1)

- Local governments (LGs) are required to consult with the Minister of MIC (or the prefectural governor) at the time of issuance of Local Government Bond (LGB).
- LGB issuance without the consent of the Minister of MIC (or prefectural governors) is not eligible for public funds nor for local allocation tax system (Although LGs can issue LGBs without the consent, there are no such case.).
- In addition, LGs with deteriorating fiscal conditions are required to obtain an approval of the Minister of MIC (or the prefectural governor) in their issuance. LGB issuance without the approval shall not be issued in this case with LGs with relatively weak fiscal conditions.

- 
- The central government(or prefectures) check all the LGBs.
 - The central government secures the redemption of LGBs as a form of a consent after a consultation.
 - Issuance of LGBs by LGs with deteriorating fiscal conditions is restricted.
(the number of LGs necessary to obtain the approval FY2011 : 114(total LGs : 1,789))

I-2 Check and control system by the central government, etc. (2)



Only the bonds which obtained the consent or the approval of MIC, LGs may borrow from the Government funds or JFM

From FY2012, LGs with sound fiscal conditions can issue LGBs[※] without the consultation or the approval by notifying the Minister of MIC (or the prefectural governor). [※] LGBs by private funds only.

I-3 Control of fiscal discipline (1)

- In Japan, there is a system of maintaining fiscal discipline by checking the fiscal conditions of LGs through the disclosure of relevant information, and taking measures for early-stage improvement of fiscal conditions before they seriously deteriorate.
- Under this system, local residents, local assemblies and auditors are to examine latent risks of relevant local public corporations and third-sector companies in addition to LGs.
- These examinations are designed to confirm both flow and stock indicators from the perspective of ensuring the medium- and long-term improvement of fiscal management.
- In addition, if the rehabilitation by LGs on their own is deemed difficult, the central government will play a role to ensure their rehabilitation.

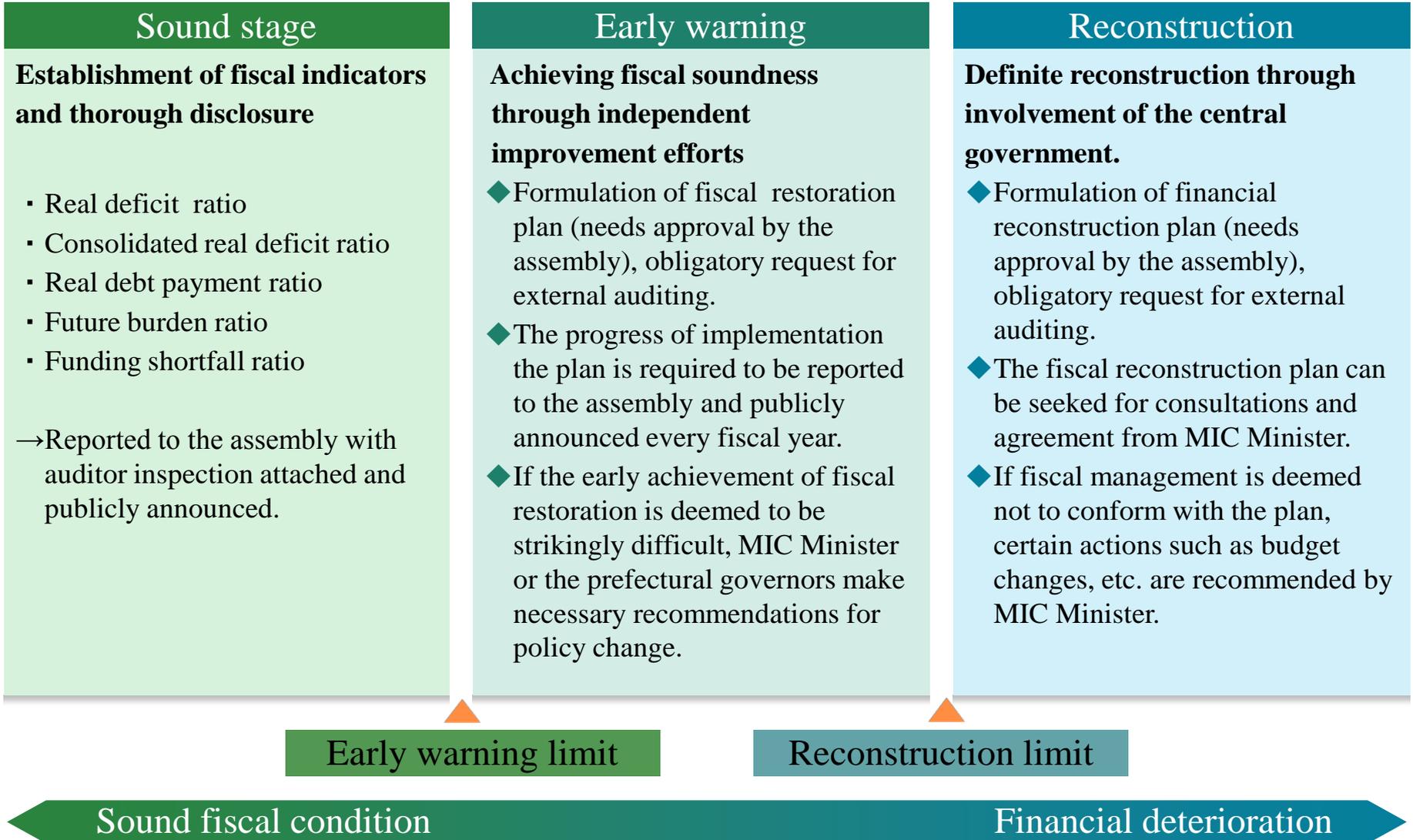
- 
- The fiscal conditions of local governments are checked in detail in terms of both flow and stock.
 - The fiscal conditions of related entities are also checked in order to prevent unforeseen liabilities.
 - As of the end of FY2011, only 2 LGs exceed the early warning limit, and 1 of those 2 LGs exceeds the reconstruction limit(out of a total of 1,789 LGs).

I-3 Control of fiscal discipline (2)

- ◆ LGs are required to report the following ratios to the local assembly every fiscal year after receiving an assessment by the auditor, and to disclose those ratios to the public.

Fiscal indicator	Definition
1. Real deficit ratio	The ratio of deficit to the standard financial scale.
2. Consolidated real deficit ratio	The ratio of consolidated deficit in the all accounts to standard financial scale.
3. Real debt payment ratio	The ratio of debt payment by general revenue to standard financial scale.
4. Future burden ratio	The ratio of outstanding debt as well as contingent liabilities of public enterprises and government affiliates, to standard financial scale.
5. Funding shortfall ratio at Public Enterprises	The ratio of the previous fiscal year's shortfall in funds for each public enterprise to the previous fiscal year's business scale.

I-3 Control of fiscal discipline (3)



■ Opinions by the International Rating Agencies

We rate Japanese regional and local governments (RLGs) at Aa3/stable, the same as Japanese government bonds, reflecting the close linkage between the central government and the RLGs, the local allocation tax (LAT) equalization system, and the central government's strong oversight. We believe that it is unlikely that any policy changes would emerge and which would weaken the government's support for the RLGs.

The central government primarily provides its strong support through LAT. The latter is designed to reduce fiscal disparities among RLGs and guarantee minimum services for all residents.

(As of 28 September 2012, Moody's)

Passage of the Act on Assurance of Sound Financial Status of Local Governments in 2007 has, in our view, enhanced extraordinary central government support for local and regional governments by providing them with unequivocal permission to access central government funds when faced with a dire shortage of liquidity.

(As of 27 November 2012, S&P)

II Attractiveness of JLGB

- ◆ JLGBs have enjoyed stable distribution thanks to public awareness of their safety natures as well as the following attractive investment features.

1. Offering diverse investment opportunities

- A steady increase in issuance size coupled with diversification of the term to maturity allows for the selection of bonds suited to investment needs

2. Attractiveness as the position similar to JGB

- Established positioning as a core asset in the investment plans of investors who are focused on safe investing
- Under the turmoil condition in Financial crisis, JLGB performed stably
- Many of credit ratings of JLGBs are equivalent to that of JGB (Moody's, S&P)

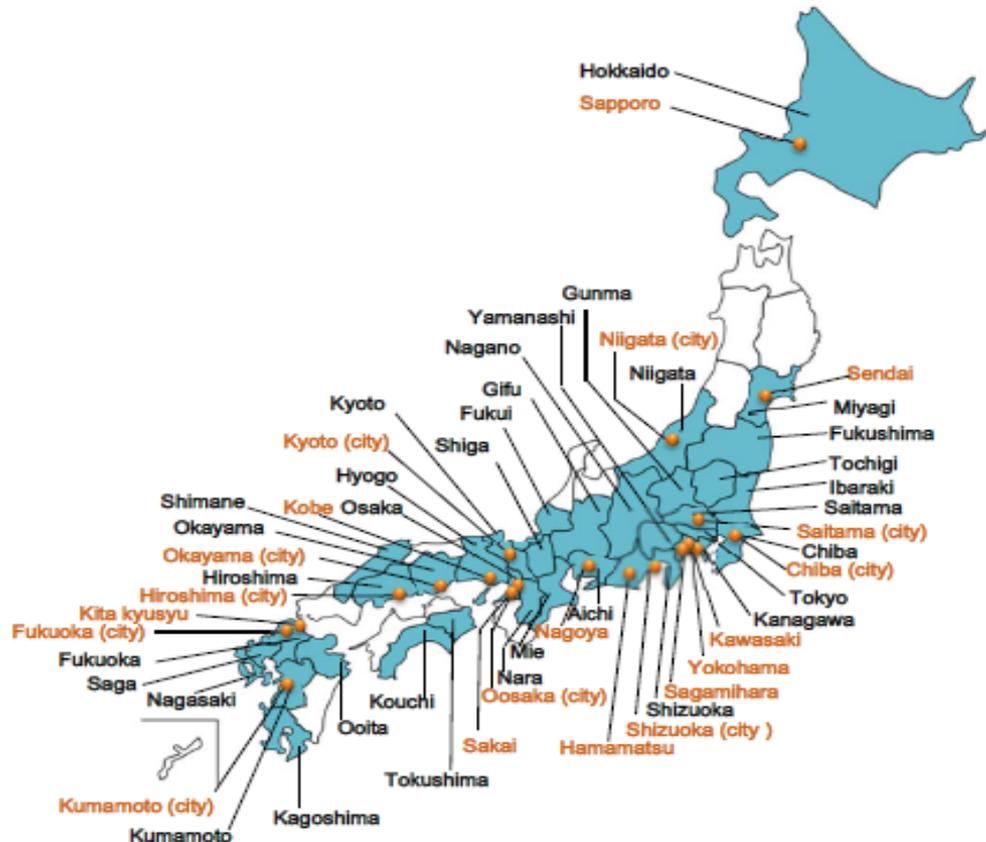
3. Further advancement of the commercial value of JLGB

- Issuance of Joint bond (2003~)
- Tax exemption measures for Nonresident investors (2008~)



MIC II-1 Offering diverse investment opportunities (1)

- ◆ A lot of LGs successfully issue public offering bonds underpinned by the solid creditworthiness through the Japanese local public finance system.



- ◆ 54 LGs issue public offering bonds in FY 2013.
 - ▶ 34 prefectures (shown in black)
 - ▶ 20 designated cities (shown in red)

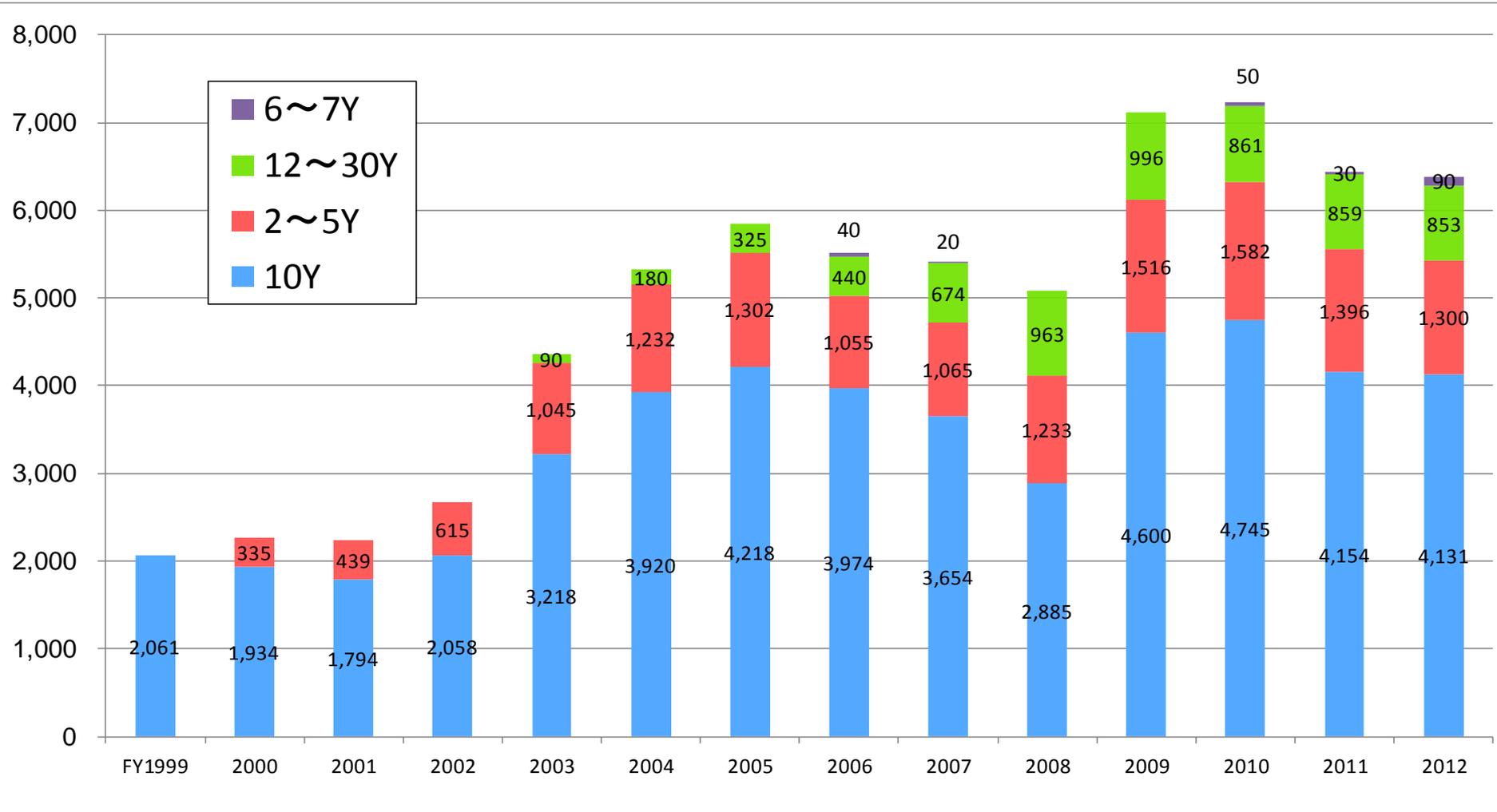
Source: Local Government Bond Association



II-1 Offering diverse investment opportunities (2)

◆ Historical issuance amount of Public Offering LGBs

(Unit: 100millions of YEN)



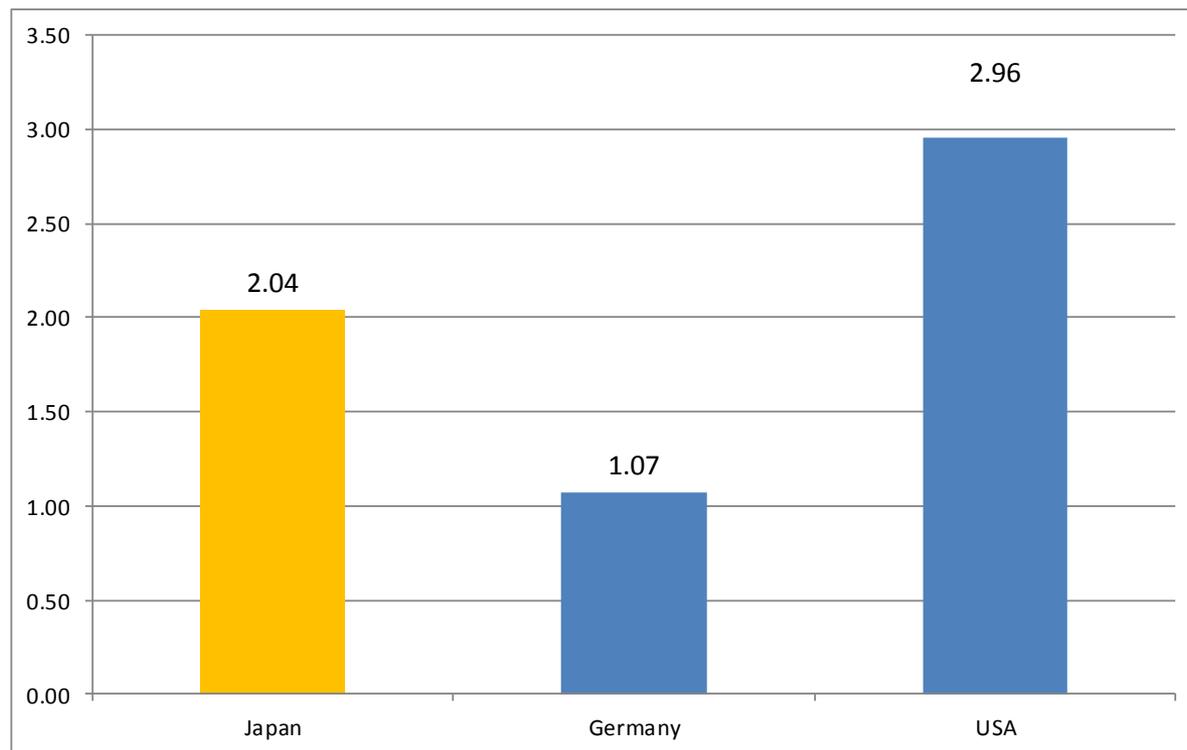


- ◆ Japanese Local Governments' total debt outstanding has reached to US\$ 2.04 trillions (next to that of USA)

*calculated by exchange rate (Oct.1, 2013)

LGs' Total Debt Outstanding (2012) Japan/Germany/USA

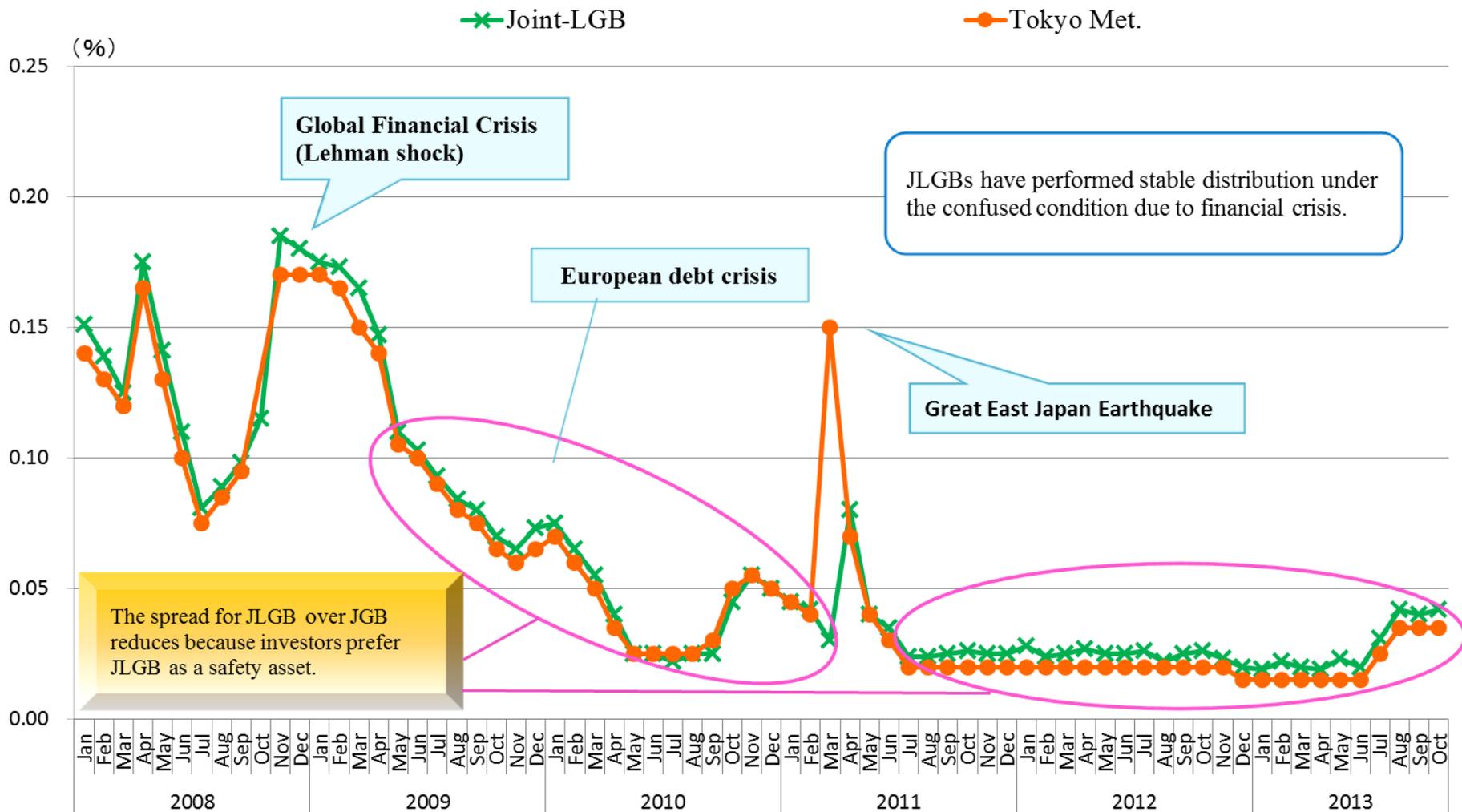
(Unit: Trillions of US-dollar)



Source: Japan Local Government Bond Association, MIC, FRB, Bundesbank

II-2 Similar attractiveness of JGB and JLGB (1)

◆ The spread for public offering JLGB (10year) over JGB (10year)



II-2 Similar attractiveness of JGB and JLGB (2)

- ◆ International rating agencies assign rating levels of JLGB close to JGB thanks to the solid JLGB system.

Local Government	Ratings	
	Moody's	S&P
JGB(Central Government)	Aa3/Stable	AA-/Negative
Tokyo	-	AA-/Negative
Niigata Prefecture*	Aa3/Stable	-
Shizuoka Prefecture*	Aa3/Stable	-
Aichi Prefecture*	-	AA-/Negative
Hiroshima Prefecture*	Aa3/Stable	-
Fukuoka Prefecture	Aa3/Stable	-
Sapporo City*	Aa3/Stable	-
Chiba City*	-	A+/Stable
Yokohama City	-	AA-/Negative
Niigata City*	-	AA-/Negative
Shizuoka City*	Aa3/Stable	-
Hamamatsu City	Aa3/Stable	-
Nagoya City	Aa3/Stable	-
Kyoto City*	Aa3/Stable	A+/Stable
Osaka City*	Aa3/Stable	AA-/Negative
Sakai City	Aa3/Stable	-
Fukuoka City*	Aa3/Stable	-
Miyazaki City	-	A/Stable

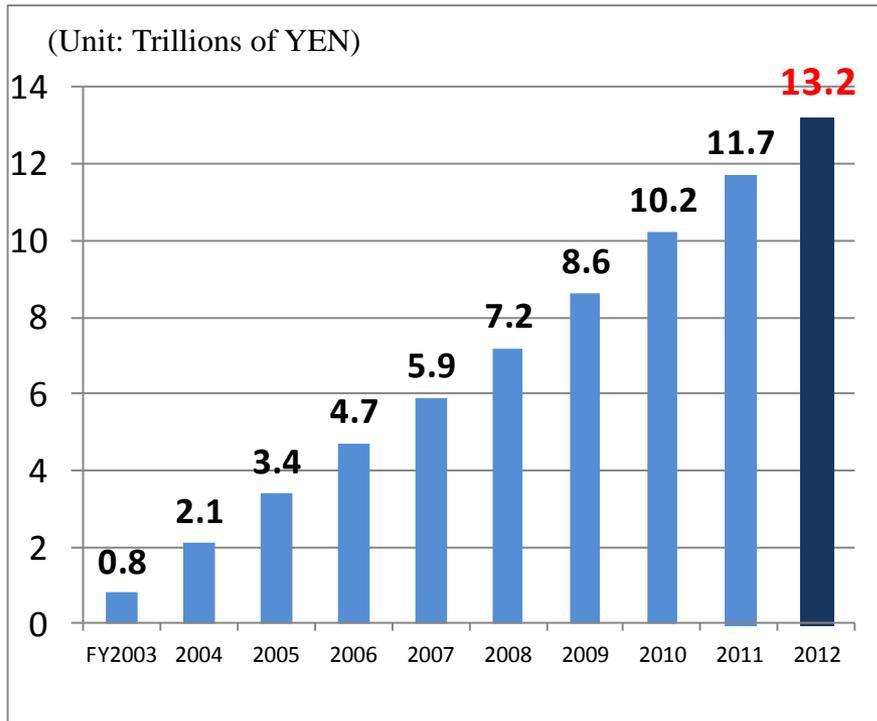
II-3 Further advancement of the commercial value of JLGB

◆ The initiative to enhance the commercial value of JLGB

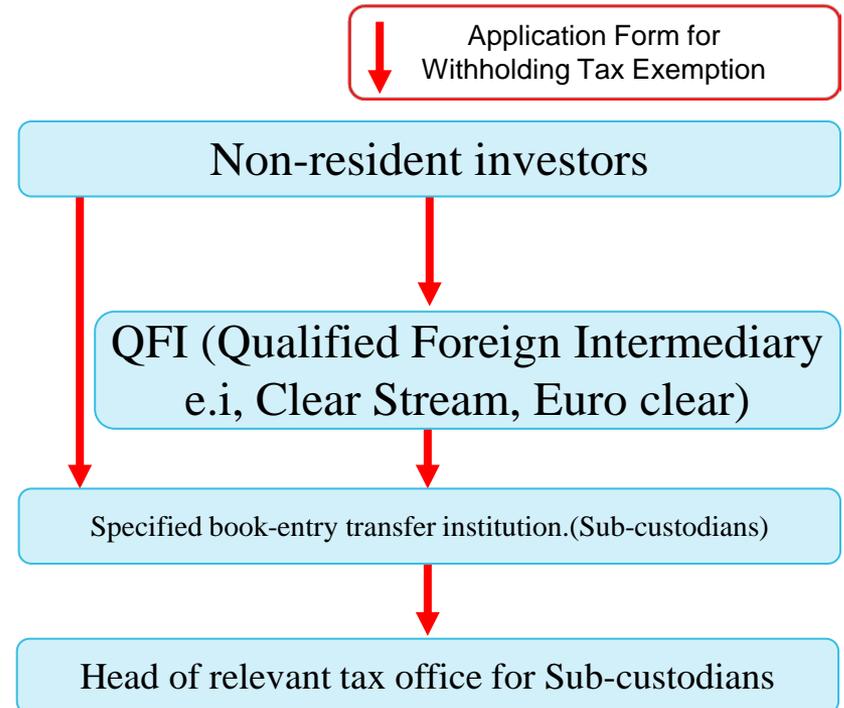
- issuance of Joint bond(2003~)
- tax exemption measures for nonresident investors(2008~).

※ Please refer to the presentation by Japan Local Government Bond Association

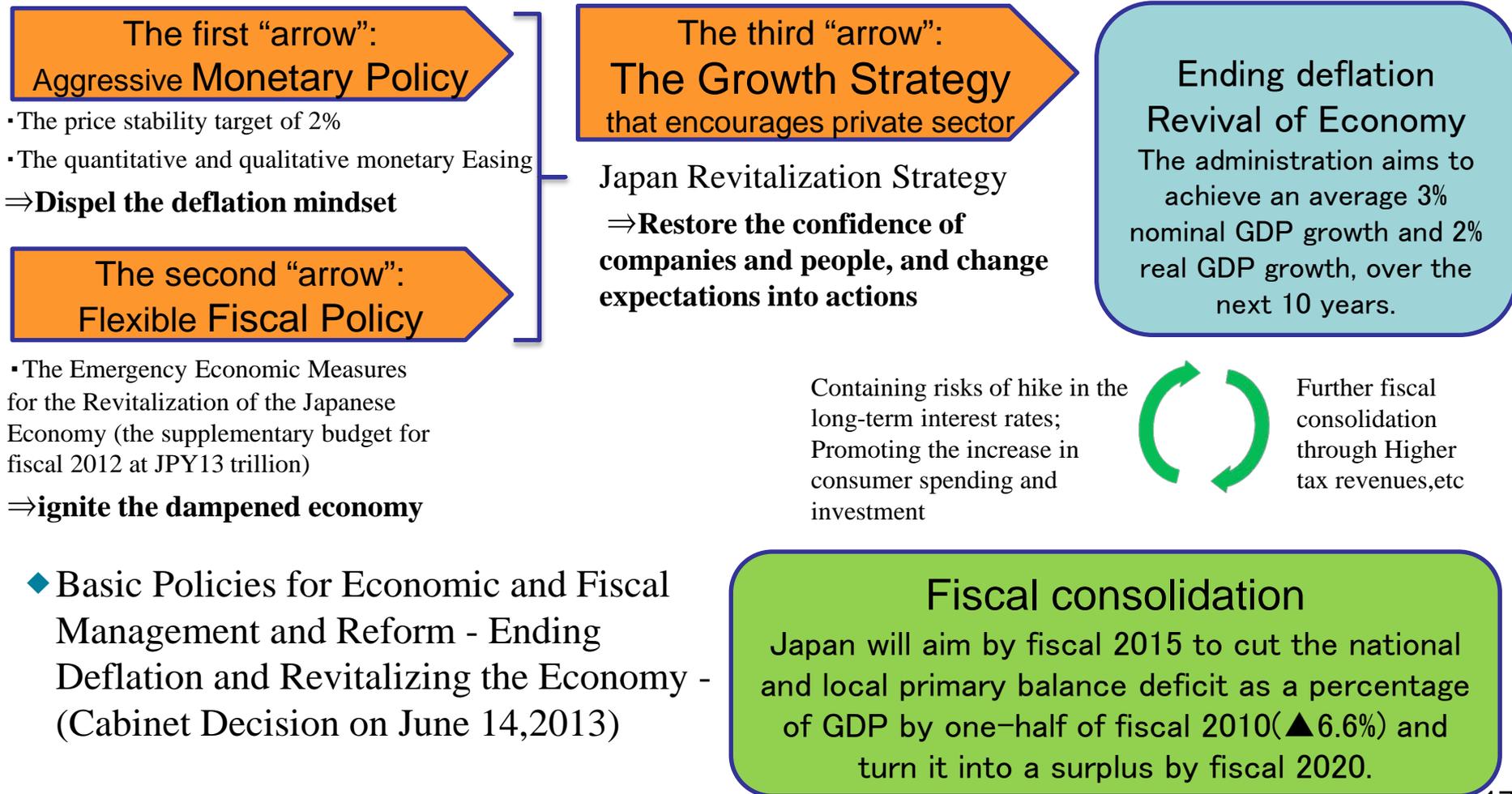
1) Market Size for Joint bond (Total Outstanding)



2) Procedure of tax exemption for nonresidents



- ◆ The Abe administration has successively implemented the policy mix of the “three arrows”(known as “Abenomics”).

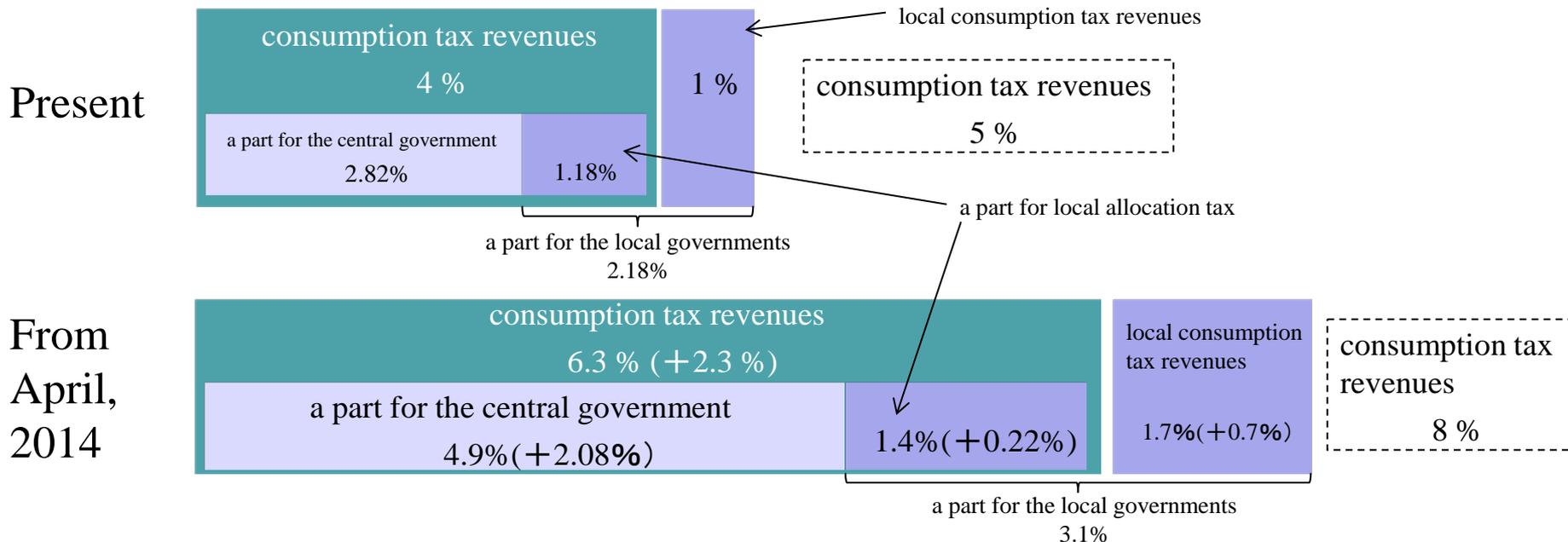


- ◆ Basic Policies for Economic and Fiscal Management and Reform - Ending Deflation and Revitalizing the Economy - (Cabinet Decision on June 14,2013)

III-2 Consumption Tax Hike

- ◆ Under the situation of a rapid dwindling birthrate and aging, and the severe financial status of Japan, in order to secure stable resources for social security the consumption tax rate will be raised from the present 5% to 8% in April, 2014 pursuant to the bill related to the comprehensive reform of social security and tax.
- ◆ The bill provides that the consumption tax rate shall be raised from 8% to 10% in October, 2015.

Distribution in the central government and the local governments of consumption tax revenues

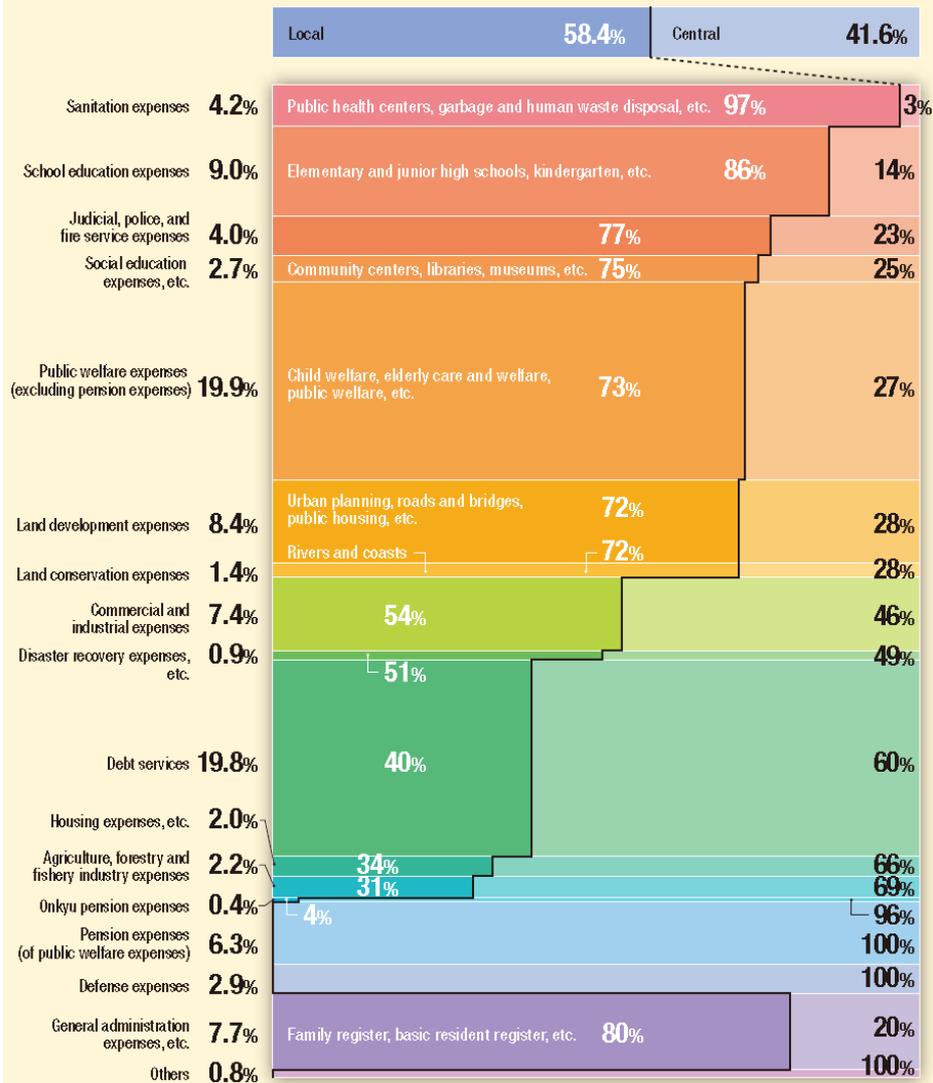


Note: When consumption tax rate is 10%, 7.8% (a part for the central government is 6.28% (+3.46%), a part for local allocation tax is 1.52% (+0.34%)) of that consists of consumption tax revenues and 2.2% (+1.2%) of that consists of local consumption tax revenues (a part for the local governments is 3.72%).

We recommend JLGB as a safe asset and believe they would enhance the value of any investment portfolio on the basis of sovereign risk, financial stability and government backing.

Appendix

Share of Expenditures by Function of Central and Local Governments (final expenditure basis)

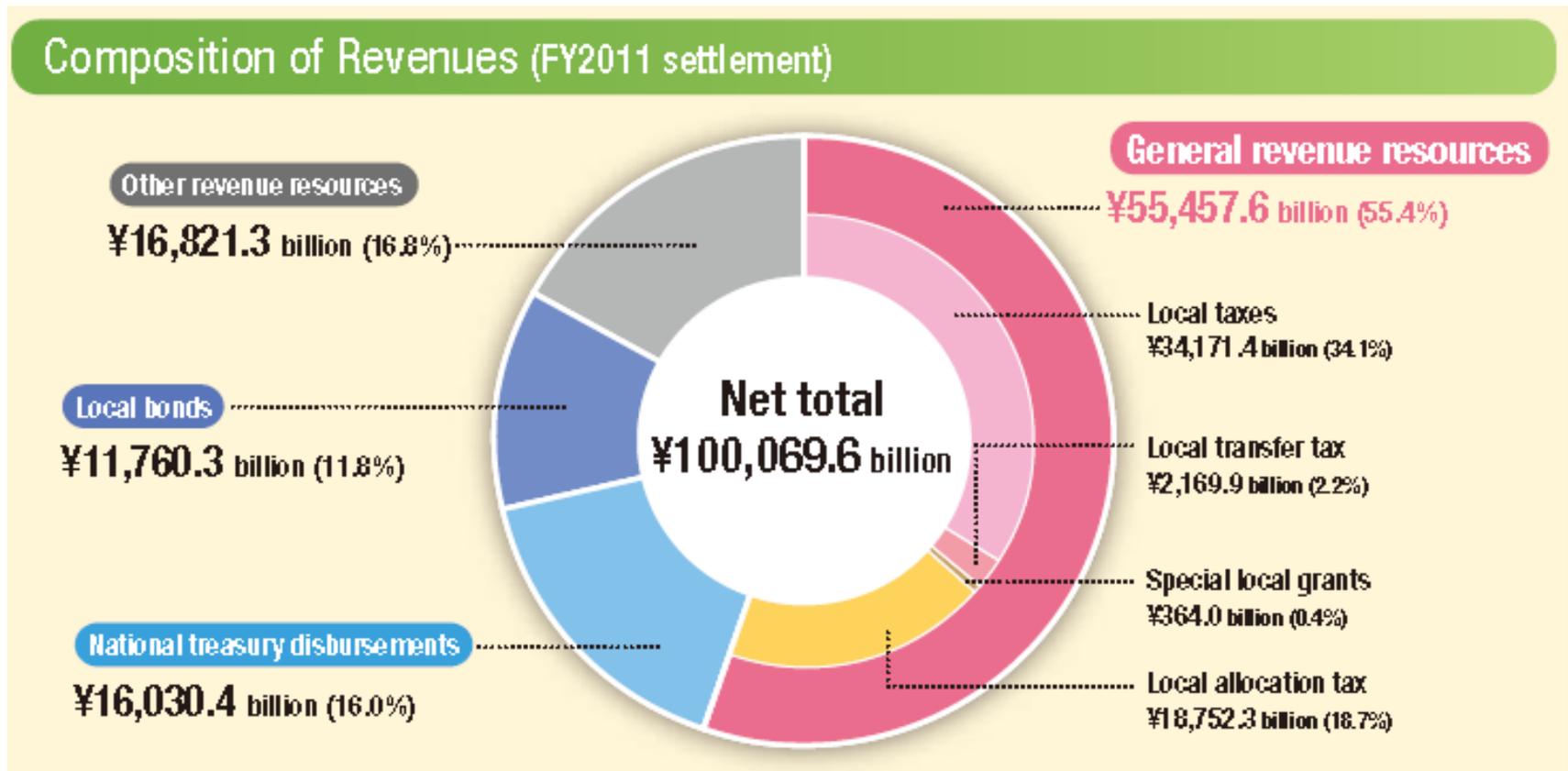


- ◆ LGs have relatively large responsibilities & functions.
- ◆ The greatest portion of local government annual expenditures is directed toward supporting everyday public services: public health and sanitation, education, social education, and police and fire prevention, etc.

Source: White Paper on Local Public Finance, 2013 “FY2011 Settlement” by Ministry of Internal Affairs and Communications

The revenue of LGs

- ◆ The revenue of LGs comes mainly from local taxes, local allocation tax, national treasury disbursements, and local bonds.



Source: White Paper on Local Public Finance, 2013 “FY2011 Settlement” by Ministry of Internal Affairs and Communications

Consultation system for the issuance of JLGB

- ◆ JLGB system changed from approval system to consultation system in FY06 due to decentralization. Moreover, notification system was introduced in FY12 limited to Private Fund from the perspective of enhancement of LGs' autonomy.

1. Consultation

LGs are required to consult with the Minister of MIC(prefectures and government designated cities) or the prefectural governor (in the case of municipalities) before debt issue.

2. Allocation of public funds for LGB with the consent

Only LGB with the consent by the Minister of MIC or the prefectural governors may borrow public funds [Government funds, JFM funds].

3. Debt payment for bonds with the consent included in Local Allocation Tax system

Debt payment for LGBs with the consent by the Minister of MIC or the prefectural governors is included in Local Allocation Tax system.

4. LGs are required to report issuance of the bond without the consent to the assembly

In order to issue LGBs without the consent, the head of the LG is required to report issuance of the bond without the consent to the assembly.

5. Standard for consent

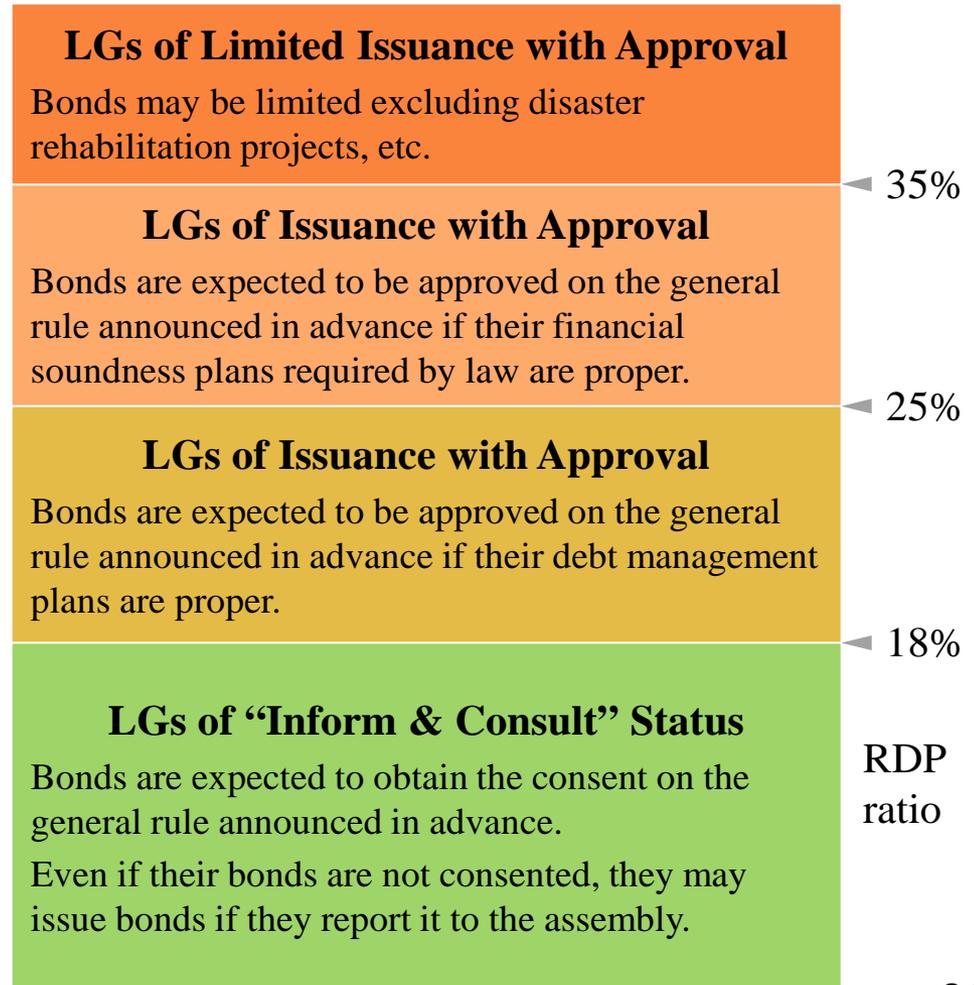
The Minister of MIC releases the standard for the consent every fiscal year. Issuers in high deficit, issuers with high real-debt-payment-ratio, and public enterprises in high deficit, etc. are required to obtain the approval of issuance from the Minister or the governor.

Consultation system for the issuance of LGB

- ◆ In order to secure fiscal soundness, LGs with higher real-debt-payment-ratio or higher deficit than a set limit are required to get the approval for bond issue instead of the consultation.

Approval required if real-debt-payment-ratio(RDP) is 18% or more

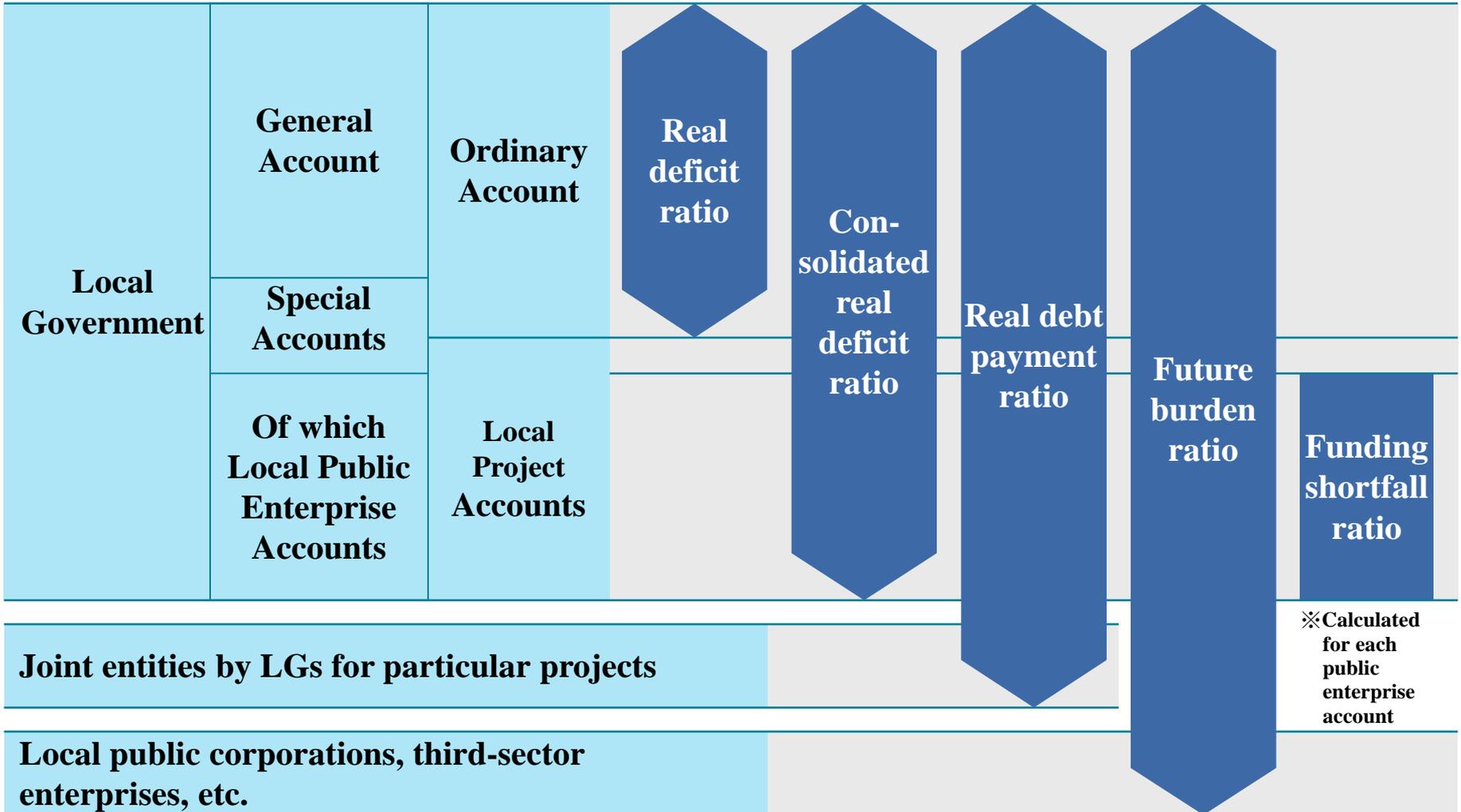
- ◆ Issuers with RDP between 18% ~ 25% must draft the debt management plan and obtain the approval of the MIC minister (or the prefectural governor), based upon the general approval standard.
- ◆ Issuers with the ratio between 25% ~ 35% must draft the financial soundness plan required by law and obtain the approval of the MIC minister (or the prefectural governor), based upon the general approval standard.
- ◆ Issuers with the ratio of 35% or more must draft the financial rebuilding plan and obtain the approval of the MIC minister. Otherwise, Issuers are prohibited from debt issue excluding disaster rehabilitation projects, etc.



Limits for Early warning and reconstruction

	Early warning limit	Reconstruction limit
1. Real deficit ratio	Prefectures: 3.75%	Prefectures: 5%
	Municipalities, depending on fiscal size: 11.25 ~ 15%	Municipalities: 20%
2. Consolidated real deficit ratio	Prefectures 8.75%	Prefectures: 15%
	Municipalities, depending on fiscal size: 16.25 ~ 20%	Municipalities: 30%
3. Real debt payment ratio	Prefectures, and Municipalities: 25%	Prefectures, and Municipalities: 35%
4. Future burden ratio	Prefectures and government-designated cities: 400%	
	Municipalities: 350%	
Management Improvement limit		
5. Funding shortfall ratio at public enterprises	20%	

Scope of fiscal indicators in the Law



Revision of consultation system for the issuance of LGB

◆ Notification system for the issuance of LGB was introduced from FY2012 by revising the part of consultation system in order to enhance the independence and autonomy of LGs.

1. Conditions of LGs that don't need consultation when they issue LGBs

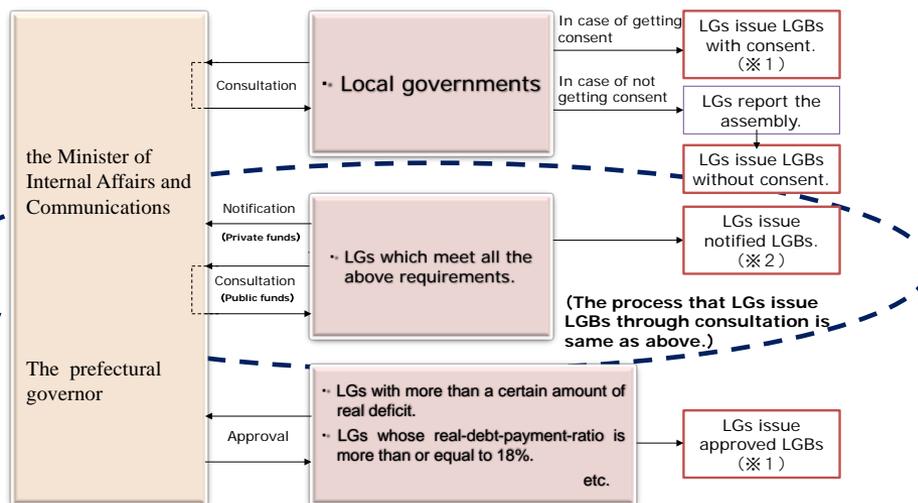
If they meet the following requirements, LGs can issue LGBs[※] without the consultation with the Minister of Internal Affairs and Communications or the prefectural governor. [※]LGBs by private funds only.

- ① Real-debt-payment-ratio is less than 16%.
- ② Real deficit is 0.
- ③ The total amount of LGBs after the consent or the approval is less than or equal to 25% of the previous three year average of the total amount of the standard fiscal scale and the scale of the business of public enterprise.

etc.

2. Local Allocation Tax system

Debt payment for notified LGBs which are approved that LGs could issue with the consent if they consult with the Minister of Internal Affairs and Communications or the prefectural governor is included in Local Allocation Tax system.



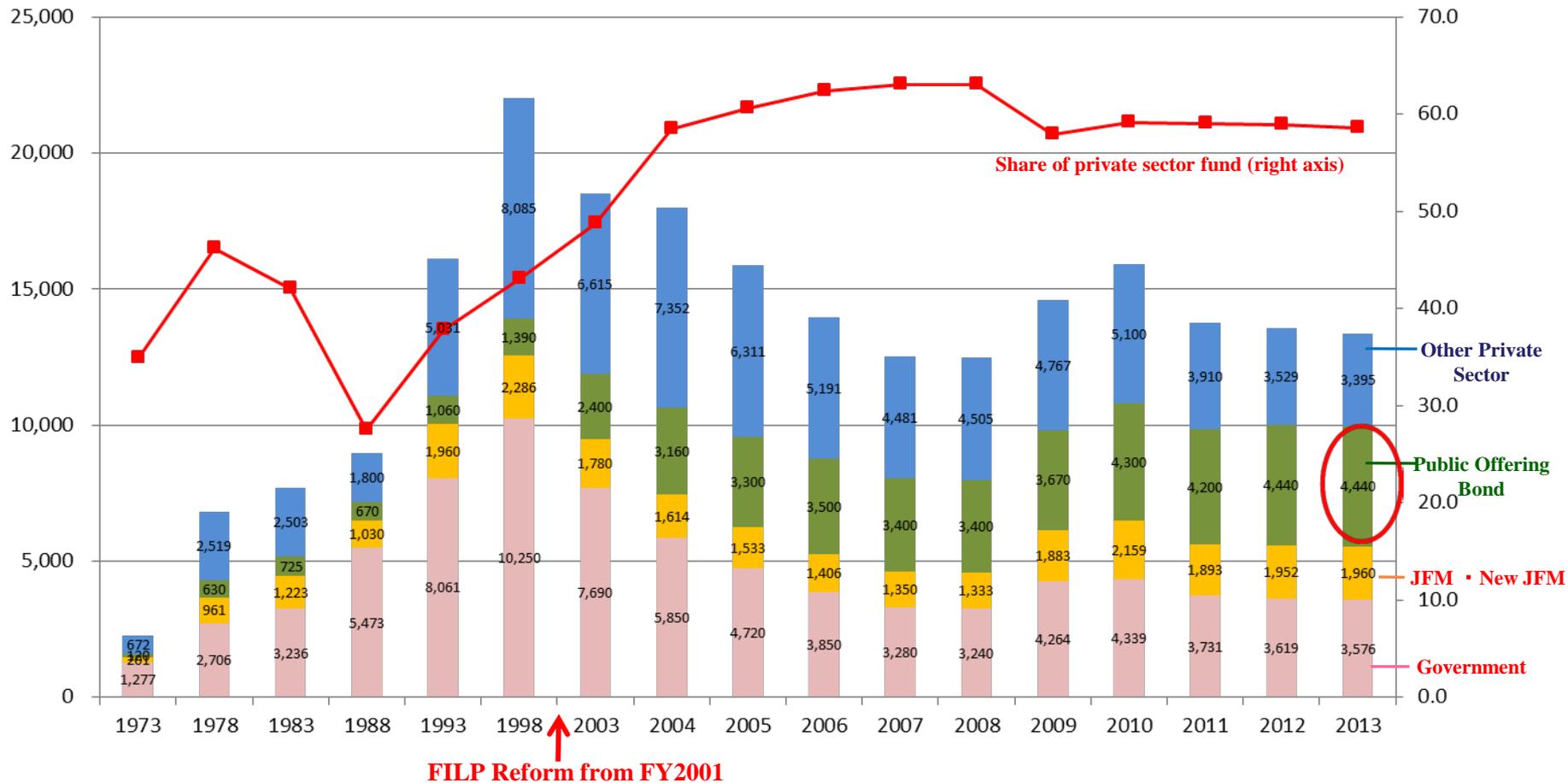
※1 LGBs with the consent(or the approval) are approved to be allocated public funds and debt payment for LGBs with the consent(or the approval) is included in Local Allocation Tax system.

※2 Debt payment for notified LGBs which are approved that LGs could issue with the consent if they consult with the Minister of Internal Affairs and Communications or the prefectural governor is included in Local Allocation Tax system.

Historical changes of annual issue amount

- ◆ Reduction in government funding due to FILP (Fiscal Investment and Loan Program) Reform to minimize government funding role from FY2001.

(Billions of yen)



Source: Ministry of Internal Affairs and Communications



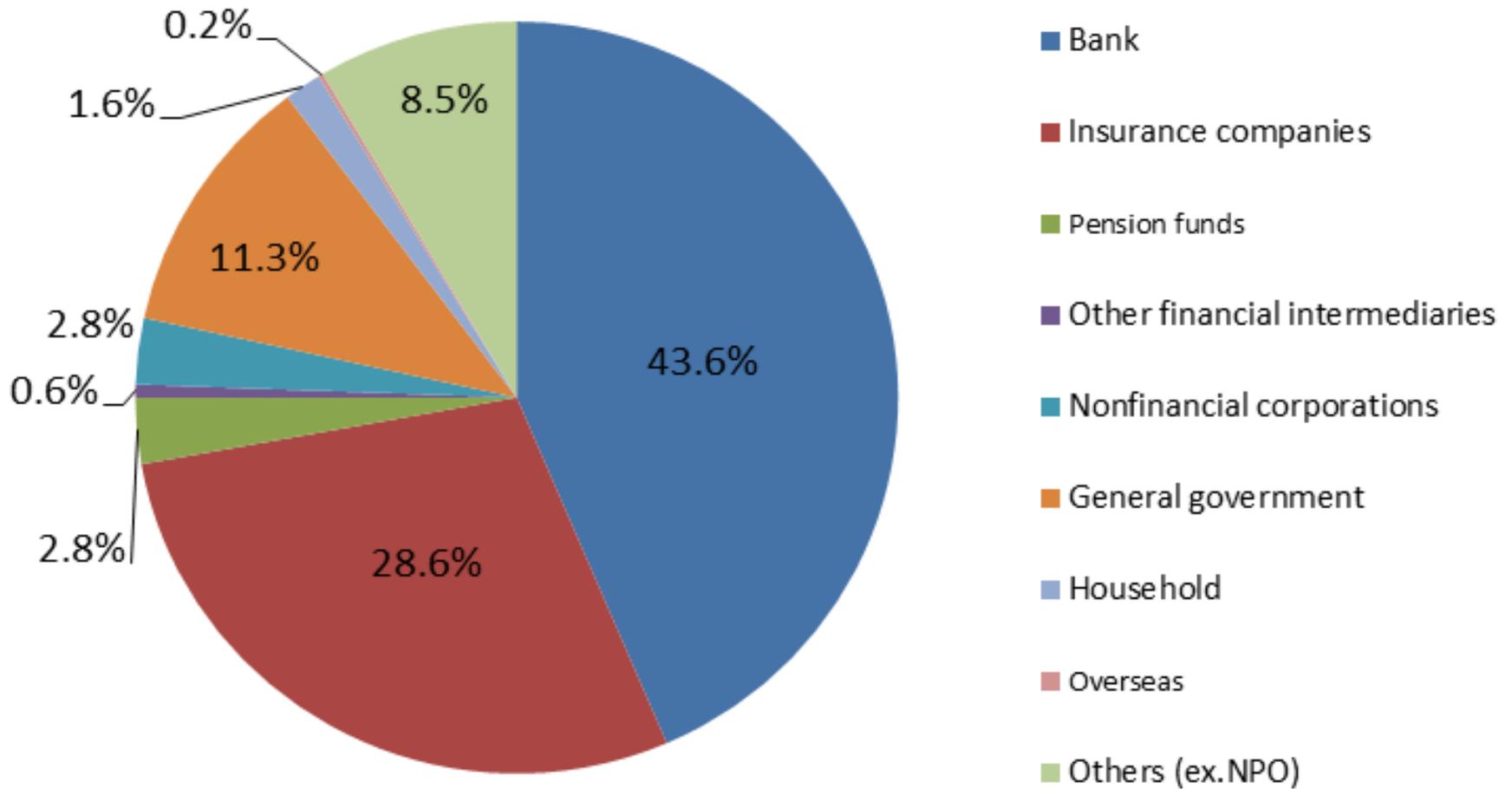
Planned Issuance for Nationwide Public Offering LGBs in Fiscal-Year 2013

(Unit: Hundred Million Yen)

Local government	total	2y or 3y 5y or 7y	10y	15y or 20y or 30y	joint-LGB	other	Local government	total	2y or 3y 5y or 7y	10y	15y or 20y or 30y	joint-LGB	other
Hokkaido	3,000	800	1,200	-	800	200	Kochi	100	-	100	-	-	-
Miyagi	1,100	300	200	-	600	-	Fukuoka	2,550	500	1000	600	-	450
Fukushima	600	100	200	-	300	-	Saga	100	-	100	-	-	-
Ibaraki	400	100	-	-	300	-	Nagasaki	100	-	100	-	-	-
Tochigi	100	-	100	-	-	-	Kumamoto	500	100	100	-	300	-
Gunma	400	100	200	100	-	-	Oita	300	-	100	-	200	-
Saitama	3,800	800	2,000	200	800	-	kagoshima	700	100	-	-	600	-
Chiba	3,600	400	2,000	400	800	-	Sapporo City	1,300	300	300	-	300	400
Tokyo	7,800	600	5,600	600	-	1000	Sendai City	510	150	-	-	360	-
Kanagawa	3,900	1,000	1,800	600	500	-	Saitama City	100	-	100	-	-	-
Niigata	1,000	-	400	-	600	-	Chiba City	500	-	200	-	300	-
Fukui	500	50	300	50	100	-	Yokohama City	2,300	800	900	200	-	400
Yamanashi	200	-	200	-	-	-	Kawasaki City	1,000	280	100	300	260	60
Nagano	800	200	-	-	600	-	Sagamihara City	100	-	100	-	-	-
Gifu	350	-	150	-	200	-	Niigata City	200	-	100	-	100	-
Shizuoka	2,900	300	1,200	300	600	500	Shizuoka City	200	-	100	-	100	-
Aichi	4,600	600	2,400	200	600	800	Hamamatsu City	100	-	100	-	-	-
Mie	200	-	100	-	100	-	Nagoya City	1,400	200	600	200	-	400
Shiga	100	-	100	-	-	-	Kyoto City	1,200	200	200	100	400	300
Kyoto	2,200	500	500	200	600	400	Osaka City	2,200	400	400	200	800	400
Osaka	7,900	3,300	2,400	-	800	1400	Sakai City	200	-	100	100	-	-
Hyogo	3,300	700	600	400	800	800	Kobe City	1,100	200	200	200	300	200
Nara	300	100	-	-	200	-	Okayama City	100	-	100	-	-	-
Shimane	300	300	-	-	-	-	Hiroshima City	600	100	200	-	300	-
Okayama	300	-	200	-	100	-	Kita-Kyushu City	850	150	200	200	300	-
Hiroshima	1,700	100	900	100	600	-	Fukuoka City	1,300	400	200	-	300	400
Tokushima	350	-	100	-	250	-	Kumamoto City	100	-	100	-	-	-
							Total	71,410	14,230	28,650	5,250	15,170	8,110

※This is based on the figures of domestic bonds announced by Ministry of Internal Affairs and Communications in Apr 2013.

Distribution of JLGB holders (2013/March end)



Source: Bank of Japan "Flow of funds accounts"

List of QFI for LGB

1	Bank Sarasin & Co. Ltd	20	FIDEURAM BANK(LUXEMBOURG)S.A.	39	RBC Dexia Investor Services Bank S.A.
2	BANQUE PRIVEE EDMOND DE ROTHSCHILD EUROPE	21	HSBC Bank Plc	40	SIX SIS AG
3	BARCLAYS BANK PLC	22	HSBC Institutional Trust Services (Singapore) Limited	41	Skandinaviska Enskilda Banken AB (publ)
4	Barclays Capital Securities Limited	23	JP Morgan Bank(Suisse)SA	42	SOCIETE GENERALE
5	BNP Paribas Securities Services	24	JP Morgan Bank(Ireland) plc	43	Standard Chartered Bank (Hong Kong) Limited
6	BNY Mellon, National Association	25	JP Morgan Bank Luxembourg S.A.	44	STATE STREET AUSTRALIA LIMITED
7	BROWN BROTHERS HARRIMAN (LUXEMBOURG)S.C.A	26	JP Morgan Clearing Corp.	45	State Street Bank and Trust Company
8	BROWN BROTHERS HARRIMAN&CO.	27	JP Morgan Chase Bank, N.A.	46	State Street Bank GmbH
9	CACEIS Bank	28	KAS BANK N.V.	47	STATE STREET BANK LUXEMBOURG S.A.
10	CACEIS Bank Deutschland GmbH	29	KBL European Private Bankers S.A.	48	STATE STREET CUSTODIAL SERVICES (IRELAND) LIMITED
11	CACEIS Bank Luxembourg	30	Mitsubishi UFJ Securities International plc	49	State Street Trust Company Canada
12	Citibank, N.A.	31	Mizuho INTERNATIONAL PLC	50	State Street Trustees Limited
13	Citigroup Global Markets Inc.	32	Mizuho Trust & Banking (Luxembourg) S.A.	51	The Bank of New York Mellon
14	Clearstream Banking Aktiengesellschaft	33	Morgan Stanley & Co. International plc	52	The Bank of New York Mellon (SA/NV)
15	CLEARSTREAM BANKING S.A.	34	Morgan Stanley & Co. LLC	53	The Northern Trust Company
16	Deutsche Bank Aktiengesellschaft	35	Norddeutsche Landesbank Luxembourg S.A.	54	UBS AG
17	Dexia Banque Internationale a Luxembourg	36	Northern Trust (Guernsey) Limited	55	UBS Securities LLC
18	DnB NOR Bank ASA	37	Northern Trust Fiduciary Services (Ireland) Limited		
19	Euroclear Bank SA/NV	38	Northern Trust Global Services Limited		

Japan Local Government Bond Association Website

(<http://www.chihousai.or.jp/english/07/investor.html>)

English Publications on JLGBs

English Publications on JLGBs	
Presentation Materials	Local Government Bond System and Market in Japan
	Public Offering Joint Local Government Bond
	Japan Finance Organization for Municipalities
	Kawasaki City
Other issuers	Tokyo Metropolitan Government (TMG), Chiba Prefecture, Shizuoka Prefecture, Aichi Prefecture, Yokohama City, Kyoto City, Kobe City, Fukuoka City
White Paper	FY2011 Settlement White Paper on Local Public Finance, 2013
Laws and Ordinances	Law on the Fiscal Consolidation of Local Governments
	Local Autonomy Law
	Local Finance Law
	Local Allocation Tax Law
Others	Issue Outline of Joint Local Government Bond
	Terms and conditions of Tokyo Metropolitan Government Bond

- **Japan Local Government Bond Association**

Website <http://www.chihousai.or.jp/english>

(This includes most comprehensive information in English)

8F, Zenkoku Choson Giin Kaikan, 25 Ichibancho, Chiyodaku, Tokyo, 102-0082, Japan

TEL +81-(0)3-5211-5291 FAX +81-(0)3-5211-5294

- **Local Government Bond Division, Local Public Finance Bureau, Ministry of Internal Affairs and Communications**

<Ministry of Internal Affairs and Communications (MIC)>

Website <http://www.soumu.go.jp/english>

<Local Public Finance Bureau, MIC>

Website <http://www.soumu.go.jp/english/lpfb/index.html>

Address) 2-1-2, Kasumigaseki, Chiyoda-ku, Tokyo 100-8926, Japan

TEL +81-(0)3-5253-5630 FAX +81-(0)3-5253-5631

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