

For the six months ended 30 September 2013

Japan Finance Organization for Municipalities
Semiannual Financial Statements

Japan Finance Organization for Municipalities

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■ Semiannual Balance Sheets (As of 30 September 2012 and 2013)

(Millions of yen)					
Item	As of 30 September 2012	As of 30 September 2013	Item	As of 30 September 2012	As of 30 September 2013
	Amount			Amount	
Assets			Liabilities		
Loans (Note 4)	¥22,385,203	¥22,757,577	Bonds (Notes 8)	¥18,927,003	¥19,196,481
Securities (Note 12)	871,904	744,945	Borrowed money	30,000	64,500
Cash and bank deposits	574,973	186,158	Other liabilities	13,484	12,849
Other assets	13,653	12,871	Reserve for bonuses	51	54
Tangible fixed assets (Note 7)	2,547	2,581	Reserve for directors' bonuses	7	7
Intangible fixed assets (Note 7)	540	823	Reserve for retirement benefits	165	145
			Reserve for retirement benefits for directors and corporate auditors	28	25
			Fund for lending rate reduction	919,279	921,082
			Basic fund for lending rate reduction	911,935	915,670
			Additional fund for lending rate reduction	7,344	5,412
			Reserves under special laws	3,854,135	3,382,326
			Reserve for interest rate volatility	1,100,000	1,320,000
			Management account reserve for interest rate volatility	2,672,708	1,991,732
			Reserve for interest rate reduction	81,427	70,593
			Total liabilities	23,744,156	23,577,473
			Net Assets		
			Capital	16,602	16,602
			Retained earnings	39,531	63,344
			General account appropriated surplus reserve	29,393	50,221
			General account semiannual unappropriated retained earnings	10,137	13,122
			Valuation, translation adjustments and others	(5,708)	(6,128)
			Management account surplus reserve	54,242	53,666
			Management account appropriated surplus reserve	53,666	53,666
			Management account semiannual unappropriated retained earnings	576	-
			Total net assets	104,666	127,484
Total assets	¥23,848,822	¥23,704,957	Total liabilities and net assets	¥23,848,822	¥23,704,957

See notes to semiannual financial statements.

■ Semiannual Statements of Income (For the six-month period ended 30 September 2012 and 2013)

Item	(Millions of yen)	
	Six months ended 30 September 2012	Six months ended 30 September 2013
	Amount	
Income	¥246,674	¥233,351
Interest income	245,714	231,786
Fees and commissions	90	85
Other income	868	1,479
Contributions from fund for lending rate reduction	592	1,457
Others	276	22
Expenses	136,669	134,989
Interest expenses	132,232	130,172
Fees and commissions	134	141
Other operating expenses	2,939	3,332
General and administrative expenses	1,362	1,342
Other expenses	-	0
Ordinary income	110,005	98,362
Special gains	575,860	875,291
Reversal of management account reserve for interest rate volatility	570,000	870,000
Reversal of reserve for interest rate reduction	5,860	5,291
Special losses	675,151	960,532
Provision for reserve for interest rate volatility	220,000	220,000
Provision for management account reserve for interest rate volatility	105,151	90,532
Payment to national treasury (Note 5)	350,000	650,000
Semiannual net income	¥10,714	¥13,122

See notes to semiannual financial statements.

■ Semiannual Statements of Changes in Net Assets
(For the six-month period ended 30 September 2012)

(Millions of yen)

(in 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 appropri ated surplus reserve	General account semiannual unappropriated retained earnings					
Balance as of 1 April 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 as of 30 September 2012	¥16,602	¥29,393	¥10,137	¥56,133	¥(5,708)	¥53,666	¥576	¥104,666

(For the six-month period ended 30 September 2013)

(Millions of yen)

	Stockholders' equity				Valuation, translation adjustments and others	Management account appropriated surplus reserve	Management account semiannual unappropriated retained earning	Total net assets
	Capital	Retained earnings		Total stockholders' equity	Unrealized gain/(loss) from hedging instruments			
		General account appropri ated surplus reserve	General account semiannual unappropriated retained earnings					
Balance as of 1 April 2013	¥16,602	¥50,221	-	¥66,824	¥(6,970)	¥53,666	¥-	¥113,520
Changes during semiannual accounting period								
Semiannual net income	-	-	¥13,122	13,122	-	-	-	13,122
Net changes during semiannual accounting period in items other than stockholders' equity	-	-	-	-	841	-	-	841
Net changes during semiannual accounting period	-	-	13,122	13,122	841	-	-	13,963
Balance as of 30 September 2013	¥16,602	¥50,221	¥13,122	¥79,946	¥(6,128)	¥53,666	¥-	¥127,484

See notes to semiannual financial statements.

■ Semiannual Statements of Cash Flows (For the six-month period ended 30 September 2012 and 2013)

Item	(Millions of yen)	
	Six months ended 30 September 2012	Six months ended 30 September 2013
	Amount	
I Cash flows from operating activities		
Semiannual net income	¥10,714	¥13,122
Depreciation and amortization	174	172
Interest income	(245,714)	(231,786)
Interest expenses	132,232	130,172
Increase/(decrease) in reserve for bonuses	4	7
Increase/(decrease) in reserve for directors' bonuses	0	2
Increase/(decrease) in reserve for retirement benefits	18	3
Increase/(decrease) in reserve for retirement benefits for directors and corporate auditors	4	(1)
Increase/(decrease) in fund for lending rate reduction	(592)	(1,457)
Increase in reserve for interest rate volatility	220,000	220,000
Increase/(decrease) in management account reserve for interest rate volatility	(114,848)	(129,467)
Decrease in reserve for interest rate reduction	(5,860)	(5,291)
Net (increase)/decrease in loans	2,207	(88,942)
Net increase/(decrease) in bonds	748,309	518,260
Net increase/(decrease) in borrowed money	-	34,500
Interest received	246,894	233,338
Interest paid	(132,350)	(130,105)
Others	505	(521)
Net cash provided by/(used in) operating activities	861,701	563,047
II Cash flows from investing activities		
Proceeds from redemption of securities	2,470,000	1,896,000
Purchases of securities	(2,578,871)	(2,041,933)
Purchases of tangible fixed assets	(14)	(29)
Purchases of intangible fixed assets	(91)	(500)
Proceeds from sales of tangible fixed assets	-	335
Net cash provided by/(used in) investing activities	(108,977)	(146,128)
III Cash flows from financing activities		
Payment to national treasury	(350,000)	(650,000)
Refund of contributions made from municipally operated racing	-	(28)
Net cash provided by/(used in) financing activities	(350,000)	(650,028)
IV Effect of exchange rate changes on cash and cash equivalents	-	-
V Net increase/(decrease) in cash and cash equivalents	402,723	(233,109)
VI Cash and cash equivalents at beginning of period	172,250	419,267
VII Cash and cash equivalents at end of period	¥574,973	¥186,158

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 consolidated semiannual financial statements. Amounts less than 1 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: 23 to 47 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 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 at the end of the semiannual period, based on the projected retirement benefit obligation and fair value of plan assets at 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 the 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········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, 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 statement of cash flows consist of “Cash and bank deposits” on the semiannual balance sheets.

(9) Fund for lending rate reduction

In accordance with the provisions of Article 46, Section 1 of the Law, JFM has established the fund for lending rate reduction to reserve contributions as stipulated in Article 32-2 of the Local Government 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, the “Predecessor”) 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”).

The management account reserve for interest rate volatility is set aside to manage interest rate risk associated with refinancing of bonds issued by the Predecessor 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 the 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

Reserve for interest rate reduction is set aside to reduce interest rates on the loans made by the Predecessor 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 the Management Account Operations Ordinance.

(12) Consumption taxes

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

3. Additional Information

JFM obtained approval of the Minister of Health, Labour and Welfare, dated 1 April 2013, for the transfer to the Japanese national government of the future payment obligation of the substitutional portion of Employees’ Pension Funds established under the Japanese Welfare Pension Insurance Law.

The total amount of refund (minimum policy reserve) measured in Employees’ Pension Funds at the end of the semiannual period was 55,980 million yen. Based on the assumption that the amount of the refund was paid at the end of the semiannual period, JFM estimates that JFM’s profit and loss will not be affected in the case that Article 44-2 of Japanese Institute of Certified Public Accountants (“JICPA”) Accounting Committee Report No. 13, “Practical Guideline on Accounting Standards for Retirement Benefits (Interim Report)”, is applied.

4. 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).

5. Payment to the National Treasury of a Portion of JFM’s Management Account Reserve for Interest Rate Volatility

In accordance with the Supplementary Provisions to the Law, a portion of JFM’s management account reserve for interest rate volatility is being 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 2013, 650,000 million yen has been transferred to the national treasury by JFM, pursuant to Article 14 of the Supplementary Provisions to the Law for fiscal 2013 (Ordinance No. 1 of the Ministry of Internal Affairs and Communication, and the Ministry of Finance, 2013).

As a result, a total of 1 trillion yen has so far been transferred to the national treasury, combined with 350,000 million yen in fiscal 2012.

6. Financial Instruments

(1) Status of financial instruments

(a) Policy for financial instruments

In order to maintain a sound and good financial standing, as well as 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 funding, 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 (the 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. At the meeting, 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 Predecessor have never experienced any loan losses.

- The Japanese national government includes principal and interest payments of local government bonds and loans 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 principal and interest payments, and total revenue. Thus, the national government effectively secures revenue sources for principal and interest payments by local governments. The national government also secures revenue sources for principal and interest payments by individual local governments by including a portion of such principal and interest 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 repayment status of local governments, and tax revenue and necessary revenue sources to be secured. Additionally, under the Early Warning System, the local governments whose principal and interest payments or 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 supervision of the national government or the respective prefectural governments 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 in accordance with the “Financial Inspection Manual” of the Financial Services Agency (FSA).

B. Credit risk on 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 majority of 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 funding.

- JFM maintains necessary reserves to cope with the interest rate risk resulting from a duration gap between lending and funding.
- As assets and liabilities in JFM’s general account will expand as a result of lending to local governments and funding, 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. In order to reduce exposure to interest rate risk, JFM has established a medium-term management target for five years from fiscal 2013, in which the duration gap is maintained below approximately two years, and also continue to regularly issue super-long bonds with maturities exceeding 10 years.
- The management account, which manages assets related to money loaned by the Predecessor, is currently exposed to greater interest rate risk than the general account. To address such risk, JFM contributes to the required reserve for interest rate volatility as described above. In accordance with Article 14 of the Supplementary Provisions to the Law, it was decided that a portion of JFM’s reserves for interest rate volatility within the 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.

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, in principle, 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 amount 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 the market risks.

With respect to loans, bonds and borrowed money in the general account, JFM establishes a management target for the duration gap in order to manage interest rate risk appropriately. With regard to the quantitative analysis of interest rate risk, while JFM does not have a management target for the quantitative figures, it reports the results of calculating the quantitative information such as the “outlier ratio” to the ALM Committee and tracks the status of the interest rate risk. The “outlier ratio” is calculated by dividing JFM’s “decline in economic value” as a result of hypothetical interest rate shocks by JFM’s net assets including the reserve for interest rate volatility in the general account and the fund for lending rate reduction. The “decline in economic value” is the largest possible loss in net present market value of its loans and bonds and long-term borrowing that JFM would suffer following a hypothetical 200 basis point increase or decrease in market interest rates.

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 30 September 2013 is used.

- Calculation of Outlier Ratio

Based on an assumption that risk variables, except for interest rate risk, are fixed as of 30 September 2013, 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 lending rate reduction.

Information of the outlier ratio as of 30 September 2013 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.

Until fiscal 2012, the outlier ratio has been used as a management target, however, it will not be used from fiscal 2013 due to the unique situation of JFM outlier ratio being at a high level. This unique situation exists for the following reasons:

- JFM maintains the sufficient reserve for interest rate volatility in order to secure its financial soundness, and uses the reserve for its lending operations. This means that bond issuances to match lending needs are not necessary.
- JFM provides long-term fixed rate loans, thus both of its assets and liabilities have a long duration. Due to such institutional design and operational nature of JFM, a large duration gap between lending and funding is created.

(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 the fund for lending rate reduction (e)
		Total (b)=(c)+(d)	Loans (c)	Bonds and borrowed money (d)	
General account	18.1% [+2.5%]	¥(418,218) [(95,161)]	¥(1,413,412) [(283,766)]	¥+995,193 [+188,605]	¥2,314,900 [+245,197]

Note: Amounts posted in square brackets indicate the change from 30 September 2012.

With respect to loans and bonds in the 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 of interest rate risk, JFM does not establish a management target or use the quantitative analysis in the management of interest rate risk, as is the case in the general account.

With respect to these financial instruments in the management account, based on an assumption that the risk variables, except for interest rate risk, hold steady, for an indicative interest rate as of 30 September 2013 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 47,311 million yen. On the contrary, for an indicative interest rate as of 30 September 2013 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 48,026 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 30 September 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 ^(*)			
Hedge accounting applied	147	147	-
Total of derivative transactions	147	147	-

The book value, fair value and difference between them as of 30 September 2013 are as follows:

(Millions of yen)

	Book value	Fair value	Difference
(1) Loans	¥22,757,577	¥24,294,659	¥1,537,082
(2) Securities			
held-to-maturity securities	744,945	744,918	(27)
(3) Cash and bank deposits	186,158	186,158	-
Total assets	23,688,681	25,225,735	1,537,054
(1) Bonds	19,196,481	19,956,439	759,958
(2) Borrowed money	64,500	65,131	631
Total liabilities	19,260,981	20,021,570	760,589
Derivative transactions ^(*)			
Hedge accounting applied	485	485	-
Total of derivative transactions	485	485	-

(*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 30 September 2012 and 2013.

(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 30 September 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 do 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)

As of 30 September 2013

(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 do not exceed the semiannual balance sheet amount	Treasury discount bills	419,945	419,918	(27)
	Negotiable certificates of deposit	325,000	325,000	-
	Sub total	744,945	744,918	(27)
Total		¥744,945	¥744,918	¥(27)

(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 30 September 2012 is as follows:

(Millions of yen)						
Hedge accounting method	Type of derivative transactions	Primary hedged items	Contract amount		Fair value	Method for calculating fair value
				Of which more than 1 year		
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 institution
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	

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 30 September 2013 is as follows:

(Millions of yen)						
Hedge accounting method	Type of derivative transactions	Primary hedged items	Contract amount		Fair value	Method for calculating fair value
				Of which more than 1 year		
Principal accounting method	Interest rate swap transactions Receive/fixed and pay/floating	Bonds Borrowed money	¥74,863	¥74,863	¥485	Based on prices provided by the counterparty financial institution
Hedge account 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	985,392	985,392	(*2)	
Deferral hedge accounting for foreign exchange contracts	Foreign exchange contracts	Foreign currency-denominated deposits	95,000	-	(*2)	
Total			¥1,250,225	¥1,155,255	¥485	

(*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. The repayment schedule for monetary claims and securities with maturities is as follows:

As of 30 September 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	872,000	-	-	-	-	-	-	-
Deposits	574,973	-	-	-	-	-	-	-

As of 30 September 2013

(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	¥1,547,898	¥1,595,085	¥1,609,039	¥1,562,797	¥1,503,559	¥6,596,035	¥6,927,256	¥1,415,905
Securities held-to- maturity securities	745,000	-	-	-	-	-	-	-
Deposits	186,158	-	-	-	-	-	-	-

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

As of 30 September 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	-	-

As of 30 September 2013

(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	¥2,358,110	¥1,731,876	¥1,608,250	¥1,872,536	¥1,725,554	¥7,873,926	¥1,821,865	¥220,000
Borrowed money	-	-	-	-	-	64,500	-	-

7. Accumulated Depreciation

Accumulated depreciation of tangible fixed assets amounted to 214 million yen and 261 million yen as of 30 September 2012 and 2013, respectively.

8. 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 amount of 18,927,003 million yen and 19,196,481 million yen as of 30 September 2012 and 2013, respectively.
- (2) Securities in the amount of 37,455 million yen and 1,479 million yen are pledged as collateral for derivative transactions as of 30 September 2012 and 2013.

9. Semiannual Net Income by Account

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

Semiannual net income of general account was 10,137 million yen, while semiannual net income of management account was 576 million yen.

(For the six-month period ended 30 September 2013)

Semiannual net income of general account was 13,122 million yen, while there was no semiannual net income of management account.

10. Information by Account (Semiannual Balance sheets)

Semiannual balance sheets of general account and management account as of 30 September 2012 were 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 lending rate reduction	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 lending rate reduction	919,279			919,279
Basic fund for lending rate reduction	911,935			911,935
Additional fund for lending rate reduction	7,344			7,344
Due to management account	1,052,816		(1,052,816)	
Due from general account for fund for lending rate reduction		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

Semiannual balance sheets of general account and management account as of 30 September 2013 were as follows:
(Millions of yen)

Item	General account	Management account	Offset	Total
(Assets)				
Loans	¥8,139,991	¥14,617,585		¥22,757,577
Securities	744,945			744,945
Cash and bank deposits	186,158			186,158
Other assets	3,681	9,190		12,871
Tangible fixed assets	2,581			2,581
Intangible fixed assets	823			823
Due from general account		678,812	¥(678,812)	
Due to management account for fund for lending rate reduction	242,831		(242,831)	
Total assets	9,321,013	15,305,587	(921,643)	23,704,957
(Liabilities)				
Bonds	6,260,613	12,935,867		19,196,481
Borrowed money	64,500			64,500
Other liabilities	1,953	10,896		12,849
Reserve for bonuses	54			54
Reserve for directors' bonuses	7			7
Reserve for retirement benefits	145			145
Reserve for retirement benefits for directors and corporate auditors	25			25
Fund for lending rate reduction	921,082			921,082
Basic fund for lending rate reduction	915,670			915,670
Additional fund for lending rate reduction	5,412			5,412
Due to management account	678,812		(678,812)	
Due from general account for fund for lending rate reduction		242,831	(242,831)	
Reserves under special laws	1,320,000	2,062,326		3,382,326
Reserve for interest rate volatility	1,320,000			1,320,000
Management account reserve for interest rate volatility		1,991,732		1,991,732
Reserve for interest rate reduction		70,593		70,593
Total liabilities	9,247,195	15,251,921	(921,643)	23,577,473
(Net Assets)				
Capital	16,602			16,602
Retained earnings	63,344			63,344
General account appropriated surplus reserve	50,221			50,221
General account semiannual unappropriated retained earnings	13,122			13,122
Valuation, translation adjustments and others	(6,128)			(6,128)
Management account surplus reserve		53,666		53,666
Total net assets	73,817	53,666		127,484
Total liabilities and net assets	¥9,321,013	¥15,305,587	¥(921,643)	¥23,704,957

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 Predecessor (management of the assets of the Predecessor).

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 the 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 lending rate reduction and due to management account for fund for lending rate reduction

These amounts represent cash received for “Fund for lending rate reduction,” which was lent to management account from the general account pursuant to the provisions of Article 9, Section 12 of the Supplementary Provisions of the Law.

11. Information by Account (Semiannual Statements of income)

Semiannual statements of income of general account and management account for six-month period ended 30 September 2012 were 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
Contributions from fund for lending rate reduction	592			592
Other	276	0		276
Administrative fee for management account	450		(450)	
Interest on fund for lending rate reduction	3,726		(3,726)	
Interest on due from general account		159	(159)	
Transfer from general account for fund for lending rate reduction		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
Other expenses				
Interest on due to management account	159		(159)	
Transfer to management account for fund for lending rate reduction	6,802		(6,802)	
Administrative fee for management account		450	(450)	
Interest on fund for lending rate reduction		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

Semiannual statements of income of general account and management account for six-month period ended 30 September 2013 were as follows:

(Millions of yen)				
Item	General account	Management account	Offset	Total
Income	¥ 57,423	¥ 185,829	¥ (9,900)	¥ 233,351
Interest income	52,282	179,503		231,786
Fees and commissions	85			85
Other income	1,479			1,479
Contributions from fund for lending rate reduction	1,457			1,457
Others	22			22
Administrative fee for management account	546		(546)	
Interest on fund for lending rate reduction	3,028		(3,028)	
Interest on due from general account		165	(165)	
Transfer from general account for fund for lending rate reduction		6,159	(6,159)	
Expenses	44,301	100,588	(9,900)	134,989
Interest expenses	35,129	95,042		130,172
Fees and commissions	37	103		141
Other operating expenses	1,559	1,773		3,332
General and administrative expenses	1,248	93		1,342
Other expenses	0			0
Interest on due to management account	165		(165)	
Transfer to management account for fund for lending rate reduction	6,159		(6,159)	
Administrative fee for management account		546	(546)	
Interest on fund for lending rate reduction		3,028	(3,028)	
Ordinary income	13,122	85,240	-	98,362
Special gains	220,000	875,291	(220,000)	875,291
Provision for management account	220,000		(220,000)	
Reversal of management account reserve for interest rate volatility		870,000		870,000
Reversal of reserve for interest rate reduction		5,291		5,291
Special losses	220,000	960,532	(220,000)	960,532
Provision for reserve for interest rate volatility	220,000			220,000
Provision for management account reserve for interest rate volatility		90,532		90,532
Transfer to general account		220,000	(220,000)	
Payment to national treasury		650,000		650,000
Semiannual net income	¥13,122	¥-	¥-	¥13,122

12. Fair Value of Marketable Securities

Marketable held-to-maturity securities as of 30 September 2012 consisted of the following:

	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)

(Millions of yen)

Marketable held-to-maturity securities as of 30 September 2013 consisted of the following:

	Book value	Fair value	Difference	Unrealized gains	Unrealized losses
Treasury discount bills	¥ 419,945	¥419,918	¥(27)	¥-	¥(27)
Negotiable certificates of deposit	325,000	325,000	-	-	-
Total	¥ 744,945	¥ 744,918	¥(27)	¥-	¥(27)

(Millions of yen)

- Notes: 1. The fair value of treasury discount bills is based on market price at 30 September 2012 and 2013.
 2. The balance sheet amount for negotiable certificates of deposit is the fair value.
 3. Difference is the net amount of “unrealized gains” and “unrealized losses.”

13. 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 funding 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: 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 by JFM.

(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 their effectiveness. Moreover, a periodic assessment of hedge effectiveness for interest rate swaps 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 with financial institutions, which are its derivative transactions counterparties, to reduce credit risk. Moreover, JFM constantly monitors restructuring costs of the transactions and the counterparties' 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.