For the six months ended September 30, 2012

Japan Finance Organization for Municipalities

Semiannual Financial Statements

Japan Finance Organization for Municipalities

Contents

■Semiannual Balance Sheets (As of September 30, 2011 and 2012)

(Millions of yen)

Item	As of September 30, 2011	As of September 30, 2012	Item	As of September 30, 2011	As of September 30, 2012
	Amount			Amount	
Assets			Liabilities		
Loans (Note 3)	¥22,238,975	¥22,385,203	Bonds (Note 7)	¥18,549,813	¥18,927,003
Securities (Note 11)	886,938	871,904	Borrowed money	-	30,000
Cash and bank deposits	421,251	574,973	Other liabilities	14,145	13,484
Other assets	16,666	13,653	Reserve for bonuses	51	51
Tangible fixed assets (Note 6)	2,993	2,547	Reserve for directors' bonuses	5	7
Intangible fixed assets	679	540	Reserve for retirement benefits	159	165
			Reserve for retirement benefits for directors and corporate auditors	22	28
			Fund for improvement of operations of municipalities	915,818	919,279
			Basic fund for improvement of operations of municipalities	908,104	911,935
			Additional fund for improvement of operations of municipalities	7,713	7,344
			Reserves under special laws	4,004,127	3,854,135
			Reserve for interest rate volatility	880,000	1,100,000
			Management account reserve for interest rate volatility	3,030,722	2,672,708
			Reserve for interest rate reduction	93,404	81,427
			Total liabilities	23,484,143	23,744,156
			Net assets		
			Capital	16,602	16,602
			Retained earnings	21,527	39,531
			General account appropriated surplus reserve	13,860	29,393
			General account semiannual unappropriated retained earnings	7,667	10,137
			Valuation, translation adjustments and others	(5,842)	(5,708)
			Management account surplus reserve	51,074	54,242
			Management account appropriated surplus reserve	47,565	53,666
			Management account semiannual unappropriated retained earnings	3,509	576
			Total net assets	83,361	104,666
Total assets	¥23,567,505	¥23,848,822	Total liabilities and net assets	¥23,567,505	¥23,848,822

See notes to semiannual financial statements.

■Semiannual Statements of Income (For the six-month periods ended September 30, 2011 and 2012)

(Millions of yen)

Item	Six months ended September 30, 2011	Six months ended September 30, 2012
	Amount	
Income	¥259,307	¥246,674
Interest income	259,191	245,714
Fees and commissions	96	90
Other income	20	868
Amount received for fund for improvement of operations of municipalities	5	592
Other	14	276
Expenses	140,425	136,669
Interest expenses	136,930	132,232
Fees and commissions	133	134
Other operating expenses	2,132	2,939
General and administrative expenses	1,228	1,362
Ordinary income	118,881	110,005
Special gains	226,484	575,860
Reversal of management account reserve for interest rate volatility	220,000	570,000
Reversal of reserve for interest rate reduction	6,484	5,860
Special losses	334,189	675,151
Provision for reserve for interest rate volatility	220,000	220,000
Provision for management account reserve for interest rate volatility	114,189	105,151
Payment to national treasury (Note 4)	-	350,000
Semiannual net income	¥11,176	¥10,714

See notes to semiannual financial statements.

■Semiannual Statements of Changes in Net Assets
(For the six-month period ended September 30, 2011)

(Millions of yen)

	Stockholders' equity				Valuation, translation adjustments and others	Management account appropriated surplus reserve	Management account semiannual unappropriated retained earnings	Total net assets
	Capital	Retained earnings		Total stockholders' equity	Unrealized gain/(loss) from hedging instruments			
		General account appropriated surplus reserve	General account semiannual unappropriated retained earnings					
Balance at April 1, 2011	¥16,602	¥13,860	-	¥30,462	¥(8,645)	¥47,565	-	¥69,382
Changes during semiannual accounting period								
Semiannual net income	-	-	¥7,667	7,667	-	-	¥3,509	11,176
Net changes during semiannual accounting period in items other than stockholders' equity	-	-	-	-	2,803	-	-	2,803
Net changes during semiannual accounting period	-	-	7,667	7,667	2,803	-	3,509	13,979
Balance at September 30, 2011	¥16,602	¥13,860	¥7,667	¥38,130	¥(5,842)	¥47,565	¥3,509	¥83,361

(For the six-month period ended September 30, 2012)

(Millions of yen)

	Stockholders' equity				Valuation, translation adjustments and others	Management account appropriated surplus reserve	Management account semiannual unappropriated retained earnings	Total net assets
	Capital	Retained earnings		Total stockholders' equity	Unrealized gain/(loss) from hedging instruments			
		General account appropriated surplus reserve	General account semiannual unappropriated retained earnings					
Balance at April 1, 2012	¥16,602	¥29,393	-	¥45,995	¥(5,964)	¥53,666	-	¥93,696
Changes during semiannual accounting period								
Semiannual net income	-	-	¥10,137	10,137	-	-	¥576	10,714
Net changes during semiannual accounting period in items other than stockholders' equity	-	-	-	-	255	-	-	255
Net changes during semiannual accounting period	-	-	10,137	10,137	255	-	576	10,969
Balance at September 30, 2012	¥16,602	¥29,393	¥10,137	¥56,133	¥(5,708)	¥53,666	¥576	¥104,666

See notes to semiannual financial statements.

■Semiannual Statements of Cash Flows (For the six-month periods ended September 30, 2011 and 2012)

(Millions of yen)

Item	Six months ended September 30, 2011	Six months ended September 30, 2012
	Amount	
Ⅰ Cash flows from operating activities		
Semiannual net income	¥11,176	¥10,714
Depreciation and amortization	176	174
Interest income	(259,191)	(245,714)
Interest expenses	136,930	132,232
Increase in reserve for bonuses	10	4
Increase/(decrease) in reserve for directors' bonuses	(0)	0
Increase/(decrease) in reserve for retirement benefits	(36)	18
Increase/(decrease) in reserve for retirement benefits for directors and corporate auditors	(4)	4
Decrease in fund for improvement of operations of municipalities	(5)	(592)
Increase in reserve for interest rate volatility	220,000	220,000
Decrease in management account reserve for interest rate volatility	(105,810)	(114,848)
Decrease in reserve for interest rate reduction	(6,484)	(5,860)
Net (increase)/decrease in loans	(7,119)	2,207
Net increase in bonds	220,760	748,309
Interest received	261,313	246,894
Interest paid	(137,009)	(132,350)
Others	(608)	505
Net cash provided by operating activities	334,096	861,701
Ⅱ Cash flows from investing activities		
Proceeds from redemption of securities	1,314,600	2,470,000
Purchases of securities	(1,743,920)	(2,578,871)
Purchases of tangible fixed assets	(97)	(14)
Purchases of intangible fixed assets	(60)	(91)
Net cash used in investing activities	(429,477)	(108,977)
Ⅲ Cash flows from financing activities		
Payment to national treasury	-	(350,000)
Net cash used in financing activities	-	(350,000)
Ⅳ Effect of exchange rate changes on cash and cash equivalents	-	-
Ⅴ Net increase/(decrease) in cash and cash equivalents	(95,381)	402,723
Ⅵ Cash and cash equivalents at beginning of period	516,633	172,250
Ⅶ Cash and cash equivalents at end of period	¥421,251	¥574,973

See notes to semiannual financial statements.

■Notes to Semiannual Financial Statements

1. Basis of Presentation

Japan Finance Organization for Municipalities (hereinafter, "JFM") has prepared semiannual financial statements in accordance with the Japan Finance Organization for Municipalities Law (Law No. 64, 2007; hereinafter, the "Law"), the ordinances based on the Law and other regulations applicable to JFM and accounting principles and practices applicable to semiannual financial statements generally accepted in Japan, which are different in certain respects as to the application and disclosure requirements of International Financial Reporting Standards.

Since JFM does not have any subsidiaries or affiliates, it does not prepare semiannual consolidated financial statements.

Amounts less than one million yen have been omitted. As a result, the totals in Japanese yen shown in the semiannual financial statements do not necessarily agree with the sum of the individual amounts.

2. Summary of Significant Accounting Policies

(1) Securities

Held-to-maturity securities are carried at amortized cost (straight-line method).

(2) Derivative transactions

Derivative transactions are carried at fair value with changes in unrealized gain or loss charged or credited to income, except for those which meet the criteria for hedge accounting.

(3) Depreciation and amortization

(a) Tangible fixed assets

Depreciation of tangible fixed assets is calculated by the straight-line method based on the estimated useful lives and the residual value determined by management. The estimated useful lives of major items are as follows:

Buildings: 20 to 41 years
Others: 2 to 19 years

(b) Intangible fixed assets

Amortization of intangible fixed assets is calculated by the straight-line method based on the estimated useful lives and the residual value determined by management. Software for internal use owned by JFM is amortized over 5 years.

(4) Deferred assets

Bond issuance costs are expensed in full when incurred.

(5) Translation of assets and liabilities denominated in foreign currencies into Japanese yen

Monetary assets and liabilities denominated in foreign currencies, for which foreign currency swaps or foreign exchange forward contracts are used to hedge the risk of foreign currency fluctuation, are translated at the contracted rate as these swap contracts or the forward contracts qualify for deferral hedge accounting.

(6) Reserves

(a) Reserve for possible loan losses

JFM has never experienced any loan losses. Accordingly, no reserve for possible loan losses has been maintained.

(b) Reserve for bonuses

The reserve for bonuses is provided for payment of bonuses to employees, in the amount of estimated bonuses, which are attributable to the semiannual period.

(c) Reserve for directors' bonuses

The reserve for directors' bonuses is provided for payment of bonuses to directors, in the amount of estimated bonuses, which are attributable to the semiannual period.

(d) Reserve for retirement benefits

The reserve for retirement benefits is provided for payment of retirement benefits to employees, in the amount deemed accrued as of the end of the semiannual period, based on the projected retirement benefit obligation and fair value of plan assets as of the end of the semiannual period.

(e) Reserve for retirement benefits for directors and corporate auditors

The reserve for retirement benefits for directors and corporate auditors is provided for payment of retirement benefits to directors and corporate auditors, in the amount deemed accrued at the end of the semiannual period based on internal policies.

(7) Hedge accounting

(a) Hedge accounting method

Interest rate swaps used to hedge the risk of interest rate fluctuations that qualify for hedge accounting and meet specific matching criteria are not measured at fair value, but the differential paid or received under the swap agreements is recognized and included in interest expense or income. If swap contracts or forward contracts used to hedge the risk of foreign currency fluctuation qualify for deferral hedge accounting, the foreign currency-denominated assets and liabilities are translated at the contracted rate.

(b) Hedging instruments and hedged items

(ⅰ) Hedging instruments･･･Interest rate swaps
Hedged items･････････Bonds and borrowed money

(ⅱ) Hedging instruments･･･Currency swaps
Hedged items･････････Foreign currency-denominated bonds

(ⅲ) Hedging instruments･･･Foreign exchange forward contracts
Hedged items･････････Receipt of interest and principal of foreign currency-denominated bank deposits

(c) Hedging policy

JFM uses hedging instruments as a means of hedging exposure to interest rate risk and foreign exchange risk. Hedged items are identified by each individual contract.

As a means of hedging foreign exchange fluctuation risks associated with the receipt of interest and principal of foreign currency-denominated bank deposits, a foreign exchange forward contract is entered into at the time of each deposit to hedge the risks.

(d) Assessment of hedge effectiveness

JFM ensures hedging instruments and hedged items have the same major terms when entering into hedge transactions to offset bond and borrowed money market fluctuation risks. Accordingly, JFM deems these to be highly effective and thus does not assess effectiveness. Moreover, a periodic assessment of hedge effectiveness for interest rate swaps for which hedge accounting is applied and currency swaps and forward contracts that qualify for deferral hedge accounting is omitted when the exceptional accrual method is applied.

(8) Cash and cash equivalents

Cash and cash equivalents in the semiannual statements of cash flows consist of “Cash and bank deposits” on the semiannual balance sheets.

(9) Fund for improvement of operations of municipalities

In accordance with the provisions of Article 46, Section 1 of the Law, JFM has established the fund for improvement of operations of municipalities to reserve contributions as stipulated in Article 32-2 of the Local Finance Law (Law No. 109, 1948). Also, pursuant to the provisions of Article 46, Section 5 of the Law, income arising from the investment of the fund (hereinafter, “investment income”) is used to reduce interest rates of the loans to municipalities, and if there is any surplus in the investment income after this interest rate reduction process, the surplus amount is added to the fund. Further, pursuant to the provisions of Article 46, Section 6 of the Law, if there is any shortfall after the interest rate reduction process, the shortfall is covered by withdrawal of the fund within the limits of the total of the additional portion to the fund made up to the previous fiscal year and the contributions made in the most current fiscal year.

(10) Reserve for interest rate volatility and management account reserve for interest rate volatility

The reserve for interest rate volatility is set aside to prepare for interest rate risk associated with refinancing of JFM bonds (excluding the bonds issued by the former Japan Finance Corporation for Municipal Enterprises; hereinafter, “former JFM”) pursuant to the provisions of Article 38, Sections 1 and 3 of the Law, and Article 9, Section 8 of the supplementary provisions of the Law, and is calculated and accounted for based on the provisions of Article 34 of the Ministerial Ordinance on Finance and Accounting of Japan Finance Organization for Municipalities (Ordinance No.87 of the Ministry of Internal Affairs and Communications, 2008; hereinafter, “Ordinance on Finance and Accounting”) and Article 22 of the Government Ordinance on Preparation of Relevant Government Ordinances and Provisional Measures for the Abolishment of the Japan Finance Corporation for Municipal Enterprises Law (Government Ordinance No. 226, 2008; hereinafter, “Preparation Ordinance”).

Management account reserve for interest rate volatility is set aside to manage interest rate risk associated with refinancing of bonds issued by the former JFM pursuant to the provisions of Article 9, Sections 9 and 10, and Article 13, Sections 5 and 7 of the supplementary provisions of the Law, and is calculated and accounted for based on the provisions of Articles 1 through 3 of the Ministerial Ordinance on the operations of Management Account at Japan Finance Organization for Municipal Enterprises (Ordinance No. 2 of the Ministry of Internal Affairs and Communication, and the Ministry of Finance, 2008; hereinafter, “Management Account Operations Ordinance”) and Articles 3 and 5 of the supplementary provisions of the above ordinance.

(11) Reserve for interest rate reduction

The reserve for interest rate reduction is set aside to reduce interest rates on the loans made by the former JFM to local governments pursuant to the provisions of Article 9, Section 13, and Article 13, Section 8 of the supplementary provisions of the Law, and Article 26, Sections 1, 3 and 4 of the Preparation Ordinance, and is calculated and accounted for based on the provisions of Article 5 of Management Account Operations Ordinance.

(12) Consumption taxes

National and local consumption taxes are accounted for using the tax exclusion method.

3. Loans

There are no bankrupt loans, non-accrual loans, past due loans (three months or more), or restructured loans. Since JFM has never experienced loan losses in the past, it does not record a reserve for possible loan loss.

Bankrupt loans represent loans to borrowers as defined in Articles 96, Section 1, Clause 3 (a) through (e) and Clause 4 of the Enforcement Ordinance of the Corporate Income Tax Law (Government Ordinance No. 97, 1965), and on which accrued interest is not accounted in revenue as there is no expectation of collection of either principal or interest because they are past due for a considerable period of time or for other reasons (excluding loans on which bad debts are written off; hereinafter, “Non-accrual loans”).

Non-accrual loans represent loans on which accrued interest is not accounted in revenue, excluding loans to bankrupt borrowers and loans with grace periods for interest payments to assist in corporate reorganization or to support business.

Past due loans (three months or more) represent loans on which payment of principal or interest is in arrears for more than three months, calculated from the day following the contractual due date, excluding bankrupt loans and non-accrual loans.

Restructured loans represent loans, given certain favorable terms and conditions, such as reduction or exemption of interest, grace periods for interest or principal payments, and debt waivers, to assist borrowers in corporate rehabilitation or to support business, excluding bankrupt loans, non-accrual loans and past due loans (three months or more).

4. Transfer to the National Treasury of a Part of JFM’s Reserve for Interest Rate Volatility within Management Account

In accordance with the supplementary provisions to the Law, a part of JFM’s reserve for interest rate volatility within management account is to be attributed to the Japanese national government over a period of three years from fiscal 2012 through fiscal 2014, with the aim of transferring 1 trillion yen over this period.

In fiscal 2012, 350,000 million yen has been transferred to the national treasury by JFM, pursuant to Article 14 of the supplementary provisions to the Law for fiscal 2012 (Ordinance No. 2 of the Ministry of Internal Affairs and Communication, and the Ministry of Finance, 2012).

5. Financial Instruments

(1) Status of financial instruments

(a) Policy for financial instruments

In order to maintain a sound and good financial standing and earn the solid confidence of capital markets, JFM needs to appropriately manage various risks including interest rate risks.

JFM adopts an integrated risk management approach to appropriately respond to various risks while endeavoring to further advance its risk analysis and management.

Accordingly, JFM has developed a system for appropriate risk management, including the establishment of the Integrated Risk Management Committee, which supervises JFM's overall risk management, and the Risk Management Office, which monitors the risks in each department. The content of risk management can then be appropriately reflected in management decisions.

(b) Details and risks of financial instruments

JFM raises funds by primarily issuing 10-year bonds, and makes loans with a maximum maturity of 30 years and with repayment of interest and principal in equal installments. Therefore, a large duration gap is created between lending and fund-raising, and JFM is exposed to the interest rate risk associated with bond and borrowed money refinancing.

JFM has set aside reserves for interest rate fluctuations (reserve for interest rate volatility), and has set up the ALM Committee separately from the Integrated Risk Management Committee to comprehensively analyze and manage JFM's assets and liabilities in a timely and appropriate manner. The ALM Committee is held four times a year, in principle. Specifically, medium- and long-term management analysis as well as risk analysis and evaluation are conducted through scenario analysis, VaR analysis, and duration analysis, among other methods. In addition, JFM reflects the findings in its bond issuance plans and other aspects of management and endeavors to reduce interest rate risk.

(c) Risk management for financial instruments

(i) Credit risk

Credit risk is the risk of loss arising from a credit event, such as deterioration in the financial condition of a borrower, which causes an asset to lose value or become worthless. In addition to credit risk associated with loans, market transactions also involve credit risk.

A. Credit risk on loans

JFM extends loans exclusively to local governments. Local governments have a zero Bank of International Settlements (BIS) risk weighting and JFM does not expect any default on loans made to local governments for the reasons outlined below. JFM and the former JFM have never experienced any loan losses.

- The national government of Japan includes local government debt servicing costs in the expenditure of the Local Government Finance Program, and secures the total amount of local allocation tax which balances local governments' total expenditures including debt servicing costs and total revenue. Thus, the national government effectively secures revenue sources for principal and interest payments for local governments. The national government also secures revenue sources for debt servicing for individual local governments by including a portion of local government debt servicing costs in the Standard Financial Needs when calculating local allocation tax.
- Under the consultation system for local government bonds and loans, credit reviews must include checks on the circumstances of local government debt servicing, and tax revenue and necessary revenue sources to be secured. Additionally, under the Early Warning System, the local governments whose debt servicing costs and financial deficits exceed a certain level must apply for approval to issue bonds or obtain loans, so that the credit standing of local government bonds and loans is maintained.
- Under the Law Relating to the Financial Soundness of Local Governments, which was promulgated in June 2007 (No.94), local governments whose fiscal indicators exceed the early warning limits must make their own efforts toward achieving fiscal soundness, and local governments whose fiscal indicators exceed the reconstruction limits must take necessary actions to restore their finances under the oversight of the national government with regard to redemption of local government bonds and loans, and other operations.

JFM is not subject to the "Banking Law" (1981, No. 59) or the "Financial Reconstruction Law" (1998, No. 132) but performs self-assessment of loans made by the former JFM to local government road corporations in accordance with the "Financial Inspection Manual" of the Financial Services Agency (FSA).

B. Credit risk on market transactions

JFM is exposed to the risk of loss arising from credit events, such as deterioration in the financial condition of a counterparty, which causes an asset to lose value or become worthless. However, JFM appropriately manages credit risk of this type by constantly monitoring counterparties' financial standing, taking measures including suspension of new deals and cancellation of transactions in case of a deterioration of their credit standings. Moreover, JFM limits counterparties to financial institutions that achieve a certain credit rating and other criteria, and conducts transactions within the credit lines for each counterparty in order to diversify risks. In addition, JFM enters into ISDA (International Swaps and Derivatives Association) master agreements and CSA (Credit Support Annex) with all derivatives counterparties to reduce credit risk.

(ii) Market risk

Market risk is the risk of loss resulting from changes in the value of assets and liabilities due to fluctuations in risk factors such as interest rates, securities prices and foreign exchange rates, or the risk of loss resulting from changes in earnings generated from assets and liabilities. Market risk includes interest rate risk, foreign exchange risk, inflation risk and price change risk.

A. Interest rate risk

Interest rate risk is the risk of losses incurred or a decrease in profits due to fluctuations in interest rates when there is an interest rate or duration gap between assets and liabilities.

JFM makes loans to local governments. The maximum term to maturity is 30 years, but the funds for these loans are raised mainly through issuance of 10-year bonds, which creates interest rate risk associated with bond refinancing. JFM takes the following measures to address the interest rate risk resulting from a duration gap between lending and fund-raising.

- JFM maintains necessary reserves to cope with the interest rate risk resulting from a duration gap between lending and fund-raising.
- As assets and liabilities in JFM's general account will expand as a result of loans and fund-raising for local governments JFM carries out an ALM analysis of this account in a timely and appropriate manner to further enhance the effectiveness of its management of interest rate risk. JFM also endeavors to reduce exposure to interest rate risk by setting the following medium-term (between fiscal 2009 and fiscal 2013) management target, such as continuously issuing super long-term bonds with maturities exceeding 10 years.

  a. Maintain the "outlier ratio" below approximately 20%

  Notes: 1. "Outlier ratio" is the ratio of "decline in economic value" as a result of interest rate shocks to net assets including the reserve for interest rate volatility and the fund for improvement of operations of municipalities.

  2. "Decline in economic value" is the decline of present value after interest rate shocks (an upward or downward 200 bp parallel shift of the yield curve).

  b. Maintain a duration gap of less than approximately 2 years

  Management account, which manages assets related to money loaned by the former JFM, is currently exposed to greater interest rate risk than general account, but JFM contributes to the required reserves for interest rate volatility as described above.
- In accordance with Article 14 of the supplementary provisions of the Law, it was decided that a part of JFM's reserve for interest rate volatility within management account would be attributed to the Japanese national government. The transfer is projected to occur over a period of three years from fiscal 2012 through fiscal 2014, with the aim of transferring 1 trillion yen over this period.

Such transfer will not affect the smooth operation of JFM's business at time of transfer or in the future.

JFM is also exposed to pipeline risk, whereby losses would be incurred or profits decreased as a result of interest rate fluctuations during the time from when JFM raises money until the point at which the money is loaned to local governments. JFM uses swap transactions to hedge against pipeline risk.

B. Foreign exchange and other risks

Various risks associated with bond principal and interest payments are hedged by swap transactions. These risks include foreign exchange risk related to foreign currency-denominated bonds, interest rate risk related to floating rate bonds, and risk of fluctuations in the amounts of principal and interest of inflation-indexed bonds.

JFM's investments of surplus funds are exposed to the risk of losses on the sale of securities resulting from price declines and the risk of realized losses on foreign currency-denominated deposits resulting from fluctuations in foreign exchange rates. Accordingly, in principle, JFM minimizes the risk of price fluctuation by holding investments until maturity, and hedges foreign exchange risk by using foreign exchange contracts.

C. Quantitative information on market risk

Loans, bonds and borrowed money are primarily affected by interest rate risk, which is a major risk variable among market risks.

With respect to general account loans, bonds and borrowed money, JFM establishes a management target and uses the outlier ratio for quantitative analysis in the management of interest rate risk.

Specifically, JFM is attempting to maintain the outlier ratio below approximately 20% from fiscal 2009 to fiscal 2013 by means of issuing bonds of various terms, including super long-term bonds, which have a redemption period of over 10 years, considering the composition of the remaining periods of the bonds held.

The outlier ratio is calculated based on the following conditions.

- Future cash flows

  With respect to loans, future cash flows regarding such loans are calculated based on the type of interest rate of the loans. In addition, the advanced redemption in the future is not expected by JFM.

  With respect to fixed-rate bonds, future cash flows regarding such fixed-rate bonds are calculated based on the redemption schedule. With respect to floating rate bonds hedged by interest rate swaps, that qualify for hedge accounting and meet specific matching criteria, future cash flows corresponding to such floating rate bonds are calculated in a manner similar to fixed-rate bonds.
- Indicative Interest Rate

  For the assessment of loans, bonds and borrowed money, the corresponding interest rate of Japanese government bonds as of September 30, 2012, is used.
- Calculation of outlier ratio

  Based on an assumption that risk variables, except for interest rate risk, are fixed as of September 30, 2012, the outlier ratio is calculated by dividing the change in fair value in the case where the indicative interest rate (government bonds) rises across-the-board by 200 basis points (2.00%) or the change in fair value in the case such rate falls across-the-board by 200 basis points (2.00%), whichever is greater, by net assets including the reserve for interest rate volatility and the fund for improvement of operations of municipalities.

Information the outlier ratio as of September 30, 2012 is as follows:
One outlier ratio reflecting a rise of 200 basis points of the indicative interest rate is calculated as JFM has determined that the change in fair value in the case of rising interest rates would be greater than that in the case of falling interest rates.

(Millions of yen)

	Outlier ratio (a)=-(b)/(e)	Change in fair value in the case of 200 basis points rise in interest rates			Net assets including reserve for interest rate volatility and fund for improvement of operations of municipalities (e)
		Total (b)=(c)+(d)	Loans (c)	Bonds and borrowed money (d)	
General account	15.6% [+0.7%]	¥(323,057) [(50,438)]	¥(1,129,645) [(284,618)]	¥+806,588 [+234,179]	¥2,069,703 [+241,597]

Note: Amounts posted in square brackets indicate the change from September 30, 2011.

With respect to loans and bonds in management account, JFM raises funds by the issuance of bonds as necessary in order to manage existing loans until their redemption. For this reason, while JFM reports the calculation results of the quantitative information regarding the interest rate risk to the ALM Committee and confirms the status or transition, etc. of interest rate risk, JFM does not establish a management target or use the quantitative analysis in the management of interest rate risk.

With respect to these financial instruments in management account, based on assumption that the risk variables, except for interest rate risk, hold steady, for an indicative interest rate as of September 30, 2012 that is 10 basis points higher than the actual rate, it is assumed that the fair value of the net amount (assets side), after offsetting such financial instruments with the financial liabilities, would decline by 57,971 million yen. On the contrary, for an indicative interest rate as of September 30, 2012 that is 10 basis points lower than the actual rate, it is assumed that the fair value of the net amount (assets side), after offsetting such financial instruments with the financial liabilities, would increase by 58,815 million yen.

(iii) Liquidity risk

Liquidity risk is the risk that JFM would incur losses due to difficulties in securing the necessary funds or the necessity of obtaining funds at far higher interest rates than under normal conditions as a result of a mismatch between the maturities of assets and liabilities or an unexpected outflow of funds (funding liquidity risk). It also includes the risk that JFM would incur losses because it is unable to conduct market transactions or is forced to conduct transactions at far more unfavorable prices than under normal conditions due to market disruption or other difficult situations (market liquidity risk).
JFM's exposure to liquidity risk is extremely low because loans are made to local governments according to a pre-set schedule, and the daily cash and liquidity management is carried out based on a quarterly plan for fund management. Moreover, JFM has entered into overdraft agreements with several financial institutions to prepare for the unexpected events, and invests surplus funds only in short-term financial products.

(iv) Supplemental remarks on fair value of financial instruments

In addition to the amount based on the market price, the fair value of illiquid financial instruments includes a value that has been rationally calculated. Since certain assumptions were made when calculating the fair value, the value may differ in the event that the assumptions change.

(2) Items related to fair value of financial instruments

The book value, fair value and difference between them as of September 30, 2011 are as follows.

(Millions of yen)

	Book value	Fair value	Difference
(1) Loans	¥22,238,975	¥23,756,568	¥1,517,592
(2) Securities			
Held-to-maturity securities	886,938	886,916	(22)
(3) Cash and bank deposits	421,251	421,251	-
Total assets	23,547,166	25,064,735	1,517,569
Bonds	18,549,813	19,282,657	732,844
Total liabilities	18,549,813	19,282,657	732,844
Derivative transactions(*1)			
Hedge accounting applied	2,695	2,695	-
Total of derivative transactions	2,695	2,695	-

The book value, fair value and difference between them as of September 30, 2012 are as follows.

(Millions of yen)

	Book value	Fair value	Difference
(1) Loans	¥22,385,203	¥23,989,467	¥1,604,264
(2) Securities			
Held-to-maturity securities	871,904	871,864	(40)
(3) Cash and bank deposits	574,973	574,973	-
Total assets	23,832,081	25,436,305	1,604,223
(1)Bonds	18,927,003	19,756,893	829,889
(2)Borrowed money	30,000	30,577	577
Total liabilities	18,957,003	19,787,470	830,467
Derivative transactions(*1)			
Hedge accounting applied	147	147	-
Total of derivative transactions	147	147	-

(*1) Assets and liabilities resulting from derivative transactions are presented on a net basis with liabilities in parentheses.

Note 1. Method for calculating fair value of financial instruments and items related to marketable securities and derivative transactions.

Assets

(1) Loans

The fair value of loans is calculated by discounting future cash flows assuming prepayment at the discount rate calculated using the Japanese government bond rates as of September 30, 2011 and 2012.

(2) Securities

All bonds are held until maturity, and the fair value of treasury discount bills is the market price.

Since all negotiable certificates of deposit are short-term, the fair value approximates the book value. As a result, the book value is deemed to be the fair value.

(As of September 30, 2011)

(Millions of yen)

	Type	Book value	Fair value	Difference
Securities with fair values exceeding the semiannual balance sheet amount	-	¥-	¥-	¥-
	Sub total	-	-	-
Securities with fair values that does not exceed the semiannual balance sheet amount	Treasury discount bills	425,938	425,916	(22)
	Negotiable certificates of deposit	461,000	461,000	-
	Sub total	886,938	886,916	(22)
Total		¥886,938	¥886,916	¥(22)

(As of September 30, 2012)

(Millions of yen)

	Type	Book value	Fair value	Difference
Securities with fair values exceeding the semiannual balance sheet amount	-	¥-	¥-	¥-
	Sub total	-	-	-
Securities with fair values that does not exceed the semiannual balance sheet amount	Treasury discount bills	479,904	479,864	(40)
	Negotiable certificates of deposit	392,000	392,000	-
	Sub total	871,904	871,864	(40)
Total		¥871,904	¥871,864	¥(40)

(3) Cash and bank deposits

The book value is used as the fair value for deposits without maturities. Since all deposits with maturities are short-term, the fair value approximates the book value. As a result, the book value is deemed to be the fair value.

Liabilities

(1)Bonds

The fair value of bonds issued by JFM that have a market price is based on the market price. The fair value of bonds without a market price is calculated by discounting the future cash flows using the interest rate that would be applied when issuing similar bonds with the same total principal and interest and payment term.
Deferral hedge accounting is used for currency swaps, and the fair value of foreign currency-denominated bonds is thus calculated using the total of the fair value of that bond and the fair value of the swap transaction.
Hedge accounting is used for interest rate swaps, and the fair value of floating rate bonds is thus calculated by determining the current value using the total of the corresponding interest rate swap accounted for together with the principal and interest and discounting the future cash flows using the interest rate that would be applied when issuing a similar bond.

(2)Borrowed money

The fair value of borrowed money is calculated by discounting the future cash flows using the interest rate that would presumably be applied when issuing bonds with the same total principal and interest and payment term.

Derivative transactions

Transactions for which hedge accounting is applied

For derivative transactions for which hedge accounting is applied, the contractual amount or the amount equivalent to the principal in the contract under each hedge accounting method as of September 30, 2011 is as follows:

(Millions of yen)

Hedge accounting method	Type of derivative transactions	Primary hedged items	Contract amount	Of which 1 year or more	Fair value	Method for calculating fair value
Principal accounting method	Interest rate swap transactions Receive/fixed and pay/floating	Bonds	¥123,000	¥123,000	¥2,695	Based on prices provided by the counterparty financial institutions
Hedge accounting for interest rate swaps	Interest rate swap transactions Receive/floating and pay/fixed	Bonds	95,000	95,000	(*1)	
Deferral hedge accounting for currency swaps	Currency swap transactions	Foreign currency-denominated bonds	483,090	483,090	(*2)	
Deferral hedge accounting for foreign exchange contracts	Foreign exchange contracts	Foreign currency-denominated deposits	55,000	-	(*2)	
Total			¥756,090	¥701,090	¥2,695	

For derivative transactions for which hedge accounting is applied, the contractual amount or the amount equivalent to the principal in the contract under each hedge accounting method as of September 30, 2012 is as follows:

(Millions of yen)

Hedge accounting method	Type of derivative transactions	Primary hedged items	Contract amount	Of which 1 year or more	Fair value	Method for calculating fair value
Principal accounting method	Interest rate swap transactions Receive/fixed and pay/floating	Bonds Borrowed money	¥258,500	¥258,500	¥147	Based on prices provided by the counterparty financial institutions

Hedge accounting for interest rate swaps	Interest rate swap transactions Receive/floating and pay/fixed	Bonds	95,000	95,000	(*1)	
Deferral hedge accounting for currency swaps	Currency swap transactions	Foreign currency-denominated bonds	666,389	666,389	(*2)	
Deferral hedge accounting for foreign exchange contracts	Foreign exchange contracts	Foreign currency-denominated deposits	55,000	-	(*2)	
Total			¥1,074,889	¥1,019,889	¥147	

(*1) Since interest rate swaps for which hedge accounting is applied are accounted for together with the bond being hedged, the fair value is presented together with the fair value of the relevant bond.

(*2) Since currency swaps and foreign exchange contracts for which deferral hedge accounting is applied are accounted for together with the foreign currency-denominated bond or foreign currency-denominated deposit being hedged, the fair value is presented together with the fair value of the relevant hedged item.

Note 2. Repayment schedule for monetary claims and securities with maturities is as follows:

As of September 30, 2011

(Millions of yen)

	Within 1 year	After 1 year through 2 years	After 2 years through 3 years	After 3 years through 4 years	After 4 years through 5 years	After 5 years through 10 years	After 10 years through 20 years	After 20 years through 30 years
Loans	¥1,542,990	¥1,533,480	¥1,552,425	¥1,527,691	¥1,478,552	¥6,351,664	¥6,935,405	¥1,316,766
Securities								
Held-to-maturity securities	886,938	-	-	-	-	-	-	-
Deposits	421,251	-	-	-	-	-	-	-

As of September 30, 2012

(Millions of yen)

	Within 1 year	After 1 year through 2 years	After 2 years through 3 years	After 3 years through 4 years	After 4 years through 5 years	After 5 years through 10 years	After 10 years through 20 years	After 20 years through 30 years
Loans	¥1,532,757	¥1,562,436	¥1,569,058	¥1,540,729	¥1,478,193	¥6,419,136	¥6,930,374	¥1,352,515
Securities								
Held-to-maturity securities	872,000	-	-	-	-	-	-	-
Deposits	574,973	-	-	-	-	-	-	-

Note 3. Repayment schedule for bonds and borrowed money is as follows:

As of September 30, 2011

(Millions of yen)

	Within 1 year	After 1 year through 2 years	After 2 years through 3 years	After 3 years through 4 years	After 4 years through 5 years	After 5 years through 10 years	After 10 years through 20 years	After 20 years through 30 years
Bonds	¥2,082,530	¥2,456,560	¥2,358,110	¥1,711,350	¥1,456,250	¥6,933,040	¥1,353,470	¥217,235

As of September 30, 2012

(Millions of yen)

	Within 1 year	After 1 year through 2 years	After 2 years through 3 years	After 3 years through 4 years	After 4 years through 5 years	After 5 years through 10 years	After 10 years through 20 years	After 20 years through 30 years
Bonds	¥2,456,560	¥2,358,110	¥1,711,350	¥1,566,250	¥1,652,536	¥7,341,833	¥1,636,535	¥220,000
Borrowed money	-	-	-	-	-	30,000	-	-

6. Accumulated Depreciation
Accumulated depreciation of tangible fixed assets amounted to 230 million yen and 214 million yen as of September 30, 2011 and 2012, respectively.

7. Assets Pledged as Collateral
(1) Pursuant to the provisions of Article 40, Section 2 of the Law, JFM's total assets are pledged as general collateral for JFM bonds in the amounts of 18,549,813 million yen and 18,927,003 million yen as of September 30, 2011 and 2012, respectively.
(2) Securities in the amounts of 469 million yen and 37,455 million yen are pledged as collateral for derivative transactions as of September, 2011 and 2012, respectively.

8. Semiannual Net Income by Account
Semiannual net income of general account amounted to 7,667 million yen and 10,137 million yen, while semiannual net income of management account amounted to 3,509 million yen and 576 million yen, for the six-month periods ended September 30, 2011 and 2012, respectively.

9. Information by Account (Semiannual balance sheets)

The semiannual balance sheet of general account and management account at September 30, 2011 is as follows:

(Millions of yen)

Item	General account	Management account	Offset	Total
(Assets)				
Loans	¥4,426,370	¥17,812,605		¥22,238,975
Securities	886,938			886,938
Cash and bank deposits	421,251			421,251
Other assets	4,830	11,836		16,666
Tangible fixed assets	2,993			2,993
Intangible fixed assets	679			679
Due from general account		1,153,035	¥(1,153,035)	
Due to management account for fund for improvement of operations of municipalities	442,831		(442,831)	
Total assets	6,185,895	18,977,478	(1,595,867)	23,567,505
(Liabilities)				
Bonds	3,202,908	15,346,904		18,549,813
Other liabilities	1,604	12,540		14,145
Reserve for bonuses	51			51
Reserve for directors' bonuses	5			5
Reserve for retirement benefits	159			159
Reserve for retirement benefits for directors and corporate auditors	22			22
Fund for improvement of operations of municipalities	915,818			915,818
Basic fund for improvement of operations of municipalities	908,104			908,104
Additional fund for improvement of operations of municipalities	7,713			7,713
Due to management account	1,153,035		(1,153,035)	
Due from general account for fund for improvement of operations of municipalities		442,831	(442,831)	
Reserves under special laws	880,000	3,124,127		4,004,127
Reserve for interest rate volatility	880,000			880,000
Management account reserve for interest rate volatility		3,030,722		3,030,722
Reserve for interest rate reduction		93,404		93,404
Total liabilities	6,153,607	18,926,403	(1,595,867)	23,484,143
(Net Assets)				
Capital	16,602			16,602
Retained earnings	21,527			21,527
General account appropriated surplus reserve	13,860			13,860
General account semiannual unappropriated retained earnings	7,667			7,667
Valuation, translation adjustments and others	(5,842)			(5,842)
Management account surplus reserve		51,074		51,074
Management account appropriated surplus reserve		47,565		47,565
Management account semiannual unappropriated retained earnings		3,509		3,509
Total net assets	32,287	51,074		83,361
Total liabilities and net assets	¥6,185,895	¥18,977,478	¥(1,595,867)	¥23,567,505

The semiannual balance sheet of general account and management account at September 30, 2012 is as follows:

(Millions of yen)

Item	General account	Management account	Offset	Total
(Assets)				
Loans	¥6,141,060	¥16,244,143		¥22,385,203
Securities	871,904			871,904
Cash and bank deposits	574,973			574,973
Other assets	3,149	10,503		13,653
Tangible fixed assets	2,547			2,547
Intangible fixed assets	540			540
Due from general account		1,052,816	¥(1,052,816)	
Due to management account for fund for improvement of operations of municipalities	292,831		(292,831)	
Total assets	7,887,007	17,307,463	(1,345,648)	23,848,822
(Liabilities)				
Bonds	4,732,218	14,194,785		18,927,003
Borrowed money	30,000			30,000
Other liabilities	2,016	11,468		13,484
Reserve for bonuses	51			51
Reserve for directors' bonuses	7			7
Reserve for retirement benefits	165			165
Reserve for retirement benefits for directors and corporate auditors	28			28
Fund for improvement of operations of municipalities	919,279			919,279
Basic fund for improvement of operations of municipalities	911,935			911,935
Additional fund for improvement of operations of municipalities	7,344			7,344
Due to management account	1,052,816		(1,052,816)	
Due from general account for fund for improvement of operations of municipalities		292,831	(292,831)	
Reserves under special laws	1,100,000	2,754,135		3,854,135
Reserve for interest rate volatility	1,100,000			1,100,000
Management account reserve for interest rate volatility		2,672,708		2,672,708
Reserve for interest rate reduction		81,427		81,427
Total liabilities	7,836,583	17,253,221	(1,345,648)	23,744,156
(Net Assets)				
Capital	16,602			16,602
Retained earnings	39,531			39,531
General account appropriated surplus reserve	29,393			29,393
General account semiannual unappropriated retained earnings	10,137			10,137
Valuation, translation adjustments and others	(5,708)			(5,708)
Management account surplus reserve		54,242		54,242
Management account appropriated surplus reserve		53,666		53,666
Management account semiannual unappropriated retained earnings		576		576
Total net assets	50,424	54,242		104,666
Total liabilities and net assets	¥7,887,007	¥17,307,463	¥(1,345,648)	¥23,848,822

Notes: 1. General account and management account

In accordance with the provisions of Article 13, Section 1 of the supplementary provisions of the Law, management account is used to conduct administration, collection and other related operations of the assets that JFM inherited from the former JFM (management of the assets of the former JFM).

Management account is separated from the other account (general account) pursuant to the provisions of Article 13, Section 3 of the supplementary provisions of the Law.

2. General account semiannual unappropriated retained earnings and management account semiannual unappropriated retained earnings

"Semiannual net income" of general account is posted as "General account semiannual unappropriated retained earnings, " while "Semiannual net income" of management account is posted as "Management account semiannual unappropriated retained earnings. "

3. Due from general account and due to management account
   These amounts represent funds lent between general account and management account pursuant to the provisions of Article 13, Section 4 of the supplementary provisions of the Law.
4. Due from general account for fund for improvement of operations of municipalities and due to management account for fund for improvement of operations of municipalities
   These amounts represent cash received for "Fund for improvement of operations of municipalities," which was lent to management account from general account pursuant to the provisions of Article 9, Section 12 of the supplementary provisions of the Law.

10. Information by Account (Semiannual statements of income)
The semiannual statement of income of general account and management account for six-month period ended September 30, 2011 is as follows:

(Millions of yen)

Item	General account	Management account	Offset	Total
Income	¥39,741	¥233,681	¥(14,115)	¥259,307
Interest income	33,445	225,746		259,191
Fees and commissions	96			96
Other income	20			20
Amount received for fund for improvement of operations of municipalities	5			5
Other	14			14
Administrative fee for management account	423		(423)	
Interest on fund for improvement of operations of municipalities	5,756		(5,756)	
Interest on due from general account		196	(196)	
Transfer from general account for fund for improvement of operations of municipalities		7,739	(7,739)	
Expenses	32,074	122,467	(14,115)	140,425
Interest expenses	21,694	115,235		136,930
Fees and commissions	19	113		133
Other operating expenses	1,245	887		2,132
General and administrative expenses	1,178	50		1,228
Interest on due to management account	196		(196)	
Transfer to management account for fund for improvement of operations of municipalities	7,739		(7,739)	
Administrative fee for management account		423	(423)	
Interest on fund for improvement of operations of municipalities		5,756	(5,756)	
Ordinary income	7,667	111,214	-	118,881
Special gains	220,000	226,484	(220,000)	226,484
Provision for management account	220,000		(220,000)	
Reversal of management account reserve for interest rate volatility		220,000		220,000
Reversal of reserve for interest rate reduction		6,484		6,484
Special losses	220,000	334,189	(220,000)	334,189
Provision for reserve for interest rate volatility	220,000			220,000
Provision for management account reserve for interest rate volatility		114,189		114,189
Transfer to general account		220,000	(220,000)	
Semiannual net income	¥7,667	¥3,509	¥-	¥11,176

The semiannual statement of income of general account and management account for the six-month period ended September 30, 2012 is as follows:

(Millions of yen)

Item	General account	Management account	Offset	Total
Income	¥48,907	¥208,905	¥(11,138)	¥246,674
Interest income	43,771	201,943		245,714
Fees and commissions	90			90
Other income	868	0		868
Amount received for fund for improvement of operations of municipalities	592			592
Other	276	0		276
Administrative fee for management account	450		(450)	
Interest on fund for improvement of operations of municipalities	3,726		(3,726)	
Interest on due from general account		159	(159)	
Transfer from general account for fund for improvement of operations of municipalities		6,802	(6,802)	
Expenses	38,769	109,037	(11,138)	136,669
Interest expenses	28,865	103,367		132,232
Fees and commissions	28	106		134
Other operating expenses	1,622	1,317		2,939
General and administrative expenses	1,291	71		1,362
Interest on due to management account	159		(159)	
Transfer to management account for fund for improvement of operations of municipalities	6,802		(6,802)	
Administrative fee for management account		450	(450)	
Interest on fund for improvement of operations of municipalities		3,726	(3,726)	
Ordinary income	10,137	99,867	-	110,005
Special gains	220,000	575,860	(220,000)	575,860
Provision for management account	220,000		(220,000)	
Reversal of management account reserve for interest rate volatility		570,000		570,000
Reversal of reserve for interest rate reduction		5,860		5,860
Special losses	220,000	675,151	(220,000)	675,151
Provision for reserve for interest rate volatility	220,000			220,000
Provision for management account reserve for interest rate volatility		105,151		105,151
Transfer to general account		220,000	(220,000)	
Payment to national treasury		350,000		350,000
Semiannual net income	¥10,137	¥576	¥-	¥10,714

11. Fair Value of Marketable Securities

Marketable held-to-maturity securities at September 30, 2011 consist of the following:

(Millions of yen)

	Book value	Fair value	Difference	Unrealized gains	Unrealized losses
Treasury discount bills	¥425,938	¥425,916	¥(22)	-	¥(22)
Negotiable certificates of deposit	461,000	461,000	-	-	-
Total	¥886,938	¥886,916	¥(22)	-	¥(22)

Marketable held-to-maturity securities at September 30, 2012 consist of the following:

(Millions of yen)

	Book value	Fair value	Difference	Unrealized gains	Unrealized losses
Treasury discount bills	¥479,904	¥479,864	¥(40)	-	¥(40)
Negotiable certificates of deposit	392,000	392,000	-	-	-
Total	¥871,904	¥871,864	¥(40)	-	¥(40)

Notes: 1. The fair value of treasury discount bills is based on the market price at September 30, 2011 and 2012.
2. The balance sheet amount for negotiable certificates of deposits are recognized as the fair value.
3. Difference is the net amount of “unrealized gains” and “unrealized losses.”

12. Information on Derivative Transactions

(1) Types of derivative transactions

Derivative transactions entered into by JFM are interest rate swaps for interest rate related transactions, and currency swaps and foreign exchange forward contracts for currency related transactions.

(2) Policies and purposes of derivative transactions

JFM uses interest rate swaps, currency swaps and foreign exchange forward contracts as a means of hedging exposure to interest rate and foreign exchange fluctuation risks, and does not enter into derivatives for speculative purposes.

Interest rate swaps are used to hedge exposure to interest rate risk on fund-raising activities. Currency swaps and foreign exchange forward contracts are used to hedge exposure to foreign exchange risk associated with issuance of foreign currency-denominated bonds and foreign currency-denominated deposits.

Hedge accounting is applied to interest rate swaps, currency swaps and foreign exchange contracts.

(a) Hedge accounting method

Interest rate swaps used to hedge the risk of interest rate fluctuations that qualify for hedge accounting and meet specific matching criteria are not measured at fair value, but the differential paid or received under the swap agreements is recognized and included in interest expense or income. If swap contracts or forward contracts used to hedge the risk of foreign currency fluctuation qualify for deferral hedge accounting, the foreign currency-denominated assets and liabilities are translated at the contracted rate.

(b) Hedging instruments and hedged items

(i) Hedging instruments: Interest rate swaps
Hedged items: Bonds and borrowed money

(ii) Hedging instruments: Currency swaps
Hedged items: Foreign currency-denominated bonds

(iii) Hedging instruments: Foreign exchange forward contracts
Hedged items: Receipt of interest and principal of foreign currency-denominated bank deposits

(c) Hedging policy

JFM uses hedging instruments as a means of hedging exposure to interest rate risk and foreign exchange risk. Hedged items are identified by each individual contract.

As a means of hedging foreign exchange fluctuation risks associated with the receipt of interest and principal of foreign currency-denominated bank deposits, a foreign exchange forward contract is entered into at the time of each deposit to the hedge the risks.

(d) Assessment of hedge effectiveness

JFM ensures hedging instruments and hedged items have the same major terms when entering into hedge transactions to offset bond and borrowed money market fluctuation risks.

Accordingly, JFM deems these to be highly effective and thus does not assess effectiveness. Moreover, a periodic assessment of hedge effectiveness for interest rate swaps for which hedge accounting is applied and currency swaps and forward contracts that qualify for deferral hedge accounting is omitted when the exceptional accrual method is applied.

(3) Risks on derivative transactions

Major risks on derivative transactions are market risk and credit risk. Market risk is the risk of future revenue fluctuations due to market value changes. Credit risk is the risk of losses incurred when counterparties are unable to fulfill their contracts due to bankruptcy or other reasons.

As for derivative transactions used for hedging purposes, market risk is offset by the corresponding change into underlying hedged items.

JFM enters into ISDA master agreements and CSA agreements with financial institutions, which are its derivative transactions counterparties, to reduce credit risk. Moreover, JFM constantly monitors the transactions' restructuring costs and their credit profiles, and deals with multiple counterparties.

(4) Risk management system for derivative transactions

Execution and management of derivative transactions are conducted by the Finance Department of JFM with the approval of persons in charge in accordance with the operational guidelines which specify transaction authority and limits on the transaction amount.

Additionally, the total amount of derivative transactions, the status of risks, the assessed fair value, and the credit risk on counterparties are regularly reported to the Integrated Risk Management Committee.