

Investigation Report

(Disclosure Version)

November 30, 2018

Kyushu Railway Company

Third-Party Committee

November 30, 2018

To: Kyushu Railway Company

Kyushu Railway Company

Third-Party Committee

Chairperson: Tohru Motobayashi

Member: Kazumine Terawaki

Member: Toshifumi Takaoka

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Section 1.

OVERVIEW OF INVESTIGATION, ETC.

No. 1. Overview of Investigation

1. Circumstances related to the establishment of the committee

On September 25, 2018, it became clear that JR Kyushu Housing Company (hereinafter, “JR Kyushu Housing”), a consolidated subsidiary of Kyushu Railway Company (hereinafter, “JR Kyushu”), was alleged to have engaged in illegal activity. Employees of JR Kyushu Housing were alleged to have played a leading role in the conclusion and execution of construction contracts based on housing sales contracts by encouraging facility owners to falsify documents to be submitted to financial institutions with regard to housing loans. Through this falsification, employees allegedly would have facility owners apply for loans based on construction contracting amounts that exceeded the actual amounts in order to receive excessive loans from financial institutions (hereinafter, “the pending case”).

As a result, at a JR Kyushu Board of Directors meeting held on October 10, 2018, in order to address the pending case, the Board of Directors resolved to establish a committee with members comprising neutral, fair, external experts who do not have conflicts of interest with JR Kyushu, and the Third-Party Committee (hereinafter, “the committee”) was established the same day.

2. Objectives of the investigation

The objectives of the committee’s investigation (hereinafter, “the investigation”), were as follows.

- (1) Investigate all of the facts related to the pending case.
- (2) Investigate the presence or absence of similar cases.
- (3) Analyze the causes if problem areas are found in (1) or (2)
- (4) Consider and provide opinions regarding measures to prevent a recurrence, with consideration for (3).
- (5) Other matters that the committee has determined to be necessary.

The investigation was not intended to pursue the issue of the legal responsibility of related parties. Accordingly, the investigation report does not consider whether or not the facts, etc., that were ascertained as a result of the investigation were crimes, etc.

3. Composition of the committee

The composition of the committee is as follows.

Chairperson: Tohru Motobayashi (Attorney-at-law, Matsuda & Partners law firm)

Member: Kazumine Terawaki (Attorney-at-law, Satoshi Suzuki law firm)

Member: Toshifumi Takaoka (Certified public accountant, KPMG FAS Co., Ltd.)

In principle, the operation of the committee is conducted in accordance with the guidelines for third-party committees pertaining to corporate scandals from the Japan Federation of Bar Associations. The committee chairperson and members do not have any conflicts of interest with JR Kyushu.

Assistants for this report included the following CPAs and attorneys, who do not have any conflicts of interest with JR Kyushu. They provided support for the committee's investigation. None of the following attorneys from Mori Hamada & Matsumoto law firm have conflicts of interest with JR Kyushu. However, other attorneys from that law firm have provided legal advice to JR Kyushu, and accordingly the operational support for the investigation was provided after information barrier measures were implemented within the law firm.

CPAs, etc., from KPMG FAS Co., Ltd.: 14 people

Attorneys from Mori Hamada & Matsumoto law firm: 5 people

4. Period under investigation

When the committee initially started the investigation, the period under investigation was the past five fiscal years, including the fiscal year in which the investigation commenced. However, as the facts started to become clear through the investigation, it became difficult to identify any specific reason for limiting the period under investigation in the manner described above, and accordingly it was decided not to establish limits on the period under investigation. In regard to these circumstances, please refer to **Section 2, No. 3, 1 (1)** below.

5. Investigation methods, etc.

(1) Period of the investigation

The period of the committee's investigation related to this report was from October 10, 2018, to November 30, 2018.

(2) Subject of investigation/consideration

Through (1) interviews with people involved with JR Kyushu Housing and inspection of related materials, (2) analysis and consideration of accounting data, etc., and (3) investigation and analysis of data stored on personal computers, etc., including electronic mail (hereinafter, “e-mail”), the committee grasped the business details, etc., of JR Kyushu Housing, conducted fact-finding regarding the pending case and similar cases, and when there were problem areas, clarified the causes and considered measures to prevent a recurrence.

(3) Investigation methods

The Committee met a total of 27 times during the period of the investigation.

Also, the specific details of the investigation are as follows.

(a) Interviews with officers and employees

During the course of the investigation, the committee conducted interviews with the following 40 people and with the accounting auditors.

The positions listed below are as of October 10, 2018, the date on which the investigation was commenced.

| Person interviewed | Unit, position, etc. |
|---|---|
| JR Kyushu | |
| Toshihiko Aoyagi | Representative Director and President, CEO |
| Ryuji Tanaka | Senior Managing Director and Corporate Officer (concurrently part-time director at JR Kyushu Housing) |
| Individual AA | Auditing Department, General Manager |
| Individual AB | Auditing Department, Assistant Manager |
| Individual AC | Auditing Department |
| Individual AD | Auditing Department |
| Individual AE | Planning Department, Administration Division |
| Individual AF | Business Development Headquarters, Condominium Development Department, General Manager (concurrently part-time director of JR Kyushu Housing) |
| Individual AG | Business Development Headquarters, Condominium Development Department, Planning & Sales Division |
| JR Kyushu Housing (officers) | |
| Hideaki Shimano | Representative Director and President |
| Individual BA (hereinafter, "Director BA") | Director / Administration Department, General Manager |
| Individual BB | Audit & Supervisory Board Member (concurrently, Audit and Supervisory Committee, Manager) |
| JR Kyushu Housing (Headquarters) | |
| Individual BC | Administration Department, Administration Division, Manager |
| Individual BD | Administration Department, Administration Division, Deputy Manager |
| Individual BE | Administration Department, Administration Division, Chief |
| Individual BF | Strategy Management Department, Deputy General Manager |
| Individual BG | Assigned to Strategy Management Department / Renovation Department, Deputy General Manager |
| Individual BH | Assigned to Strategy Management Department (temporary employee) |
| JR Kyushu Housing (northern Kyushu block general sales office) | |
| Individual BI (hereinafter, "Northern Sales Office General Manager BI") | General Manager / Design Department, General Manager |
| Individual BJ (hereinafter, "Marketing & Sales Department General Manager BJ") | Marketing & Sales Department, General Manager |
| Individual BK | Marketing & Sales Department, Marketing & Sales Planning Division, Deputy Manager |
| Individual BL | Marketing & Sales Department, Marketing & Sales Planning Division, Deputy Chief |
| Individual BM | Marketing & Sales Department, Marketing & Sales Planning Division, Deputy Chief |
| Individual BN | Marketing & Sales Department, Marketing & Sales Planning Division, Deputy Chief |
| Individual BO | Marketing & Sales Department, Marketing & Sales Planning Division, Deputy Chief |
| Individual BP | Marketing & Sales Department, Marketing & Sales Planning Division, Chief (temporary employee) |

| Person interviewed | Unit, position, etc. |
|--|---|
| Individual BQ | Renovation Department, Marketing & Sales Planning Division, Manager |
| JR Kyushu Housing (southern Kyushu block Kagoshima sales office) | |
| Individual BR | General Manager |
| Individual BS (hereinafter, “Deputy General Manager BS”) | Marketing & Sales, Deputy General Manager |
| Individual BT | Marketing & Sales, Deputy General Manager |
| Individual BU | Manager |
| Individual BV | Deputy Manager |
| Individual BW | Chief |
| JR Kyushu Housing (former officers and employees) | |
| Individual CA | Former Audit & Supervisory Board Member (currently, director of JR Kyushu Retail, Inc.) |
| Individual CB | Former Audit & Supervisory Board Member (currently, JR Kyushu, Railway Operations Headquarters, Deputy Director General / Planning & Transportation Safety Department, General Manager) |
| Individual CC | Former Audit & Supervisory Board Member (currently, JR Kyushu, Business Development Headquarters, Planning & Development Department, Construction Division) |
| Individual CD | Former employee at northern Kyushu block general sales office |
| Individual CE | Former employee at northern Kyushu block general sales office |
| Customers | |
| Two customers involved with cases subject to examination. (Please refer to Section 2, No. 3, 1 (1) below). | — |
| Accounting auditors | |
| Deloitte Touche Tohmatsu LLC | Accounting auditors |

(b) Inspection and consideration of accounting data and related materials

The committee inspected and considered accounting data and related materials, such as various voucher documents, that could possibly be related to the objectives of the investigation. In addition, the committee also inspected and considered, to the extent judged to be necessary, related materials, such as internal rules, etc.

(c) Implementation of digital forensic investigation

The committee preserved the personal computers, mail server data, and mobile phones that had been used by 26 officers and employees of JR Kyushu Housing, as well as 5 personal computers and file server data that had been used jointly. In regard to the preserved electronic data, after restoring files that had been deleted, the committee analyzed and considered data that it judged to be necessary.

(d) Implementation of questionnaire investigation

- (1) Questionnaire investigation of the JR Kyushu Business Development Headquarters, Condominium Development Department (hereinafter, “JR Kyushu Condominium Development Department”)

To confirm the presence or absence of incidents similar to the pending case in the JR Kyushu Condominium Development Department, the committee sent a questionnaire to employees of the JR Kyushu Condominium Development Department on November 12, 2018, and replies were received from all 46 employees of that department by November 20, 2018.

- (2) Questionnaire investigation of JR Kyushu Housing

To confirm the presence or absence of incidents similar to the pending case in JR Kyushu Housing, the committee sent a questionnaire to officers and employees of JR Kyushu Housing (excluding part-time directors and audit & supervisory board members) on November 6, 2018, and replies were received from all 59 officers and employees of JR Kyushu Housing by November 9, 2018.

(e) Establishment of third-party committee hotline

With the objective of understanding the pending case and similar cases, from November 8, 2018, to November 22, 2018, the committee opened a hotline. The contact addresses for the hotline were Mori Hamada & Matsumoto law firm, which is assisting in the investigation, and the JR Kyushu Auditing Department executive office. Awareness of this hotline was widely promoted among officers and employees of JR Kyushu Housing. In this way, the committee appealed for the provision of information.

No. 2. FACTS ASSUMED FOR THE INVESTIGATION

1. Overview of JR Kyushu

(1) Company overview

The overview of JR Kyushu is as follows.

(As of the end of March 2018)

| | |
|--------------------------------|---|
| Company Name | Kyushu Railway Company |
| Stock Exchange Listings | Tokyo Stock Exchange, First Section Fukuoka Stock Exchange Securities Code: 9142 |
| Fiscal year-end | March 31 |
| Shareholder composition | Morgan Stanley MUFG Securities Co., Ltd. (5.55%), The Master Trust Bank of Japan, Ltd. (Trust Account) (4.80%) |
| Representatives | Representative Director and Chairman, Corporate Officer: Koji Karaike Representative Director and President, CEO: Toshihiko Aoyagi |
| Head office location | 3-25-21 Hakata-ekimae, Hakata-ku, Fukuoka |
| Number of employees | 8,859 (as of April 1, 2018) |
| Business activities | The Group is composed of JR Kyushu, 44 subsidiaries, and 4 affiliates. Centered on all of Kyushu, the Group conducts business operations in the transportation, construction, real estate, retail and restaurant, and other segments. |
| Accounting auditors | Deloitte Touche Tohmatsu LLC |

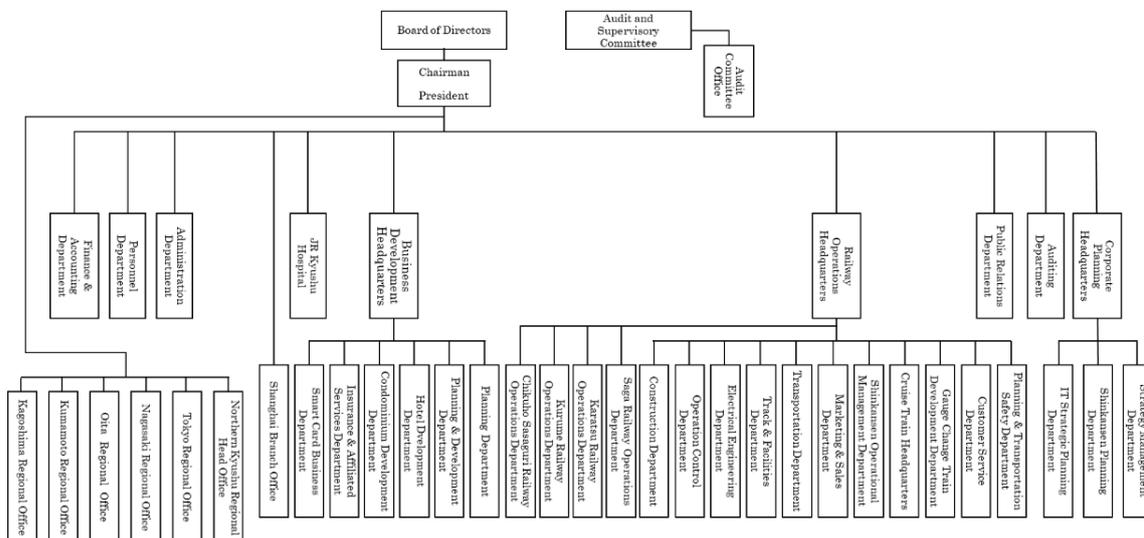
(2) History

An overview of the history of JR Kyushu is as follows.

| Date | Overview |
|---------------|---|
| April, 1987 | Established under the Japanese National Railways Restructuring Law (Law No. 87, 1986) |
| April, 2001 | Head office functions consolidated in Fukuoka, northern Kyushu head office established |
| March, 2004 | Kyushu Shinkansen launched (Shin-Yatsushiro - Kagoshima-Chuo, 137.6 km), Kagoshima Main Line (Yatsushiro - Sendai, 116.9 km) transferred to Hisatsu Orange Railway Co. Ltd. |
| March, 2011 | Operation of the entire Kyushu Shinkansen line (Hakata - Kagoshima-Chuo) commenced, JR Hakata City opened |
| April, 2016 | Excluded from provisions of the Law Concerning the Passenger Railway Companies and the Japan Freight Railway Company (Law No. 88 of 1986) |
| October, 2016 | Complete privatization through the sale of 160 million shares of JR Kyushu stock held by Japan Railway Construction, Transport and Technology Agency (JRJT) |

(3) Organizational structure

The overview of JR Kyushu's organizational structure is as follows.



2. Overview of JR Kyushu Housing

(1) Company overview

An overview of JR Kyushu Housing is as follows.

(As of the end of March 2018)

| | |
|--------------------------------|---|
| Company Name | JR Kyushu Housing Company |
| Fiscal year-end | March 31 |
| Shareholder composition | Kyushu Railway Company (100%) |
| Representatives | President and Representative Director: Hideaki Shimano |
| Head office location | 13-109 Yoshizuka-honmachi, Hakata-ku, Fukuoka |
| Number of employees | 58 (as of October 1, 2018) |
| Business activities | <ul style="list-style-type: none"> • Construction work contracts, design, construction, supervision • Renovation work contracts, design, construction, supervision • Condominium sales, real estate purchase and sale, real estate brokerage |
| Accounting auditors | Not appointed |

(2) History

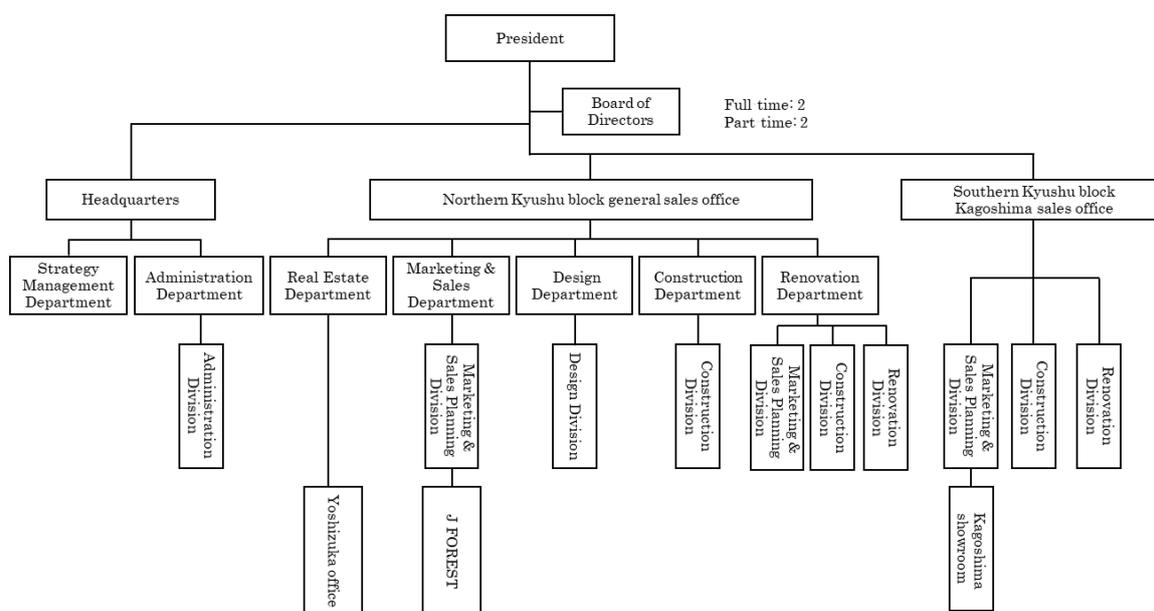
An overview of the history of JR Kyushu Housing is as follows.

| Date | Overview |
|----------------|--|
| April, 1987 | JR Kyushu established |
| March, 1992 | Housing Department established in the Related Business Headquarters |
| December, 1992 | Joyer House sales office established |
| March, 1998 | Housing Department changed to Housing & Urban Development Department |
| June, 1999 | Housing & Urban Development Department split into Urban Development Department and Housing Department |
| June, 2000 | Housing Department split off to establish JR Kyushu Housing |
| December, 2000 | Start of operations at JR Kyushu Housing |
| April, 2004 | Sales offices (Kitakyushu, Fukuoka, Oita, Kumamoto) consolidated into northern Kyushu block general sales office, offices established (Kitakyushu, Oita, Kumamoto) |
| April, 2010 | Oita Office closed |
| July, 2012 | Company name in Japanese changed |
| April, 2013 | Kumamoto Office closed |
| April, 2017 | Kitakyushu Office closed |

(3) Organizational structure

An overview of JR Kyushu Housing's organizational structure is as follows.

The head office and the northern Kyushu block general sales office (hereinafter, "northern sales office") conduct operations at the same place of business located in Fukuoka City, Fukuoka Prefecture. The southern Kyushu block Kagoshima sales office (hereinafter, "southern sales office"), is located in Kagoshima City, Kagoshima Prefecture. However, in addition to these offices, in practice there are cases in which residence showrooms and sales facilities have been established in locations in which properties are sold. There are many cases in which salespeople are stationed and conducting operations at these showrooms, etc., rather than at the worksites at the northern sales office and the southern sales office. In addition, the southern sales office is in charge of Miyazaki, Kagoshima, and Kumamoto prefectures, and the northern sales office is in charge of regions to the north of those prefectures. The number of employees was 12 at the head office, 31 at the northern sales office, and 15 at the southern sales office (as of October 1, 2018, in each case).



3. Trend in Results at JR Kyushu Housing

An overview of the profit/loss and finances of JR Kyushu Housing is as follows.

(Millions of Yen)

| | Fiscal year ended March 31, 2014 | Fiscal year ended March 31, 2015 | Fiscal year ended March 31, 2016 | Fiscal year ended March 31, 2017 | Fiscal year ended March 31, 2018 |
|--|----------------------------------|----------------------------------|----------------------------------|----------------------------------|----------------------------------|
| Sales | 2,250 | 2,302 | 3,273 | 3,154 | 3,779 |
| (of which, sales within the JR Kyushu Group) | 539 | 369 | 519 | 559 | 551 |
| Operating income | 6 | (127) | 15 | 28 | 16 |
| Net income | 1 | (135) | 5 | 20 | 11 |
| Total assets | 1,185 | 2,255 | 2,169 | 1,877 | 2,689 |
| Net assets | 68 | (67) | (62) | (42) | (31) |

The internal sales of the JR Kyushu Group are for renovation work, etc., for the renovation and sale of previously owned condominiums conducted by JR Kyushu, and JR Kyushu Group internal sales account for approximately 15% to 20% of the sales of JR Kyushu Housing.

JR Kyushu's consolidated operating revenues in the fiscal year ended March 31, 2018, were ¥413,371 million, and net income was ¥50,410 million. JR Kyushu Housing's operating revenues and net income were both less than 1% of the corresponding amounts in JR Kyushu's consolidated financial statements.

In addition, looking at internal figures for JR Kyushu Housing, the ratio of the sales of the northern region sales office to the sales of the southern region sales office is approximately 4-to-1.

4. Status of Changes in Assignments of Officers of JR Kyushu Housing

The status of changes in assignments of officers of JR Kyushu Housing is as follows.

| | Fiscal year ended March 31, 2014 | Fiscal year ended March 31, 2015 | Fiscal year ended March 31, 2016 | Fiscal year ended March 31, 2017 | Fiscal year ended March 31, 2018 | Fiscal year ended March 31, 2019 |
|-----------------|--|--|----------------------------------|--|--|----------------------------------|
| Individual CF | Representative Director and President | | | | → | |
| Hideaki Shimano | | | | | Representative Director and President | ● → |
| Individual BA | Director | | | | | → |
| Individual CG | Director | → | | | | |
| Individual CH | Director | → | | | | |
| Individual CI | | | Director | | | → |
| Individual BX | | | | | | Director ● → |
| Ryuji Tanaka | Part-time Director | | Part-time Director | | | → |
| Individual CJ | | Part-time Director | | | | → |
| Individual CK | | Part-time Director | | | | → |
| Individual CL | | | Part-time Director | | | → |
| Individual AF | | | | Part-time Director | | → |
| Individual CB | Part-time Director | Part-time Audit & Supervisory Board member | | | | |
| Individual CC | Part-time Audit & Supervisory Board member | | | | | |
| Individual CA | | | | Part-time Audit & Supervisory Board member | | → |
| Individual BB | | | | | Part-time Audit & Supervisory Board member | ● → |

5. Relationship between JR Kyushu and JR Kyushu Housing

(1) Management in which the JR Kyushu Administration Department is the lead organizational unit

At JR Kyushu, a director in charge and a lead organizational unit are determined for each subsidiary. For JR Kyushu Housing, the officer in charge is Senior Managing Director and Corporate Officer Ryuji Tanaka, and the lead organizational unit is the Business Development Headquarters, Administration Department.

For each subsidiary of JR Kyushu, performance targets are set at the end of each fiscal year. These targets are the subsidiary's mission for the following fiscal year. The missions include plans for revenues and expenditures, uses of funds, initiatives, etc. In determining these missions, the Business Development Headquarters, Administration Department and the Corporate Planning Headquarters conduct multiple interviews with subsidiaries. For JR Kyushu Housing, interviews are conducted with the president and other directors, reviews are conducted of the previous fiscal year's results, etc., and on that basis the next fiscal year's objectives are determined.

JR Kyushu Housing's performance has not been favorable, and the company has been designated for special monitoring. A monitoring meeting is being held once per quarter. The participants in the monitoring meeting are JR Kyushu Housing's officers (including part-time officers) and JR Kyushu's Corporate Planning Headquarters and Business Development Headquarters, Administration Department. At the monitoring meetings, reports are provided on the quarterly management situation, etc., and discussions are conducted, principally in regard to financial results. In addition, if there are scandals, accidents, etc., that have a significant influence on the management of subsidiaries, the Business Development Headquarters, Administration Department, and the Corporate Planning Headquarters receive reports.

JR Kyushu has a hotline, known as the JR Kyushu Group Corporate Ethics Hotline, which includes subsidiaries. However, there was only one example of a report to this hotline from an employee of JR Kyushu Housing that was confirmed through this investigation, and that one report was about workplace harassment.

(2) Seconding of personnel from JR Kyushu to JR Kyushu Housing

At JR Kyushu Housing, the majority of managers at the general manager level and above have been seconded from JR Kyushu. Under the system for seconding personnel, the seconding period is, in principle, three years. However, there are seconded personnel who have been at JR Kyushu Housing since its establishment in 2000, such as Director BA and Deputy General Manager BS.

In regard to the seconded personnel, people who have a certain degree of compatibility with the operations of JR Kyushu are selected, but it is not necessarily the case that the seconded employees are sent from specific organizational units.

(3) Audits by accounting auditors

Deloitte Touche Tohmatsu (hereinafter, "DTT"), which is the accounting auditor for the JR Kyushu Group, conducts accounting audits of JR Kyushu Housing as one part of the auditing

of the consolidated financial statements of JR Kyushu.¹ In consideration of the scale of JR Kyushu Housing within the JR Kyushu Group, etc., DTT treats JR Kyushu Housing as a subsidiary with a low degree of influence on the consolidated financial statements of JR Kyushu. On-site audits are conducted approximately once every five years, while procedures are implemented in other fiscal years, centered on the analysis of changes in important items. An on-site audit was conducted in the fiscal year ended March 31, 2015, but there were no comments regarding inappropriate loan applications. (Please refer to **Section 2, No. 3, 1 (3)** below.)

¹ JR Kyushu Housing is not a “large company” under the Companies Act, and it is not subject to separate audits by an accounting auditor. In addition, among the subsidiaries of JR Kyushu, several companies that have a scale exceeding a certain level have signed voluntary auditing contracts with DTT, but JR Kyushu Housing is not one of those subsidiaries.

Section 2.

FACTS, ETC., THAT BECAME CLEAR AS A RESULT OF THE INVESTIGATION

No. 1. Custom-Built Housing Business and Pre-Built Housing Business at JR Kyushu Housing

1. Business processes² in the custom-built housing business and the pre-built housing business at JR Kyushu Housing

(1) Custom-built housing business

(a) Preliminary meeting, conclusion of contract, decision on loan from financial institution

(1) Preliminary meeting / settlement

At the preliminary meeting with the customer, the salesperson interviews the customer about his or her budget³, wishes, etc. The preliminary meetings for detailed plans for the design, etc., are conducted with three parties: the customer, the salesperson, and the Design Department.

After the preliminary meeting with the customer, the Design Department calculates the costs in line with the plan.⁴ In principle, the scope of the calculation by the Design Department includes not only the house itself but also secondary work, such as solar panels, exterior construction work and landscaping, wood decks, etc.

(2) Formulation of rough estimate / funding plan

The salesperson adds a standard profit to the amount calculated by the Design Department, calculates the estimate amount that will be shown to the customer, and prepares the rough estimate. The rough estimate includes not only the cost of purchasing the land and the construction but also miscellaneous costs, such as the cost of purchasing curtains, moving, furniture and appliances, etc., as well as miscellaneous expenses, such as registration expenses, loan-related expenses, etc. In making these calculations, the salesperson, in general, does not obtain estimates from external contractors⁵. Rather, amounts based on the experience of the salesperson are used.⁶

² Unless otherwise noted, the descriptions below are based on the business practices of the Northern Sales Office.

³ For estimates, in regard to the amount of housing loans, the explanation to the customer from the salesperson is based on estimates using 7 times annual income as the standard for the upper limit. A loan can be received if the annual repayment amount is no more than 35% of annual income (40% if the customer has a high annual income), with a repayment period of 35 years. If the repayment period is less than 35 years, the standard that is applied is reduced in line with the period. The standard for the upper limit on the housing loan amount, is a shared understanding within the Marketing & Sales Department.

⁴ At this stage, basically, a plan for which settlement is feasible is determined, and at subsequent meetings equipment, interior finishing, external walls, exterior construction work and landscaping, etc., are determined in a more-detailed manner.

⁵ Depending on the project, there are cases in which the salesperson obtains estimates from external contractors.

⁶ Accordingly, in preparation for the unlikely event that there is a deficit, a reserve fund (approximately ¥400,000 to ¥500,000) is sometimes added.

Also, based on the rough estimate, the salesperson prepares a funding plan that includes a repayment plan, etc.

(3) Submission for approval/conclusion of land sale contract⁷

When the rough estimate and the funding plan have been approved by the customer and the plan has basically been settled, the parties conclude a sale contract⁸ for the land on which the custom-built housing is to be constructed.

For the conclusion of the land sale contract, the salesperson formulates a draft that is entitled “contract approval inquiry.” This draft is confirmed and stamped with a seal by the General Manager of the Marketing & Sales Department, the Sales General Manager, and all full-time directors, including the President.

After the above procedures, the land sale contract is concluded with the customer. The land sale contract is stamped with the JR Kyushu Housing representative’s seal. At that point, the customer pays earnest money to JR Kyushu Housing⁹.

(4) Application for provisional examination for housing loan

At the stage of concluding the land sales contract, an application is made for a provisional examination for a housing loan. In regard to the financial institution to which the application is made, there are cases in which the customers search on their own for a financial institution with low interest rates, such as an Internet bank. However, different financial institutions offer different terms, and accordingly, in general, the salesperson explains the characteristics of each financial institution to the customers, and in the end the customers select the financial institution. In addition, there are also cases in which applications are simultaneously submitted to multiple financial institutions.

The following are submitted for the application for provisional examination: (1) the customer’s tax withholding certificate, (2) identity verification document (driver’s license, health insurance certificate, etc.), (3) private seal, and (4) repayment plan if the customer has existing debt. If requested by the financial institution, the rough estimate and funding plan are submitted. (Submission is generally requested, so these are submitted in almost all cases.)

In the application for provisional examination, the customer directly fills in the address, name, amount applied for, and repayment period in his or her own handwriting. The

⁷ If the customer already owns land, or if the land is purchased from a third-party other than JR Kyushu Housing, this process is not followed.

⁸ As a suspensive condition, this sale contract stipulates that the building construction starts within three months.

⁹ In principle, the earnest money is ¥500,000, but for customers who do not have cash on hand, there are cases in which the earnest money is ¥100,000.

breakdown of the loan amount into land, building, miscellaneous expenses, etc., is filled in by the salesperson.

(5) Approval of housing loan provisional examination

If the application for provisional examination is approved, consultations are held among four parties — the customer, the salesperson, the Design Department, and the Construction Department — to confirm that there are no differences in understanding between the customer and the various people in charge.¹⁰

(6) Application for building construction

Subsequently, the customer makes an application for building construction, and a meeting is held in regard to the building specifications, etc. (equipment, interior finishing, external walls, exterior construction work and landscaping, etc.) At the time of the application for building construction, ¥500,000 is received from the customer as an application fee.¹¹

(7) Submission for approval/conclusion of construction contract

If the building specifications, etc., are settled and customer agrees to the construction contracting amount, the construction contract is concluded.

In concluding the construction contract, in the same manner as with the conclusion of the land sale contract, the salesperson formulates a draft that is entitled “contract approval inquiry,” and this draft is confirmed and stamped with a seal by the General Manager of the Marketing & Sales Department, the Sales General Manager, and all full-time directors, including the President.

After the above procedures, the construction contract is concluded with the customer. Unlike the land sale contract, the construction contract is stamped with the seal of the Sales General Manager, who acts nominally as the proxy of the Representative Director and President of JR Kyushu Housing.¹²

(8) Finalized application for housing loan

After the conclusion of the construction contract, the finalized application for the housing loan is submitted to the financial institution. For the finalized application, the following are submitted: construction contract, land sale contract, blueprints, certified

¹⁰ The consultations among these four parties have been held since the fiscal year ending March 31, 2019, and accordingly prior to that time there were cases in which each person in charge had a different understanding of the situation.

¹¹ The application fee of ¥500,000 is a recent practice. Previously the fee was ¥100,000.

¹² The reason why the construction contract is stamped with the seal of the Sales General Manager rather than the representative’s seal is not clear. However, an explanation that was offered was that in regard to land, because the registration of ownership transfer is in the name of JR Kyushu Housing, the land sales contract is stamped with the representative’s seal.

copy of the land register, rough estimate, funding plan¹³, certificate of residence, etc. The method of submission differs with the financial institution. In some cases, the documents need to be taken directly to the financial institution for submission and in other cases they can be submitted by fax. In the case of direct submission, in many cases copies of the contracts are sufficient, and there are only a small number of cases in which the original contracts are confirmed by the financial institution.

After the application, the housing loan is approved in approximately one week. If the provisional examination is passed, the finalized application is almost always approved.

The contract related to the housing loan (contract for monetary loan) between the customer and the financial institution is concluded by the customer and the financial institution, and JR Kyushu Housing is not a direct party to the contract. However, in general the salesperson is present when the contract is concluded.

(b) Execution of the housing loan

The timing of the execution of the housing loan differs slightly by financial institution, but typically one week prior to the date of delivery of the building the customer completes procedures at the financial institution and the money is received prior to the delivery. Also, for a bridging loan, first, the land sale price is transferred, and subsequently the loan is disbursed in accordance with the progress of the building (start-of-construction funds, interim funds, delivery funds).

The funds are temporarily deposited into the customer's account and then, in accordance with advance transfer instructions, immediately transferred from the customer's account to a JR Kyushu Housing account. However, if the financial institution has concluded a tie-up loan arrangement with JR Kyushu Housing, then there are cases in which the funds are transferred directly into a JR Kyushu Housing account.

In regard to the confirmation of the amount transferred to JR Kyushu Housing, the salesperson enters the anticipated amount of the transfer into the customer management system in advance, and an accounting employee confirms the transfer by comparing this anticipated transfer amount to the amount actually transferred.¹⁴ The results of the transfer are reflected in the customer management system, and the reflected results are communicated to the salesperson by the accounting employee who is assigned to cover the Marketing & Sales Department.

¹³ In addition to the sale price of the land and the building construction contracting amount, miscellaneous costs, miscellaneous expenses, etc., are also listed.

¹⁴ This work is conducted after 3:00 pm as part of the daily closing procedures.

Note that there are cases in which the details of the construction are changed and the construction contracting amount increases or decreases after the construction work is commenced. When the construction contracting amount decreases due to changes in the details of the construction, initially, a surplus is generated in the housing loan for which the application was submitted. However, unless there is a special request from the financial institution, JR Kyushu Housing does not contact the financial institution in regard to the change in the construction work. Also, JR Kyushu Housing does not ask the customer to contact the financial institution.

(c) Settlement of differences

After construction is commenced, funds are transferred in by the customer or the financial institution and expenditures are made as payment for the work of subcontractors, for small-amount expenses, etc. After the delivery of the building, in the end, that difference is settled.¹⁵

In the settlement, there are cases in which the customer is requested to make an additional transfer (if the amount transferred is not sufficient for expenditures) and cases in which a reimbursement is made to the customer. Overall, many cases involve reimbursements.¹⁶

These include cases in which, from the beginning, the housing loan includes miscellaneous expenses, etc., such as curtain purchase expenses, moving expenses, etc., that are paid for with the customer's own money. They also include cases in which the housing loan is a full loan (a loan that covers the entire price of the land and the building), while initially the customer's own money is used, such as for the down payment, etc.

The detailed settlement process is as follows.

First, based on the details entered into the customer management system, the salesperson

¹⁵ At JR Kyushu Housing, after the funds are transferred from the customer, the amount of the transfer is recorded as a deposit, and expenditures are made for payments to subcontractors for construction work, small-amount expenses, etc. (In regard to the details of payments to contractors, invoices are confirmed by the Design Department. For expenses related to the application for approval and the initial fee for new water-service hookup, the salesperson prepares a simple draft of a standard form, which is approved by the General Manager of the Marketing & Sales Department.) The transfer processing is handled by the accounting employee who is assigned to cover the Marketing & Sales Department. In regard to the transfer processing, the accounting employee who is assigned to cover the Marketing & Sales Department makes the entry into the accounting system, and receipts and disbursements are entered into the receipts and disbursements book. At the end of the month, the accounting employee who is assigned to cover the Marketing & Sales Department provides a report to the person in charge of accounting. The person in charge of accounting implements confirmation by comparing the details of the entries in the accounting system with the receipts and disbursements book. Also, the work of making entries into the supplementary ledger for each project is implemented by the person in charge of accounting. From an accounting perspective, deposits are decreased when expenditures are made. In the end, if the amount of expenditures exceeds the amount of the deposit, then from an accounting perspective it is recorded as an advance for which the customer is charged. Also, if there is a remaining balance of the amount recorded as deposit, it is settled as a reimbursement to the customer.

¹⁶ Some of the people who were interviewed felt that if the settlement funds were less than ¥1 million, then it was a commonly accepted matter (there was no sense of unease). One explanation was that because there had been cases in which financial institutions made loans to customers who did not have their own money, or loans for miscellaneous costs, such as moving expenses, etc., there had recently been a large number cases in which reimbursement was provided. During the period when customers had needed to have a certain amount of their own money, when reimbursements were implemented the amount was generally in the range of several thousand yen.

prepares the account settlement statement¹⁷ and stamps it with a seal. Subsequently, the accounting employee who is assigned to cover the Marketing & Sales Department confirms that there are no inconsistencies in the amounts, and stamps the statement with a seal (approval seal). Basically, if the expenditure items and amounts that have been entered into the customer management system match those recorded in the receipts, invoices, and account settlement statement, then the accounting employee concludes that there is no problem. No further confirmation is conducted. If the land sales price and construction contracting amount that appear in the account settlement statement match the information entered into the customer management system, then it is concluded that there is no problem and there is no confirmation of the contract originals, etc.

After confirmation by the accounting employee, the General Manager of the Marketing & Sales Department confirms and stamps the account settlement statement with his or her seal, and the salesperson stamps the account settlement statement with the seal of the Sales General Manager. In this way, despite the fact that the seal of the Sales General Manager has been stamped on the account settlement statement, in practice the Sales General Manager has done hardly any confirmation of the account settlement statement at all.

The salesperson presents to the customer the account settlement statement that has been prepared through the above process, and after confirming the details the customer signs it and stamps it with his or her seal.

When the amount transferred in is greater than the amount charged and the customer is reimbursed, the account settlement statement that has been signed and sealed by the customer is forwarded to the person responsible for accounting via the accounting employee who is assigned to cover the Marketing & Sales Department. After obtaining the approval of the director in charge of administration (currently, Director BA), the person responsible for accounting prepares a request for payment and the reimbursement is processed. The fact that reimbursement has been processed is confirmed by a manager in the Administration Department.

When the total incoming transfer amount is less than the total amount of the charges, and the customer will be asked to provide additional funds, then an invoice is issued. Note that the salesperson enters the amount of the anticipated incoming transfer into the cash management sheet and the person responsible for accounting implements confirmation by comparing this anticipated incoming transfer amount to the amount actually transferred.

Note that in the above process, if the person responsible for approval is absent, then

¹⁷ The account settlement statement includes the dates of the incoming transfers, the amounts of the incoming transfers, the dates of the charges, the details of the charges, and the amounts of the charges. The settlement amount is calculated as the difference.

approval is not made by someone else acting as proxy. Approval is always made by the person responsible.

In addition, at the Southern Sales Office, rather than the salesperson, Individual BV, an accounting employee, prepares the account settlement statement based on the ledger that contains the information related to the contract amount, etc., and on receipts, etc., related to miscellaneous costs. The seal of the Southern Sales Office Sales General Manager is used by Individual BV to stamp the account settlement statement, and the Southern Sales Office Sales General Manager receives a report related to the settlement.

(2) Pre-built housing business

(a) Preliminary meeting, conclusion of contract, decision on loan from financial institution

Basically, in the same way as with custom-built housing in **(1)(a) above**, first, the salesperson interviews the customer about his or her budget, wishes, etc.

Also, a meeting is held to discuss additional optional work (solar panel installation, etc.) and miscellaneous costs, and then the rough estimate and funding plan are prepared and proposed to the customer. The rough estimate also includes miscellaneous expenses, such as curtain purchase expenses, etc.

If the customer agrees to the rough estimate and the funding plan, then he or she files a housing purchase application and submits an application for a housing loan provisional examination to the financial institution. The desired amount of the housing loan is calculated by adding additional construction expenses, miscellaneous costs, etc., to the housing sales price.

After the provisional examination is approved, a real estate sales contract is concluded for the pre-built housing (land and building). When the real estate sales contract is concluded, 5% of the sales price is received as a deposit.¹⁸ In the same manner as with the conclusion of the contract for custom-built housing in **(1)(a)(3)** and **(1)(a)(7) above**, in concluding the real estate sales contract for the pre-built housing, the salesperson formulates a draft that is entitled “contract approval inquiry,” which is confirmed and stamped with a seal by the General Manager of the Marketing & Sales Department, the Sales General Manager, and all full-time directors, including the President. Note that a draft is also prepared and confirmation obtained when the sales price is discounted.

After the conclusion of the real estate sales contract, the finalized application for the

¹⁸ When the customer, etc., has only a small amount of his or her own money, etc., only low-amount application fees, etc. are received.

housing loan is submitted to the financial institution.

(b) Execution of the housing loan

After the approval of the finalized application, the loan amount is temporarily transferred to the customer's account¹⁹, and then the entire loan amount is subsequently transferred from the customer's account to a JR Kyushu Housing account.

In regard to the management of the incoming transfers, the process is confirmed in the same manner as with custom-built housing in **(1)(b) above**.²⁰

(c) Settlement of differences

After the housing is delivered to the customer, the difference is settled in the same manner as with custom-built housing in **(1)(c) above**.

(3) Status of seal management

As with **(1)(a)(7) and (c) above**, the construction contract must be stamped with the seal of the Sales General Manager and the account settlement statement must be stamped with the seals of the Sales General Manager and the General Manager of the Marketing & Sales Department. In regard to the management of seals at JR Kyushu Housing, there are rules in the document management regulations. In summary, it is stipulated that the General Manager of the Administration Department has final responsibility for seal management, and that, in practice, seal management should be implemented by the highest-ranking person in the location where the seals are stored. Under these regulations, the Sales General Manager and the General Manager of the Marketing & Sales Department have the responsibility for the management and use of their respective seals.

However, the Sales General Manager's seal was stored in a seal box in a drawer in his or her desk, and the drawer was not locked. (Or, the drawer was locked, but employees knew that the key was in the drawer immediately above.) Anyone could use the seal if they made an entry in the seal record book, which was stored together with the seal box. Also, the seal of the General Manager of the Marketing & Sales Department was stored in his or her desk in a drawer that was not locked. In the Southern Sales Office, the seal of the General Manager of the Marketing & Sales Department and the seal of the Sales General Manager were simply

¹⁹ If the building has not yet been completed, then the loan is executed after the completion of the building.

²⁰ In pre-built housing business as well, as described in **(1)(b) above**, in general, even if there is a reduction in the sales price or the construction contracting amount due to a change in the construction details, etc., JR Kyushu Housing does not ask the customer to contact the financial institution. However, as described in **No. 3, 2 (4) below**, exceptions were discovered, i.e., cases involving the preparation of a memorandum that included a condition stipulating that "changes in the housing loan amount will be handled as the responsibility of the purchaser."

placed on a shelf in the Marketing & Sales Department, and there were no measures to control the seals through the use of a key, etc.

2. Quotas for the Marketing & Sales Department and individual quotas for salespeople

As described in **Section 1, No. 2, 5 (1) above**, JR Kyushu assigns fixed performance targets for JR Kyushu Housing. These targets are each year's mission. Inside JR Kyushu Housing, the performance targets based on these missions are distributed among the departments and specified for each department. In the Marketing & Sales Department, principally, targets are established for the number of buildings sold in custom-built housing and pre-built housing.²¹ However, looking at results to date, there are not many instances in which these targets have been achieved.

These are overall targets for the Marketing & Sales Department as a whole, and they are not simply distributed among each salesperson as a quota. The quotas (targets) for each salesperson are determined separately from the mission by consultation between each salesperson and the General Manager of the Marketing & Sales Department. In general, each salesperson takes the lead in setting his or her sales targets, and the quotas are set in such a way that, at the least, the total of the quotas for all salespeople exceeds the figure for the mission. Looking at actual plan trends, generally there is a trend toward setting a figure for each individual that slightly exceeds the previous year's figure. It is possible that the setting of quotas was significantly influenced by the wishes of the General Manager of the Marketing & Sales Department and executives.

In regard to both the quota for the Marketing & Sales Department and the quota for each salesperson, even assuming that the quotas are not achieved, the individual salespeople are not subject to any particular penalty, such as reduction of salary, etc.

3. Framework for incentive system for salespeople

In custom-built housing, pre-built housing, renovations, and real estate brokerage, incentives are paid to salespeople based on the conclusion of contracts.

In custom-built housing, incentives are linked to the gross profit margin or the gross profit amount. For one building, the salespeople are paid an amount that is equivalent to or greater than their monthly base salary. In pre-built housing, there are differences based on the time from the start of sales (the sooner the contracts are concluded the higher the incentives), and the amounts are low in comparison with custom-built housing. However, for one building, they are paid incentives in amounts that are comparable with their monthly base salary.

²¹ The targets are set separately at the Northern Sales Office and the Southern Sales Office.

No.2. The Pending Case

1. Overview of the pending case

In regard to the pending case, which led to the start of the investigation, the results of the investigation included the confirmation of the following facts.

(1) Overview of the circumstances leading up to the discovery of the pending case

An overview of the results of the investigation and the circumstances leading up to the discovery of the pending case are as follows.

| Date | Details |
|---|---|
| September 22, 2017 | Couple X, who are the customers for the pending case, visited a JR Kyushu Housing sales center, and Individual BN became responsible for them. |
| Around the end of September 2017 | A communication was received from Bank 3, which was the first bank handling the advance application for the housing loan, indicating that Couple X had not passed the provisional examination. At that point, it became clear that Couple X had existing loan debt. |
| Subsequent to the matters described above | <p>In response to the fact that the provisional examination for the housing loan from Bank 3 had not been passed, Individual BN consulted with an employee, who was senior at that time, in regard to methods, etc., for securing the acceptance of the housing loan application of Couple X. At that time, Individual BN was taught that examination standards, etc., differed by financial institution, and that there was a method of increasing the amount of a housing loan by using a construction contract for which the construction contracting amount had been inflated as an application document.</p> <p>Individual BN thought that if advance applications for a housing loan were submitted at financial institutions other than Bank 3 (including Bank 1), and the above-described method taught by the senior employee was utilized, then Couple X would be able to repay their existing loan. Individual BN proposed to Couple X that they submit a housing loan application following the method of using a construction contract for which the construction contracting amount had been inflated as an application document.</p> |
| October 25, 2017 | A land sale contract for the housing site was concluded between JR Kyushu Housing and Couple X. |
| October 26, 2017 | A communication indicating that the provisional examination had been passed was received from Bank 1. |
| November 15, 2017 | A genuine building construction contract (for which the construction contracting amount had not been inflated) (construction contracting amount: ¥23,652,000) was concluded between JR Kyushu Housing and Couple X. |
| Around mid-November 2017 | Individual BN prepared a construction contract for which the construction contracting amount had been inflated to ¥30,132,000 and a rough estimate for which the breakdown of the construction contracting amount had been inflated, and these were faxed to Bank 1 as necessary documents for the finalized application for the housing loan. |

| Date | Details |
|---|---|
| Subsequent to the matters described above | Based on the altered construction contract, Bank 1 executed a loan for a total of ¥40,000,000, and the start-of-construction funds, interim funds, and final funds were transferred to JR Kyushu Housing via the account of Couple X that had been opened at Bank 1. |
| April 17, 2018 | The land and building were delivered to Couple X. |
| May 18, 2018 | Individual BN presented the genuine account settlement statement (for which the construction contracting amount had not been inflated) to Couple X, and Couple X signed the account settlement statement and stamped it with their seal. |
| June 21, 2018 | As settlement funds, ¥7,530,890 was transferred from JR Kyushu Housing to the deposit account of Couple X at Bank 1. |
| Around the end of July 2018 | Couple X used these settlement funds to repay their existing loan debt, which predated the housing loan. Bank 1 was suspicious about the pending case because the cost per unit area of Couple X's building was high in comparison with that of other JR Kyushu Housing cases. |
| September 22, 2018 | Bank 1 asked Individual BN to provide the account settlement statement. |
| September 23, 2018 | With the cooperation of Couple X, Individual BN prepared a non-genuine account settlement statement with an inflated construction contracting amount and faxed it to Bank 1. |
| September 25, 2018 | The person responsible at Bank 1 requested an explanation from Individual BN about the account settlement statement. |

(2) Specific circumstances leading up to the alteration of the construction contract and rough estimate

Couple X had not passed the provisional examination for a housing loan at Bank 3. Individual BN had just recently joined JR Kyushu Housing, and for Individual BN this was the first instance in which a provisional examination for a housing loan had not been passed. As a result, Individual BN requested assistance from Individual CD, who was a senior employee at that time. (Individual CD had already retired by the time of the investigation.)

In response, Individual CD explained that, looking at the household annual income, etc., it would be possible for Couple X to obtain a housing loan of approximately ¥40 million through the use of joint and several debt. Also, Individual CD provided guidance to Individual BN that it would be possible to increase the housing loan amount by preparing a construction contract with an inflated construction contracting amount, and that it might be possible for Couple X to use those funds to repay their existing loan debt.

However, Individual BN recollected having second thoughts about preparing a construction contract with an inflated construction amount as guided by Individual CD, and accordingly Individual BN made an inquiry about the propriety of this method to Individual CN, a different senior employee who also had a role in providing instruction to Individual BN. (Individual CN had already retired by the time of the investigation.) The reply from Individual CN indicated that Individual CN had also done this in the past and that it was not

anything special.

With the addition of this explanation from a senior employee, Individual BN started to think that, if it would serve the interests of Couple X, even just to a small extent, then Individual BN would inflate the housing loan amount through the preparation of a construction contract with an inflated construction contracting amount, and subsequently have Couple X use the funds to repay their existing loan debt. Individual BN proposed to Couple X the submission of a housing loan application using this method. However, Individual BN recognized that a housing loan application using this method was not proper.

(3) Method of altering the construction contract and rough estimate

As described in **No. 1, 1(1)(a)(8) above**, it was necessary for JR Kyushu Housing to submit to the financial institution the construction contract and rough estimate concluded with the customer as necessary documents for the finalized application for the housing loan. The construction contracting amount listed in the construction contract and rough estimate is one of the bases for the determination of the housing loan amount.

Accordingly, Individual BN made a copy of the genuine construction contract that had been concluded with Couple X (for which the construction contracting amount had not been inflated), and then prepared and affixed to the column for the construction contracting amount, etc., a strip of paper of the same scale on which had been written an inflated construction contracting amount, etc. Correction tape was used to hide the border line of the affixed section and the contract section. This was copied again, and that copy was sent to the financial institution by fax. (The signature and seal column was not forged because the document was based on a copy of the genuine construction contract.)

Through the method described above, the construction contract was altered with the details in the table below. (The altered portions are underlined.) Note that in regard to this alteration, Individual CD stood next to Individual BN and provided detailed guidance about the method.

| Item | Genuine amount | Altered amount |
|--|--------------------|--------------------|
| Construction contracting amount | | |
| Construction contracting amount (including consumption tax, etc.) | <u>¥23,652,000</u> | <u>¥30,132,000</u> |
| Consumption tax, etc. | <u>¥1,752,000</u> | <u>¥2,232,000</u> |
| Construction contracting amount excluding consumption tax, etc. | <u>¥21,900,000</u> | <u>¥27,900,000</u> |
| Breakdown of construction contracting amount payments | | |
| Amount paid with funds on hand (Individual X) | ¥900,000 | ¥900,000 |
| Amount paid with loan funds from official loan or from JR Kyushu Housing tie-up loan, etc. | <u>¥22,752,000</u> | <u>¥29,232,000</u> |
| Payment method | | |
| Contract money | ¥900,000 | ¥900,000 |
| Start-of-construction funds | <u>¥7,584,000</u> | ¥9,700,000 |
| Interim funds | <u>¥7,584,000</u> | <u>¥9,700,000</u> |
| Final funds | <u>¥7,584,000</u> | <u>¥9,832,000</u> |

On the other hand, it was necessary to list the breakdown of the construction contracting amount in the rough estimate, and accordingly Individual BN altered the rough estimate so that it conformed with the inflated construction contracting amount by stating that ¥7,000,000 was needed for secondary work. Note that the rough estimate did not include a section for the signature and seal of the customer, and accordingly it was not necessary to make a copy and then cut and paste in order to alter the document, as was done with the construction contract. Information that was entered into a personal computer was printed out.

(4) Preparation of the genuine account settlement statement

As described in **No. 1, 1(1)(c) above**, at the Northern Sales Office, in handling a settlement, the salesperson prepares the account settlement statement, and after approval-seal confirmation by accounting, it is necessary for the General Manager of the Marketing & Sales Department and the Sales General Manager to confirm the account settlement statement and stamp it with their seals. Finally, following confirmation by the customer, it is necessary for the customer to sign the statement and stamp it with his or her seal.

Accordingly, in handling the settlement of the pending case, Individual BN prepared a genuine account settlement statement that listed the building price at ¥23,652,000.

However, in the column for “breakdown of funds transferred in,” this account settlement statement had entries indicating that a total of ¥31,879,627 had been transferred in (breakdown: building earnest money: ¥900,000; deposit: ¥100,000; start-of-construction building funds: ¥9,800,000; interim building funds: ¥9,700,000; and final building funds: ¥11,379,627). On the other hand, in the “building price” section of the “breakdown of funds transferred in,” section, the building price was listed at ¥23,652,000. Looking at the amount

transferred in and the amount charged, a substantial discrepancy could be seen. (Funds were transferred in from Bank 1 based on the inflated construction contracting amount, but on the other hand the amount charged was based on the construction contract (for which the construction contracting amount had not been inflated), so there would necessarily be a discrepancy.) Nonetheless, in the confirmation/approval process, there were no special comments about this account settlement statement.

(5) Method of preparing non-genuine account settlement statement

Individual BN received a request for the submission of the account settlement statement from Bank 1, which was suspicious about the cost per unit area of Couple X's building, which was high in comparison with that of other buildings. To conceal the alteration of the construction contract, Individual BN used a personal computer to input an amount of ¥30,132,000 for the amount in the "building price" section of the "breakdown of funds transferred in" section so that it conformed with the inflated construction contracting amount in the altered construction contract. On the other hand, Individual BN created and input an entry of (¥6,480,000), as if the amount had been reduced for the reason that the contract had been changed, so that the amount of settlement funds would conform with the actual reimbursement amount. Then, without having gone through the internal approval process, after explaining the circumstances, Individual BN obtained the signature and seal of Couple X on the account settlement statement on which that data had been printed. Subsequently, Individual BN, without permission, stamped the statement with the seal of the Sales General Manager and the seal of the General Manager of the Marketing & Sales Department, which were stored in the office. Note that, as described in **No. 1, 1(3) above**, at JR Kyushu Housing, the seal of the General Manager of the Marketing & Sales Department was stored in an unlocked manner in a drawer of the General Manager's desk. Also, the seal of the Sales General Manager was stored in a manner such that it could be used by employees if they made an entry in the seal record book.

Subsequently, Individual BN sent the non-genuine account settlement statement to Bank 1 by fax.

The entries in in the "breakdown of funds transferred in" sections and the "building price" sections of the genuine account settlement statement and the non-genuine account settlement statement are shown in the table below. (The altered portions are underlined.) For the reimbursement amount, both list ¥7,530,890.²²

²² The reimbursement of the difference with the above ¥6,480,000 (¥1,050,890) was not clarified, even in the interview with Individual BN, but as described **No. 3, 2(2) below**, it is thought that the inappropriate loan application was based on estimate inflation.

Genuine account settlement statement

| Breakdown of requested amount | | |
|-------------------------------|---|-------------------|
| Building | Building price | <u>23,652,000</u> |
| | Amount of change in contract (1st time) | 197,467 |
| | Amount of change in contract (2nd time) | (100,000) |
| | Sub-total | 23,749,467 |

Non-genuine account settlement statement

| Breakdown of requested amount | | |
|-------------------------------|---|--------------------|
| Building | Building price | <u>30,132,000</u> |
| | Amount of change in contract (1st time) | 197,467 |
| | Amount of change in contract (2nd time) | (100,000) |
| | Amount of change in contract (3rd time) | <u>(6,480,000)</u> |
| | Sub-total | 23,749,467 |

2. Evaluation of the pending case

The pending case involves a large amount of money— ¥7,530,890 — and the inflated amount of the reimbursed housing loan was planned as excess financing from the beginning with the objective of using the excess funds to repay existing loan debt that was unrelated to the custom-built housing purchased by Couple X. It has been confirmed that, shortly after joining JR Kyushu Housing, Individual BN received guidance from Individual CD and Individual CN. However, based on the motivation of an excessive customer orientation, Individual BN personally proposed to Couple X the excessive financing, altered the construction contract, and prepared a non-genuine rough estimate. Also, it has been confirmed that Individual BN made ex post facto use of the seal of the General Manager of the Marketing & Sales Department and the seal of the Sales General Manager, thereby preparing a non-genuine account settlement statement and aiming to conceal it.

Accordingly, considering the amount and the circumstances, it must be said that the pending case is a highly damaging case.

No. 3. Analysis of inappropriate loan application cases that were discovered through the investigation

1. Circumstances of the investigation related to separate cases other than the pending case

(1) Extraction of cases subject to examination

As described in **Section 1, No.1, 4 above**, it was decided that the investigation would be implemented without placing any limits on the number of years for which past cases were investigated. However, in the pre-built housing and custom-built housing businesses, JR Kyushu Housing handles an average of approximately 60 to 70 contracts a year. There were limits on the committee's capacity to investigate all past cases going back to 2000, when JR Kyushu Housing was established. Accordingly, through the following methods the committee investigated and narrowed down the cases that were subject to examination (hereinafter, "cases subject to examination").

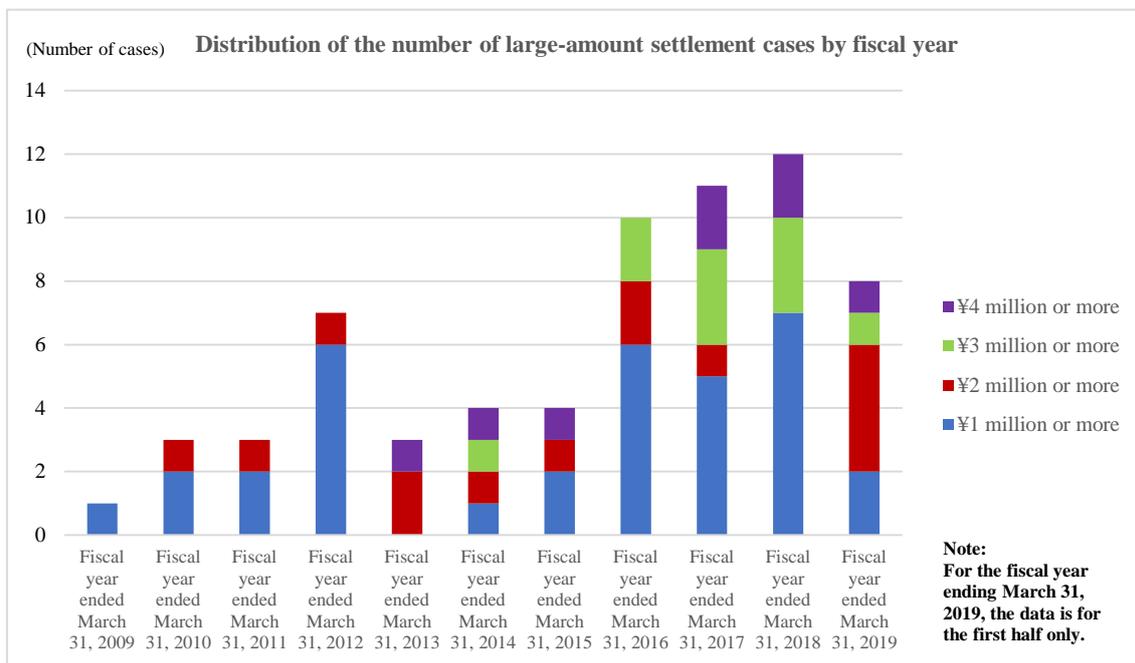
- (a) As indicated in **No 2.1** above, the pending case, which led to the start of the investigation, involved the following. An altered construction contract was submitted to a financial institution. Consequently, a housing loan was executed in an amount that exceeded the actual construction contracting amount. The portion of the loan that was an excessive loan was reimbursed to the customer through settlement procedures.

Accordingly, with the objective of discovering major excessive loan cases similar to the pending case, the committee looked at settlement amounts to narrow down the scope of the investigation. Namely, cases in which large amounts were reimbursed to customers through settlement procedures were considered to have a high probability of involving an application for an excessive loan through the use of some sort of harmful method. Consequently, on October 13, 2018, the committee obtained 311 account settlement statements²³ that had been stored at JR Kyushu Housing and for which a reimbursement had been made to the customer, and subsequently the committee obtained 5 account settlement statements for cases in which settlement had been implemented during the period of the investigation (hereinafter, "account settlement statements subject to investigation"). From these, cases in which the settlement amount was more than ¥1,000,000²⁴ were extracted. There were 65 of these cases (hereinafter, "large-amount settlement cases").

²³ Account settlement statements are stored for the previous 10 years (fiscal year ended March 31, 2009, to fiscal year ended March 31, 2019). The oldest was dated April 15, 2008, and the most recent was dated June 15, 2018. Those for the most recent five years are stored in the JR Kyushu Housing Head Office, and those for previous years are stored in an outside warehouse.

²⁴ The total settlement amount of the large-amount settlement cases accounted for more than 75% of the total settlement amount of all of the account settlement statements subject to investigation.

The distribution of the number of large-amount settlement cases by year is shown below.²⁵



- (b) With the cooperation of certain financial institutions (Bank 2, Bank 1, Bank 3) that had made housing loans for JR Kyushu Housing cases, the committee compared the contracts that were stored at JR Kyushu Housing (for custom-built housing: land sale contracts and construction contracts (appended changed contracts); for pre-built housing: real estate sales contracts) with the housing loan application documents that had been submitted to and stored by financial institutions.

There were 160 cases for which comparison was possible. Among those, there were 8 cases in which there were discrepancies (the construction contracting amounts, etc., in the contracts were different) between the documents stored at JR Kyushu Housing and the documents stored at financial institutions (4 of which were large-amount settlement cases that had been discovered as described in (a) above).²⁶

- (c) In parallel with this investigation, JR Kyushu's Business Development Headquarters and JR Kyushu Housing conducted comparisons of documents stored by Bank 2, Bank 3, and Bank 1; conducted interviews with JR Kyushu Housing employees; etc. As a result, 4 cases

²⁵ For instances in which there were multiple reimbursements for a single case, each reimbursement is counted separately in the distribution chart.

²⁶ Of these, there were 67 cases related to Bank 3 for which a comparison was completed. Of those, there were 3 cases in which there were discrepancies between the documents stored by JR Kyushu Housing and the documents stored by the financial institution. In regard to these cases, as with other cases described below, there are suspicions about alteration of contracts and preparation of inappropriate contracts, but considering the time constraints on the investigation, a separate investigation was not necessarily conducted for all of these cases (excluding those that were, for other reasons, in the category of cases subject to examination).

for which there was a possibility that inappropriate loan applications (see **(3) below**) had been submitted were discovered and reported to the committee. Of these 4 cases, there were 2 cases that had not been discovered through the investigation methods described in **(a)** and **(b) above**.

- (d) As described in **Section 1, No. 1, 5(3)(d) above**, a non-anonymous questionnaire was distributed to all employees of JR Kyushu Housing, and the committee did not receive replies that led to the discovery of cases for which there was a possibility that inappropriate loan applications (see **(3) below**) had been submitted.
- (e) As described in **Section 1, No. 1, 5(3)(e) above**, from November 8, 2018, to November 22, 2018, the committee opened a hotline. The contact addresses for the hotline were the Mori Hamada & Matsumoto law firm, which is assisting in the investigation, and the JR Kyushu Auditing Department, which is working as the executive office for the committee. However, the committee did not receive information that led to the discovery of cases for which there was a possibility that inappropriate loan applications (see (3) below) had been submitted.

Using the methods described in **(a) to (e) above**, a total of 71 cases were extracted (65 large-amount settlement cases plus 6 cases other than large-amount settlement cases that were discovered using the methods described in **(b) and (c) above**). These cases were handled as “cases subject to examination.”

Note that as described in **Section 1, No. 1, 4 above**, the committee initially expected that the scope of the investigation of past cases would be the previous five fiscal years, including the fiscal year in which the investigation commenced. However, in the process of extracting the cases that were examined and collecting basic information, it became clear that it was possible that inappropriate loan applications (see **(3) below**) had been submitted over a period of time longer than the previous five fiscal years. The committee reached the conclusion that it was not reasonable to exclude from the cases subject to investigation, for the reason of timing, those cases for which there is still a remaining balance to be repaid on the housing loan. The cases discovered through the use of the methods described in **(a) to (e) above** were all treated as cases subject to examination to the extent possible, without regard to timing.

(2) Methods of investigating cases subject to examination

For the cases subject to examination that were extracted as described in **(1) above** (71 cases), the following investigations were conducted.

- At JR Kyushu Housing, files were prepared that contained important documents, such as real estate sales contracts, construction contracts, account settlement statements, delivery

certificates, etc. Accordingly, for all of the cases subject to examination, the original documents in these files were confirmed.²⁷

- Interviews were conducted with the salespeople for cases subject to examination (including people who have retired). (Of the 71 cases subject to examination, the committee was able to conduct interviews with the salespeople for 36 cases.)
- Among the cases subject to examination (71 cases), there were 2 cases for which the cooperation of the customer purchasing the housing was obtained, and separate interviews were conducted.
- Generally, interviews were conducted with officers and management supervisors who were in charge of sales operations at JR Kyushu Housing and with employees responsible for accounting operations related to cases subject to examination.

(3) Objectives of the investigation: Discovery and analysis of cases of “inappropriate loan applications”

As a result of the investigations described in **(1) and (2) above**, the following was confirmed. At JR Kyushu Housing, contracts were altered with the objective of obtaining excessive loans, as with the pending case. In addition, as described below, to obtain excessive loans and meet other objectives, in dealing with financial institutions, inflated estimates were deliberately submitted, contracts were altered, non-genuine contracts were prepared, etc. Housing loan operations that are difficult to describe as appropriate were commonplace, and a wide range of techniques were used.

Accordingly, this report is not overly focused on the characteristics of the pending case, which was the start of the investigation (more concretely, the characteristics of “aiming to obtain excessive loans” and “altering contracts”). Rather, the report broadly addresses what are referred to as “inappropriate loan applications,” which is the term used to describe cases at JR Kyushu Housing where false or inaccurate applications were submitted to financial institutions and housing loans were executed in situations where, if the financial institution had known the actual facts, with the same details, it would likely not have approved the loan or it would likely have requested a reduction in the loan amount or an adjustment (or, instances of involvement in this kind of case or instances of active assistance in this kind of case).

(4) Handling of the JR Kyushu Condominium Development Department

The JR Kyushu Condominium Development Department conducts condominium development and sales. This condominium development and sales business also involves

²⁷ There was no uniform policy for the management of documents prepared during the progress of a case. In the end, contracts that had been concluded, delivery-related documents, etc., were filed, but documents, etc., from meetings between salespeople and customers were scattered and lost, and the committee did not implement an exhaustive investigation that included those documents.

operations related to housing loans. The results of a questionnaire conducted at the JR Kyushu Condominium Development Department included replies from several people indicating that in the past they had been involved in operations related to housing loans. However, based on interviews of employees assigned to the JR Kyushu Condominium Development Department and on investigation of documents, the committee determined that the probability of inappropriate loan applications at JR Kyushu Condominium Development Department was low. Therefore, the committee did not conduct separate investigations, etc., of specific cases handled by the JR Kyushu Condominium Development Department.

- Currently, in the JR Kyushu Condominium Development Department, sales operations have been entrusted to a company specializing in real estate sales. (However, that company is not JR Kyushu Housing. Hereinafter, “sales agent company.”) The sales agent company is also providing assistance with housing loan applications, etc.²⁸
- Until August 2017, employees in the JR Kyushu Condominium Development Department had actually conducted sales operations on a trial basis for limited periods of time. The purpose was for these employees to understand the details of the sales operations that are normally entrusted to the sales agent company. This is the reason why, in the questionnaire, several employees of the Condominium Development Department indicated that in the past they had been involved in operations related to housing loans, as described above. It is presumed that because the employees of the JR Kyushu Condominium Development Department did not personally have a high degree of active responsibility for sales results, they did not have the motivation to go so far as to prepare inappropriate loan applications.
- In condominium sales, in principle, the sales price is fixed. Accordingly, there is little room to apply for an excessive housing loan that exceeds the sales price. Also, the housing loan amount could be adjusted in accordance with interior finishing and other additional work, but estimates for the additional work are consistently acquired from general contractors and other contractors. In that event, there is little leeway in which to prepare an inappropriate loan application by adjusting the estimates.
- In looking at the details of the settlement cases implemented in the past by the JR Kyushu Housing Condominium Development Department, it was confirmed that all of these cases involved the subtraction of miscellaneous costs from the deposits received from the customers (the customer’s own money deposited as earnest money, or loans for miscellaneous costs), and they were not cases involving the reimbursement of excessive housing loans. In addition, in regard to applications for loans for miscellaneous costs, the sales agent company handled all of the arrangements, including the preparation of the necessary documents and the submissions to financial institutions, as well as money management operations related to settlement deposits and payments. The sales agent company had responsibility for these arrangements and conducted them under its own name.

²⁸ A sample of the sales consignment contract concluded with the sales agent company was confirmed, and the contract clearly stated that the sales agent company was also responsible for operations related to housing loans.

- The business relationship between the JR Kyushu Condominium Development Department and JR Kyushu Housing was limited to the placing of orders and consignment of renovation work for previously owned condominiums.

2. Methods used in the inappropriate loan applications that were detected

(1) Inappropriate loan applications implemented through the alteration of contracts and the preparation of non-genuine contracts

(a) Situation regarding the alteration of contracts and the preparation of non-genuine contracts

As described in **No. 2, 1(3) above**, in the pending case there was an alteration of the construction contracting amount in the construction contract that had been concluded. On the other hand, there are also cases in which the method used was not a partial alteration but rather the preparation of a non-genuine contract. Those cases for which it is acknowledged that contracts were altered or non-genuine contracts were prepared accounted for 12 of the cases subject to examination (71 cases).²⁹

(b) Settings in which the methods of altering contracts or preparing non-genuine contracts were used

In general, it is clear that the methods of altering contracts and preparing non-genuine contracts are highly harmful, and it is natural that the people using these methods remember having had second thoughts about these activities. Nevertheless, the following cases, in which contracts were altered or non-genuine contracts were prepared, were discovered among the cases subject to examination.

(1) Situations involving an application for a large excessive loan

In cases in which the objective was to obtain a large excessive loan, the method of inflating various items in the estimate was, by itself, not sufficient (see **(2) below**). Accordingly, it was necessary to alter contracts / prepare non-genuine contracts.

(2) In addition to the situation described in (1), situations in which the salesperson decided that it would be difficult to prepare an application for an excessive loan through estimate inflation (see **(2) below**).

Depending on the financial institution (person in charge), there are situations involving ex post facto requests for evidence, such as receipts, etc., to confirm that the loaned funds were used in accordance with the rough estimate that was submitted at the time of the housing loan application. Accordingly, for example, with a financial institution (person in charge) that was being used as the housing loan lender for the first time by the JR Kyushu Housing salesperson, it was possible that in the future there could be a strict check of the supporting evidence for the rough estimate. Accordingly, there were

²⁹ In practice, there are situations in which the contracts submitted to and stored by financial institutions were copies, and the originals, which were the basis on which contracts were altered and non-genuine contracts were prepared, were destroyed. Accordingly, there are many situations in which, with just a simple comparison of documents, it is not clear if a contract was partially altered or if a non-genuine contract was prepared.

situations in which the method of altering contracts or preparing non-genuine contracts was used rather than the method inflating the rough estimate.

(3) Situations in which “Flat 35” was used

“Flat 35” is one type of housing loan product. In comparison with other housing loan products, “Flat 25” has low interest rates, while on the other hand fewer expenditure items are eligible for the loan. Other than the price of the land and the building, expenses, etc., are not widely covered.³⁰ Accordingly, contracts were altered and non-genuine contracts were prepared with amounts that included miscellaneous costs, etc., in addition to the original amount. These were submitted to financial institutions.

(4) Cases in which it was necessary to accelerate the settlement of the land price and implement execution

In order to raise funds through a bridging loan when the settlement of the land price was accelerated due to the situation at JR Kyushu Housing or other circumstances, a finalized application for a housing loan was necessary, and in that event there were situations in which a construction contract that had been concluded as an application document was also requested. However, at that stage, the building specifications, etc., had not yet been decided with the customer, and accordingly the tentative, approximate amount at that point in time (or, the maximum loan amount that the customer wanted) was entered into a non-genuine construction contract with provisional details, which was submitted to the financial institution as if it were the final contract.

(c) Methods of altering contracts or preparing non-genuine contracts

(1) Sections with JR Kyushu Housing signature and seal

With a construction contract, in the section for JR Kyushu Housing’s signature and seal, the seal of the Sales General Manager was used a proxy for the JR Kyushu Housing representative director. As described in **No. 1, 1.(1).(a)(8) and No. 1, (3) above**, in regard to the seal of the Sales General Manager, the flow was as follows. After the necessary approval of the documents, the people responsible would enter the subject documents in the seal record book and use the seal themselves.

The seal of the Sales General Manager was stored together with the seal record book in the desk of the Sales General Manager, but key-based management was not implemented, and each person responsible was able to use them freely. The salespeople responsible for the preparation of non-genuine sales contracts were using the seal of the Sales General Manager without obtaining approval and without making entries in the

³⁰ The system was revised in April 2018, and currently loans can be arranged that include a wide range of miscellaneous costs, including with Flat 35.

seal record book.³¹

(2) Revenue stamp section

There were cases in which revenue stamps were actually attached, and cases in which copies of revenue stamps were used. When a revenue stamp was actually used, the revenue stamp was purchased by the salesperson at his or her own expense. There was no confirmation that the revenue stamps purchased and stored by JR Kyushu Housing were actually misappropriated.

When it was sufficient to submit to the financial institution just a copy of a contract, such as via fax, the method of affixing a copy of a revenue stamp was used. There were cases in which the revenue stamp section of other contracts that had been concluded was copied (including the tally impression seal extending over the stamp and the document) and affixed, and cases in which a revenue stamp that had not yet been used was copied and pasted and the tally impression seal was stamped on top. When a copy was affixed, correction tape was used so that the border would not be conspicuous.

(3) Contract details

In Individual X's case, in which a contract that had already been concluded was partially altered, as described in **No. 2, 1(3) above**, the alteration was made by pasting over the section for the total amount. In contrast, the preparation of a non-genuine contract required the creation of a contract separately from the properly concluded contract, and as a result a technique other than cutting and pasting was necessary.

(4) Section for the signature and seal of the customer

Among the cases subject to examination, even in cases in which contracts were altered or non-genuine contracts were prepared, the sections for the signatures and seals of the customers were prepared by the customers themselves. No cases were discovered in which that section was forged through such methods as the salesperson copying and pasting, the salesperson writing in that section on behalf of the customer, etc.

When a non-genuine contract was prepared, there were two contracts: one that was submitted to the financial institutions and another that was prepared as a genuine contract. The customers were asked to sign and seal two contracts with different amounts. However, the salespeople explained that this was a necessary procedure, and it seems that the customers signed and sealed the contracts without experiencing any particular sense of unease.

³¹ In addition to the method of using the seal of the Sales General Manager without permission, there was also another method that would involve making a copy of the section with the seal of the Sales General Manager from another contract that had been concluded and then pasting that copy. However, it was not possible to clearly confirm whether or not there were cases in which that method had actually been used.

The subsequent handling of contracts that were altered or non-genuine differed by salesperson and timing. Sometimes they were immediately destroyed, and other times they were stored until the delivery/settlement of the land/building.

(d) Preparation of non-genuine account settlement statements

When a contract was altered or a non-genuine contract prepared, as with the pending case, there were cases in which the concealment scheme involved alteration of account settlement statements or preparation of non-genuine account settlement statements for submission to the financial institution. The sales price and construction contracting amount listed on the account settlement statement were based not on the contracts submitted to the financial institution (on which the amounts had been inflated) but rather on the genuine contracts that had been concluded with the customer. Accordingly, when there was a request for the submission of the account settlement statement to the financial institution, it became necessary to alter the relevant portion of the account settlement statement.

In fact, two cases were discovered in which account settlement statements had been prepared in order to be consistent with the details of the contracts that had been submitted to the financial institutions, including the pending case.

(2) Inappropriate loan applications based on inflated estimates

When the finalized application for a housing loan was submitted, as described in **No. 1, 1(1)(a)(8) above**, estimate documents (the “rough estimate” and “funding plan”) regarding housing-related expenditures that were expected to be paid, based on the concluded construction contract, etc., the housing loan, and the customer’s own money (if there was any), were submitted. Based on these documents, the financial institution confirmed that the loan amount was reasonable.

In the rough estimate and the funding plan, in addition to the land sales price and the construction contracting amount, there were other items, such as “secondary work” and “miscellaneous costs.” The salesperson who planned/tacitly approved the excessive loan inflated the estimates for these items without any support for detailed expenditure estimates. In this way, applications were submitted for housing loans in amounts that substantially exceeded the amounts of expenditures that were actually expected.³²

Note that these estimates and funding plans that were submitted to financial institutions were prepared by the salespeople on their own authority and were not subject to internal approval

³² Among the salespeople, there was a salesperson who stated that a fixed, standard amount had been suggested by the person in charge at the financial institution as a yardstick for an amount of miscellaneous costs, etc., for which there would not be any particular requests for submission of detailed evidence in regard to the uses of funds from the housing loan.

at JR Kyushu Housing.

The inflation of estimates was a method of preparing inappropriate loan applications at JR Kyushu Housing. As described below, in accordance with the concept of “looking for leeway in advance,” adding an amount on top of the estimates of the actual expenditure amounts in the rough estimates and funding plans became, in practice, the general rule at JR Kyushu Housing. The amounts that were added varied based on the case and the salesperson, but the committee believes that it would not be an exaggeration to say that inflation in amounts of several hundred thousand yen was implemented not just for the cases subject to examination but for nearly all of the housing loan applications at JR Kyushu Housing.

(3) Inappropriate loan applications based on contracts that were changed ex post facto

In custom-built housing cases, in some situations, after the construction contract was concluded, the construction for which JR Kyushu Housing had originally expected to receive an order ended up not being conducted, and as a result the construction contracting amount was reduced ex post facto. The reasons were that in some cases the construction would not be conducted at all, while in other cases the customer would not place an order for the construction with JR Kyushu Housing but instead would directly commission a third-party contractor to do the work. In both of these types of situations, almost without exception, the occurrence of this change was not reported to the financial institution. In addition, even when the customer directly commissioned a third-party contractor, almost without exception, JR Kyushu Housing did not confirm if the customer had actually commissioned the third-party contractor to perform the work in accordance with the estimate. As a result, the amount of the reduction in contracts that had been changed became an excessive loan (especially notable in cases in which the construction work was not performed), and a reimbursement was provided to the customer through the settlement process.

Among the cases subject to examination (71 cases), there were 17 cases in which the amount of the reduction in a contract that was changed was reimbursed. Solar panel installation and exterior construction work and landscaping were items that were typically reduced in a contract that was changed. Each of these items was typically estimated at more than ¥1 million. (In some cases, the amounts were high, more than ¥3 million). By removing these items from contracts that were changed, the amount of the reimbursement provided through the settlement process was increased by the same amount.

The amount of reduction for a contract that was changed depended purely on the circumstances after the conclusion of the contract. Moreover, there were cases in which a reduction resulted in a reimbursement through settlement procedures and that reimbursement was actually used in the originally envisioned construction work, etc. This group of cases includes cases that cannot be considered to have risen to the level of inappropriate loan

applications. However, the cases that involved the conclusion of a contract that was changed included some situations in which the customer considered competitive bids, etc., and as a result selected a contractor other than JR Kyushu Housing. The committee thinks that possibly there were many cases in which actual expenses were held to a lower amount than was initially envisioned. (In fact, that was the very reason why the customer directly commissioned a third-party contractor without placing an order with JR Kyushu Housing.) If so, then this led to excessive loans from the financial institutions.

(4) Inappropriate loan applications using post-contract discounts (pre-built housing)

In contrast to custom-built housing, in sales of pre-built housing, the sales price is generally set in advance, but there are situations in which a discount is agreed upon in the process of negotiations with the customer. This is not a problem if the discount is agreed upon prior to the conclusion of the real estate sales contract, and the discount is reflected in the price in the real estate sales contract. However, among the cases subject to examination (71 cases), there were two cases in which a discount was not reflected in the price in the real estate sales contract but rather was reflected in an ex post facto manner, and there is no indication that this was reported to the financial institution.

In other words, for these cases, real estate sales contracts between JR Kyushu Housing and customers were concluded with amounts that had not been discounted (at the initially-set sales price), and those contracts were used for housing loan applications submitted to financial institutions. Accordingly, the housing loans were approved and executed in amounts that covered the pre-discount sales prices. However, the sales prices were actually discounted, so in the end an excess arose in the loan funds, and the portion corresponding to the amount of the discount was reimbursed to the customer through the settlement process.

Furthermore, the committee believes that in the two cases that were discovered, these types of discounts were agreed upon by JR Kyushu Housing and the customer prior to the conclusion of the contract. (For a specific example, see the case of Individual Y in **4 below**.)

In addition, with these cases, separate from the real estate sales contracts, memorandums were concluded with the customers. In addition to the fixed amount discount, those memorandums stipulated that the purchaser was responsible for changes in the amount of the housing loan.³³ However, the committee believes that prior to the conclusion of the contracts, JR Kyushu Housing and the customers agreed on the discounts as a precondition for the contracts, and that JR Kyushu Housing gave unspoken agreement that the amount of the

³³ Note that these memorandums contained a provision stipulating that the purchaser not reveal the discount to a third party, but there was also a person who commented in the interviews that this was done with the objective of avoiding dissatisfaction or criticism from other customers, given that information about the discounts had spread widely because JR Kyushu Housing was conducting a large number of housing sales in the same region.

housing loans would not be changed.³⁴

³⁴ Of these cases, in 1 case the customer already had a car loan, and the fact that an excessive loan had been obtained in order to repay the car loan was made clear in an internal report. (See Individual Y's case described in **4 below**.) In addition, in the other case, at the stage of negotiations before the conclusion of the contract, it became clear that the customer had a car loan and other debts and had meager financial resources. It is difficult to accept that this customer, on his or her own, envisioned making an adjustment to reduce the amount of the housing loan from the financial institution.

(5) Summary

The numbers of inappropriate loan applications discovered among the cases subject to investigation (71 cases) are listed below by category. There are incidents in which a single case involves multiple categories, and those are counted separately. Also, among the cases subject to investigation, there were 16 cases which were not considered to have involved inappropriate loan applications.

| Category | Number of cases |
|---|------------------------|
| Production of altered/non-genuine contracts | 12 cases |
| Inflation of estimates | See (2) above |
| Alteration of contracts | 17 cases |
| Post-contract discounts (pre-built housing) | 2 cases |
| Cases which were not considered to have involved inappropriate loan applications | 16 cases |

3. Views at the time of inappropriate loan applications

There are minor differences in the extent and details of the perceptions and views of the JR Kyushu Housing salespeople in regard to the submission of inappropriate loan applications. There is a wide range for each case, but looking at the perceptions of the use of the funds raised through housing loans, in general they can be broadly classified into the following two groups.

- (1) Situations in which there is clear recognition that the uses of funds envisioned by the client include details that would not be approved by the financial institution

In regard to the application of certain portions of the executed housing loans for fund uses that would not be approved by the financial institution, among the subject cases (71 cases), there were 10 cases for which it has been confirmed that the salespeople definitely recognized this in advance.

Specifically, cases like the following were discovered.

- (a) Cases in which the customer had a car loan, consumer loan, etc., in addition to the housing loan, and envisioned using the excess portion of the housing loan to repay these loans.

For the customer, simultaneously repaying the previous loans and the housing loan is a major burden. From the standpoint of economic rationality, it is natural to think of borrowing a large amount as a housing loan, which has a comparatively low interest rate, and then using the excess money to repay the other loans. There were also cases in which the JR Kyushu

Housing salespeople learned of the wishes of the customer, and in accordance with the self-justification that they were giving the highest priority to the interests of the customer, the salespeople arranged applications for excessive loans corresponding to the amount needed for repayment.³⁵

This category of cases includes the pending case and cases in the pre-built housing business in which discounts were implemented after the contracts were concluded. (See **2(4) above**.)

It is obvious that the repayment of borrowings unrelated to housing is not the original purpose of a housing loan, and these cases are the most conspicuous examples of inappropriate housing loans.

- (b) There were examples of customers planning to make a replacement house purchase who planned to secure an excessive loan in preparation for the event that the sales price of their previous residence was less than expected. A housing loan is executed as a loan secured by the land and building purchased by the customer, and accordingly, it is obvious that supplementing the sales price received for the existing residence is not part of the purpose of a housing loan. Accordingly, it is acknowledged that such an application is an inappropriate loan application.
 - (c) As described above, in principle, the Flat 35 is only for the price of the land and the building (and a limited range of expenses). There were cases in which contracts were altered or non-genuine contracts were prepared with the objective of including in a Flat 35 loan expense items that would not be expected to be included in a proper loan. In these situations too, it was recognized that the uses of funds would not be approved by the financial institution.
- (2) Cases in which there was recognition (tacit approval) of the possibility that the details of the uses of funds envisioned by the customer would not be approved by the financial institution

Even in situations other than those cases in which there is clear recognition that the use of funds envisioned by the customer includes details that would not be approved by the financial institution, as described in **(1) above**, the committee believes that this possibility was recognized (tacitly approved) in a very large number of situations. Among the cases subject to examination (71 cases), there were 45 cases in which this type of willfully negligent recognition could be recognized.

There are a very large number of cases in which the methods used for inappropriate loan applications were the inflation of estimates and the reduction of construction contracting

³⁵ Certain salespeople made comments suggesting that it was possible that customers would be taken away by other companies if their wishes were not addressed.

amounts through ex post facto alteration of contracts, as described in **2.(2) and (3) above**. In these situations, there were a wide range of perceptions/intentions among salespeople at the time when the housing loan applications were made. They can be classified into the following general types.

- Situations in which applications were submitted with larger amounts of miscellaneous costs, etc., in a routine manner, despite the fact that no particular wishes or instructions were received from the customer.³⁶
- Cases in which, despite the fact that information about specific uses of funds has not been received from the customer, applications are filled out with a large amount of miscellaneous costs, etc., based on concerns that some additional housing-related expenditures might become necessary, such as furniture, interior finishing, etc., or based on the concept of “looking for leeway in advance,” with the objective of guaranteeing the smooth progress of business affairs after the specifications change.
- Cases in which, even though it is recognized that the customers want specific secondary/additional work, it is not clear whether or not that work will actually be performed, or whether or not the order will be placed with JR Kyushu Housing if the work is performed, but nonetheless this work is added on to the estimate.

In almost all of these cases, the charges from JR Kyushu Housing and the miscellaneous costs did not, in the end, total up to the amount of the estimate, and settlement funds were reimbursed to the customer. JR Kyushu Housing did not always track (confirm) what the customer was actually using the reimbursed portion for, nor was there an institutional means of assuring such tracking.³⁷ Accordingly, the committee believes that the salespeople tolerated (tacitly approved) the possibility that the customer would utilize the settlement funds for purposes other than housing-related expenditures.

Note that, as described in **2(1)(b)(4) above**, there were cases in which an early loan application became necessary due to the acceleration of the land settlement. These are one type of case in which, in particular, non-genuine contracts were prepared. With this type of case, the fund usage itself was not necessarily a major subject of interest among the parties. However, because the construction contract was prepared at a stage when the details of the contract were not yet actually clear, budget estimates were naturally made higher to avoid an

³⁶ As described in **No. 1, 1(1)(a) and (2)(a) above**, housing loan applications are implemented in two stages, a provisional examination and a subsequent finalized application. If it is within the limit of the loan amount approved under the provisional application, then there is no problem if the amount of the loan actually received is less than the amount approved, but if the loan amount exceeds the amount approved, then a reapplication is necessary. Accordingly, it is generally accepted that the salespeople arrange applications for the full loan amount that would be possible given the customer's income circumstances, etc. It is the customer who makes the decision on the final loan amount. There are many situations in which, given the low interest rates for housing loans, customers think they would like to obtain a loan for the maximum amount that has been approved. Consequently, this gives rise to a situation in which estimates that have been inflated as much as possible at the provisional examination stage are supported until the end.

³⁷ There are also cases in which the implementation of the secondary work that had been envisioned can be confirmed when the salesperson visits the building after delivery, but that only happens by chance, and even in such a case the salesperson would not know the expenses required for the relevant construction work.

insufficient loan amount in the future. Accordingly, these can be classified as cases in which there was an excess in the amount of the housing loan that was applied for and executed and a recognition of the possibility that those funds would be used for something other than housing-related expenditures.

4. Case of Individual Y (analysis of characteristic examples — 1)

In the case of Individual Y, an excessive loan was planned with the objective of using the funds to repay the remaining balance on a car loan. Those facts were shared with executives, and accordingly, this case is given special attention in this report.

(1) Factual circumstances

- Individual Y was a customer who wanted to purchase pre-built housing.
- At a meeting between Individual CE (already retired at the time of this investigation), who was the salesperson, and Individual Y, Individual Y made a statement that he had a car loan of ¥1,900,000 and that if that loan was paid off then he could purchase a home. Then, Individual CE proposed to Individual Y that the housing price be reduced by ¥1,900,000 and simultaneously the ¥1,900,000, which corresponded to the remaining balance on the car loan, would be included in the housing loan. The approval of Individual Y was obtained.
- In regard to the above scheme, Individual CE consulted with Individual BJ (currently, General Manager of the Marketing & Sales Department), and a memo was prepared to obtain internal approval. The memo included statements such as the following. “The existing car loan will be incorporated into this housing loan,” and “It will be an excessive loan, so your decision is requested.” The memo clearly indicated that an application would be submitted for an excessive loan and the funds used to repay the car loan.
- In February 2015, Individual BJ (currently, Marketing & Sales Department General Manager) made a report related to Individual Y’s case through an e-mail to which this memo was attached. The e-mail was sent to Individual BH, who was General Manager of the Real Estate Department at that time, and Northern Sales Office General Manager BI.
- After internal approval, on February 22, 2015, a real estate sales contract was concluded with Individual Y at the pre-discount sales price of ¥35,400,000. Based on this sales contract, a housing loan of ¥36,500,000 was received.
- On March 16, 2015, after the real estate sales contract was concluded, in regard to Individual Y’s case, a draft of a memorandum that was to be concluded with Individual Y was prepared and circulated. The draft memorandum indicated that the building sales price would be discounted by ¥1,900,000, and included such statements as “The purchaser will not disclose the details of the memorandum to third parties, and in the unlikely event that the seller incurs damages due to disclosure by the purchaser, then the purchaser must compensate the seller for the damages.” This was approved with the

approval of Northern Sales Office Sales General Manager BI and Director BA (at that time, General Manager of the Planning Department). This memorandum was actually concluded with Individual Y.

- In April 2015, as a result of the reflection of the ¥1,900,000 discount, ¥2,238,552 was reimbursed to Individual Y. The reimbursement of approximately ¥300,000 in addition to the discount portion is thought to possibly have been a discrepancy, etc. from the estimate for miscellaneous costs, etc.

(2) Evaluation of Individual Y's case

In Individual Y's case, an excessive loan was planned from the beginning, with the objective of using the funds to repay a car loan. It was clearly recognized that this was an inappropriate loan application. In addition, the method used was to conclude a real estate sales contract at a price that did not reflect a discount, and then submit that contract to the financial institution, while agreeing in advance that a discount would be implemented after the contract was concluded. Effectively, there was no difference between this method and altering the sales price.

Individual BJ (currently, General Manager of the Marketing & Sales Department), Individual BH, and Northern Sales Office General Manager BI had a clear recognition that this was an excessive loan with the objective of repaying a car loan. Director BA only approved the circulated draft related to the memorandum about the ex post facto discount in a superficial manner. However, in the first place, a post-contract discount itself is highly unusual in pre-built housing, and there are no indications that any discussions were held before it was approved. Given those circumstances, all of the people who approved this scheme, which involved advance agreement on a discount as a means of obtaining an excessive loan, reconciled the details of the scheme in advance. At the least, it can be inferred that this scheme was tacitly approved.

5. Case of Individual Z (analysis of characteristic examples — 2)

In the case of Individual Z, the land settlement was accelerated due to circumstances at JR Kyushu Housing, and as a result the salesperson prepared a non-genuine construction contract with the objective of obtaining a bridging loan. Even though it was indirect, nonetheless instructions from JR Kyushu Housing to record sales by the end of the period were the cause of the preparation of a non-genuine contract, and this case is a typical example of the preparation of a non-genuine contract for a reason other than an excessive loan. Accordingly, it is given special attention in this report.

(1) Factual circumstances

- In November 2017, Individual Z visited a JR Kyushu Housing sales office, and after

subsequent negotiations, decided to purchase custom-built housing.

- Initially, the schedule was envisioned as follows: conclusion of the construction contract related to the building in May 2018, delivery of the land in August, start of construction in September, roof-laying in October, and delivery of the building in December. However, thinking that JR Kyushu Housing executives wanted to record the sales related to this land in the fiscal year ending March 31, 2018, Director BA and Marketing & Sales Department General Manager BJ instructed the salesperson, Individual CD, to conclude the delivery of the land and the settlement of the land-portion of the price by the end of March 2018.
- The delivery of land involves the exchange of the land for money, so if the delivery of the land is accelerated it is necessary to decide on the land price. On the other hand, a construction contract is necessary for the application for the housing loan. Consequently, Individual CD prepared a construction contract at a stage at which the building specifications, etc., had not yet been settled. Individual CD used the seal of the Sales General Manager, without permission, to stamp the construction contract; purchased a revenue stamp himself and affixed it; and had the contract signed and sealed by Individual Z. In this way, the construction contract was prepared, and a copy of the contract was submitted to the financial institution for the housing loan application.
- Note that when a bridging loan is used to accelerate settlement of the land price, the customer's interest burden increases. Consequently, it was agreed with Individual Z that in response there would be a discount of ¥440,000. This was also approved by Director BA and Marketing & Sales Department General Manager BJ.
- Individual CD retired from JR Kyushu Housing at the end of July 2018, and this case was passed on to Individual BK. Individual BK received only the construction contracting amount and a rough estimate of the total amount, and was not aware that a construction contract had already been prepared. Consequently, a construction contract was once again concluded with Individual Z.
- The construction contracting amount in the construction contract that had been submitted to the financial institution was ¥23,760,000 (including tax), and the construction contracting amount in the construction contract subsequently prepared by Individual BK was ¥23,540,000 (including tax).
- In September 2018, while organizing documents, Individual BK unexpectedly discovered the construction contract prepared by Individual CD. After this investigation commenced, the existence of Individual Z's case was revealed by an independent statement from Individual BK.

(2) Evaluation of Individual Z's case

As indicated by the fact that the construction contracting amounts in the two construction contracts that were prepared were basically not different, the preparation of the inappropriate loan application in Individual Z's case was not done with the objective of securing an

excessive loan. However, the housing loan application prepared by Individual CD, the person previously responsible, involved the submission of a non-genuine contract with meager backing, based on the expectation that subsequently a genuine construction contract would be concluded separately. It is clear that this was an inappropriate loan application with details that could not be approved by a financial institution.

Another important point about the case of Individual Z is that Director BA and Marketing & Sales Department General Manager BJ instructed Individual CD to implement the land price settlement by the end of March 2018. At JR Kyushu Housing, where the achievement of profitability is the number one objective, it is not necessarily unreasonable to request that employees work to record sales by the end of the fiscal year, and the simple fact that Director BA and Marketing & Sales Department General Manager BJ gave such instructions does not lead directly to the conclusion that they were aware of the inappropriate loan application activity by Individual CD. However, it is to be expected that they shared a common awareness that excessive bridging loans would be generated in order to record the sales. In consideration of the fact that both Director BA and Marketing & Sales Department General Manager BJ had a thorough awareness of the existence of inappropriate loan applications, as described in **No. 4, 2 and 3 below**, it is possible that they had a certain level of awareness regarding the preparation of inappropriate loan applications (or the possibility of such preparation) by Individual C in the case of Individual Z.

6. Individual BU's case (analysis of characteristic examples — 3)

Individual BU, an employee of JR Kyushu Housing, used JR Kyushu Housing for work related to the renovation of his home. Individual BU's case involves the receipt through settlement procedures of a large-amount reimbursement exceeding ¥4 million in September 2013. The method can be classified into the category of preparation of non-genuine contracts, which has already been analyzed. However, this is a case in which employees were involved. Also, it had been taken up as a problem case within JR Kyushu Housing at that time, and it could have been used as an opportunity to raise issues regarding inappropriate loan applications. Accordingly, it is given special attention in this report.

(1) Factual circumstances

- Individual BU joined JR Kyushu Housing in 2005, and subsequently worked in the Southern Sales Office.
- In August 2013, Individual BU applied for a renovation loan in the amount of ¥5 million from Company 4, with the objective of home renovation. At that time, Company 4 had a tie-up relationship with JR Kyushu Housing related to renovation loans. When applying for the renovation loan, Individual BU prepared a construction contract with JR Kyushu Housing, with a construction contracting amount of ¥5,040,000. This contract was

submitted to Company 4.

- However, the renovation work for which Individual BU placed an order with JR Kyushu Housing was actually only for ¥721,875. There was no construction contract for this amount, nor was there a contract that was changed to reduce the construction contracting amount in the contract that was initially prepared, which was ¥5,040,000. Individual BU placed the order in line with the application form. In the account settlement form dated September 13, 2013, the construction contracting amount was listed as if it had been ¥721,875 from the beginning.
- Consequently, of the ¥4,900,000 that was transferred from Company 4 to JR Kyushu Housing upon the execution of the renovation loan, ¥4,178,125 remained after the actual price of the construction work was subtracted, and that amount was reimbursed to Individual BU.
- At the renovation loan application stage, Individual BU expected to commission JR Kyushu Housing for only a small amount of work, and to directly commission contractors outside of JR Kyushu Housing to handle other work, purchase of fixtures, etc. To enable those funds to be raised with a single low-interest renovation loan, as described above, JR Kyushu prepared and submitted a contract indicating that it would handle work equivalent to ¥5,040,000. In addition, Individual BS, who at that time was the Southern Sales Office Sales General Manager (currently, Deputy General Manager), was consulted in advance by Individual BU, and Individual BS was aware of and approved the fact that Individual BU would apply for a renovation loan with a false construction contract.
- This case was seen as a problem even within JR Kyushu Housing, and Director BA took steps to advance an investigation of all of the facts, such as requesting a report from Individual BU and Southern Sales Office Sales General Manager BS (at that time; currently, Deputy General Manager), conducting interviews with both of them, etc. As a result of the investigation, the factual circumstances described above became known. A disciplinary action plan was prepared, comprising a stern warning for Southern Sales Office Sales General Manager BS (at that time; currently, Deputy General Manager), and a reprimand for Individual BU. Nonetheless, in the end no disciplinary action was taken. Consequently, this case was not officially known within JR Kyushu Housing.
- In addition, in the process of the investigation of the facts, Southern Sales Office Sales General Manager BS (at that time; currently, Deputy General Manager) made a report to Director BA regarding Individual BU's use of a portion of reimbursed settlement funds to purchase a condominium. However, that report was false. In regard to Southern Sales Office Sales General Manager BS (at that time; currently, Deputy General Manager), the reason why he and Individual BU had been criticized was thought to have been that Individual BU had directly conducted transactions with a contractor outside JR Kyushu Housing while being an employee of JR Kyushu Housing. The false report was prepared with the objective of protecting Individual BU.

(2) Evaluation of Individual BU's case

Putting aside the issue of whether or not the settlement funds were actually used for the renovation of Individual BU's home, in any case, a construction contract was concluded that included work for which, from the beginning, there was no intention to place the order with JR Kyushu Housing. That contract was submitted to a consumer finance company, and funds were received through a renovation loan. Even among inappropriate loan applications, this was a harmful case.

Furthermore, this case was the subject of an internal investigation, and in the process of that investigation a report was made to Director BA regarding the preparation of a non-genuine construction contract. Under ordinary circumstances, Individual BA's case should have functioned as an opportunity to heighten the awareness of problems related to the widespread inappropriate loan applications at JR Kyushu Housing, and to take measures to eliminate those applications.

(3) Other cases in which employees were customers

Among the cases subject to examination (71 cases), there were 2 cases (Marketing & Sales Department General Manager BJ and Couple CD) in which settlement funds were received by employees of JR Kyushu Housing (including retired employees), as with Individual BU's case. Of these, it was confirmed that the construction contract was altered in Couple CD's case (settlement funds: ¥3,210,292).

No. 4. Status of involvement by principal officers and employees in activities related to inappropriate loan applications

1. Salespeople

As described in **No. 3, 2 above**, a variety of methods were used for inappropriate loan applications, and it was the salespeople who played the central role in the actual implementation of those applications. In almost all of the cases of inappropriate loan applications that were discovered, the salesperson implemented the application in accordance with his or her judgment that some form of inappropriate loan application was necessary in order to conclude the contract. It was confirmed that background circumstances leading to inappropriate loan applications included, as described in **Section 3, No. 5 below**, pressure to achieve quotas and record sales for the Company. However, it has not been confirmed that direct instructions from executives or superiors compelled the salespeople to implement inappropriate loan applications. The salespeople themselves were thoroughly aware that these inappropriate loan applications were inherently not permissible. On the other hand, there were only a small number of cases in which the salespeople gave their supervisors point-by-point explanations about the details of inappropriate loan applications and asked for instructions.

The salespeople at JR Kyushu Housing include a large-number of mid-career hires who have operational experience in the real estate industry. Accordingly, there are cases in which, at the point when they joined JR Kyushu Housing, they already had a certain level of knowledge and experience in regard to inappropriate loan applications. It cannot be denied that, as described in **Section 3, No. 3, 4 below**, JR Kyushu Housing's lack of an operations manual and lack of training, combined with these circumstances, contributed to an environment in which the operational execution by the salespeople was characterized by growing self-justification and increasing black-box functioning. In addition, salespeople were assigned in a dispersed manner to multiple sales bases where they performed their duties, and consequently, close, mutual communication was not necessarily implemented. This also contributed to the growing self-justification and increasing black-box functioning of the salespeople's operational execution. On the other hand, it was confirmed that there was a certain amount of information exchange regarding inappropriate loan applications (albeit a small amount).³⁸ For example, Individual BN, who was in charge of the pending case, received guidance from senior employees, Individual CD and Individual CN, which led to the alteration of the construction contract.

Note that in regard to the pending case and other cases of inappropriate loan applications, the committee did not discover evidence indicating the salespeople received rebates, entertainment, cash, or other benefits from customers. On the other hand, as described in **No. 3, 6 above**,

³⁸ For example, it has been confirmed that, when a salesperson who had been a new mid-career hire considered using at JR Kyushu Housing an inappropriate loan application method that had been used at a previous workplace, the salesperson asked other salespeople if this method was also used at JR Kyushu Housing.

Individual BU and Individual CD, while in the position of salespeople, themselves acted as customers in situations leading to the alteration of contracts or the preparation of non-genuine contracts. These cases are the most conspicuous examples of moral breakdown among the salespeople.

2. Marketing & Sales Department General Manager BJ

On April 1, 2014, Marketing & Sales Department General Manager BJ was seconded from JR Kyushu's Condominium Development Department to JR Kyushu Housing, and after approximately one year of work in the Real Estate Department, he became General Manager of the Marketing & Sales Department in 2015.

Marketing & Sales Department General Manager BJ understood the progress of each case through weekly sales progress meetings held in the Marketing & Sales Department, sales progress reports, and individual consultations with salespeople. However, it was not necessarily the case that he received detailed reports about the progress of all cases. As described in **1 above**, the inappropriate loan applications were basically implemented in accordance with the judgment of the salespeople themselves, and it has not been confirmed that the salespeople actively consulted with or asked for instructions from Marketing & Sales Department General Manager BJ in regard to the inappropriate loan applications.

Nonetheless, considering the information below, it is clear that Marketing & Sales Department General Manager BJ was aware of (tacitly approved) the existence of a considerable number of inappropriate loan application cases at JR Kyushu Housing. Marketing & Sales Department General Manager BJ, as described in **No. 3, 4 above**, was aware of the use of the excessive portion of a loan resulting from a discount to repay a car loan in Individual Y's case. Nevertheless, the case proceeded without change, and Marketing & Sales Department General Manager BJ himself distributed a memo indicating that the car loan would be incorporated into the housing loan. Note that, as described in **No. 3, 2(4) above**, examples of post-contract discounts (pre-built housing) include one other case in addition to Individual Y's case. (Moreover, the amount of settlement funds was extremely high: ¥6,387,183.) For this case too, the customer had extremely meager financial resources and other loan debt in addition to the housing loan. This information was shared within the company by Marketing & Sales Department General Manager BJ. There is a high probability that this case also involved an inappropriate loan application with the objective of essentially incorporating other loan debt into the housing loan, and it has been confirmed that Marketing & Sales Department General Manager BJ was actively involved.

In addition, Marketing & Sales Department General Manager BJ was also the person responsible for approval of the account settlement statements, and looked at all of those statements. Accordingly, Marketing & Sales Department General Manager BJ was naturally

aware that settlements exceeding ¥1,000,000 occurred on a daily basis, and that occasionally large-amount reimbursements of several million yen were implemented (the pending case: ¥7,530,890).

Considering these facts, even if there were not always detailed consultations or reports from the salespeople about inappropriate loan applications for individual cases, it is not possible to conclude that there was no involvement in inappropriate loan applications in cases other than those in which specific involvement was confirmed, such as Individual Y's case. Rather, there is no alternative but to conclude that Marketing & Sales Department General Manager BJ gave tacit approval to the situation overall, even while being aware of the possibility that a range of methods, including inappropriate loan applications, were being used by salespeople, who were exposed to intense customer acquisition competition from other housing companies. These methods were being used in order to address the wishes of customers and conclude contracts, or to address the requirements of JR Kyushu Housing (for example: instructions to record sales by the end of the period, such as in the case of Individual Z, described in **No. 3, 5 above**).

3. Director, Administration Department General Manager BA

Director BA worked in the JR Kyushu Business Development Headquarters, Housing Division from 1995. He was seconded to JR Kyushu Housing from 2000, when that company was established, and became Director in 2009. Over that period, Director BA gained experience as General Manager of the Marketing & Sales Department and Sales General Manager. Accordingly, Director BA had considerable knowledge in business affairs related to housing sales, including housing loans.

As with Marketing & Sales Department General Manager BJ and others, Director BA received and approved drafts related to discounts for two cases of post-contract discounts, described in **No. 3, 2(4) above**. In addition, in a separate case, in December 2015 Director BA received an individual report that an excessive loan had been executed for the reason that the sales price on the previous residence was insufficient.³⁹

Furthermore, Director BA was also the person who gave final approval for settlement procedure disbursements. He was naturally aware that settlements exceeding ¥1,000,000 occurred on a daily basis, and that occasionally large-amount reimbursements of several million yen were implemented (the pending case: ¥7,530,890).

Moreover, in Individual BU's case, described above, it was Director BA who took the lead in

³⁹ In this case, due to the circumstances on the customer's side, it was necessary to reimburse the settlement funds more quickly than normal. Accordingly, Director BA, who managed receipts and disbursements, received an explanation of the situation directly from the salesperson. This communication included a clear explanation that an excessive loan had been executed because the sales price of the customer's previous residence had been insufficient.

the formulation of the ex post facto fact-finding and disciplinary action plan. Through various investigations, Director BA was also aware of the fact that Individual BU had obtained a large-amount of settlement funds, more than ¥4 million, by preparing a non-genuine construction contract and submitting it to a consumer finance company.

Considering these facts, there is no doubt that Director BA was also clearly aware that inappropriate loan applications were being implemented at JR Kyushu Housing. Given both Individual BU's case and the existence of other large-amount settlements as described above, it should have been easy to envision that there could be a large number of other cases in which inappropriate loan applications were being implemented by the same methods. Nonetheless, there is absolutely no indication that Director BA made an effort as a Director to find out the facts of the situation, prevent a recurrence, etc. (Individual BU's case, which provided an excellent opportunity to prevent the occurrence of cases similar to the pending case, was, in the end, ignored for no rational reason.) There is no alternative but to conclude that Director BA used the fact that he was not in a position to directly receive reports from salespeople as a cover for indifference, and that he continued to give complete tacit approval of inappropriate loan applications.

4. Southern Block Sales Deputy General Manager BS (formerly, Southern Block Kagoshima Sales Office, Sales General Manager)

After JR Kyushu Housing was split off as a separate company in 2000, Deputy General Manager BS worked in the Construction Department at the Southern Sales Office until March 2013. Subsequently, Deputy General Manager BS worked as the Sales General Manager at the Southern Sales Office from April 2013 to March 2017, and has been Sales Deputy General Manager since April 2017.

Shortly after Deputy General Manager BS became Sales General Manager at the Southern Sales Office, Individual BU's case arose, as described in **No. 3, 6 above**. As described above, Individual BU's case involved the preparation and submission to a financial institution of a large-amount construction contract for work that would not actually be ordered from JR Kyushu Housing, in order to receive a tie-up renovation loan at a low-interest rate for the renovation of a residence. Deputy General Manager BS, who was at that time the Sales General Manager at the Southern Sales Office, was in a position with responsibility for preventing inappropriate loan applications. In response to advance consultations with Individual BU, Deputy General Manager BS approved the raising of funds through a tie-up renovation loan that included work that would not actually be ordered from JR Kyushu Housing. In addition, according to the ex post facto internal investigation that was implemented for Individual BU's case, Deputy General Manager BS had a completely incorrect perception that "the placing of orders with contractors outside of JR Kyushu Housing by employees of JR Kyushu Housing is a problem." In accordance with that incorrect perception, Deputy General Manager BS made a

false report that Individual BU used a portion of the settlement funds as a portion of the funds for the purchase of a condominium for use by Individual BU. Deputy General Manager BS had no awareness of the problems related to inappropriate loan applications.

In addition, Deputy General Manager BS was the person who gave final approval for settlement procedures at the Southern Sales Office. At the Southern Sales Office, the number of cases involving large-amount settlements was small in comparison to that at the Northern Sales Office. In the period when Deputy General Manager BS was working as the Sales General Manager, settlement was implemented for five large-amount settlement cases. (Including two large-amount cases of more than ¥3,000,000, other than Individual BU's case.) As described above, Deputy General Manager BS was aware of Individual BU's case, which could be called a typical example of an inappropriate loan application, shortly after becoming Sales General Manager at the Southern sales Office, and despite having subsequently seen large-amount account settlement statements, Deputy General Manager BS did not implement any response, such as taking steps to find out the facts. There is no alternative but to evaluate this as complete tacit approval of inappropriate loan applications.

5. Northern Block General Sales Office, Sales General Manager; Design Department, General Manager BI

Northern Sales Office Sales General Manager BI was assigned to JR Kyushu Housing after its establishment in 2000, and from 2008 he was responsible for the renovation business. In 2011, he became Sales General Manager at the Northern Sales Office, and since March 2018 he has worked as both Sales General Manager of the Northern Sales Office and General Manager of the Design Department. Note that he was permanently reassigned from JR Kyushu to JR Kyushu Housing on March 1, 2018.

Heretofore, Northern Sales Office Sales General Manager BI was principally responsible for the renovation business, and was not directly responsible for sales operations in custom-built housing and pre-built housing. Also, he did not actively give instructions for, or take part in, the cases subject to examination.

However, Northern Sales Office Sales General Manager BI received and approved drafts related to discounts for the cases of post-contract discounts (pre-built housing) described in **No. 3, 2(4) above**. In addition, in regard to Individual Y's case, he received an e-mail that clearly described a proposal to incorporate a car loan into a housing loan. Accordingly, there were sufficient clues to recognize the fact, or the possibility, that inappropriate loan applications were being implemented.

It has been confirmed that Northern Sales Office Sales General Manager BI was not himself involved in settlement-related approvals or other procedures, but he did leave the situation

alone without doing anything to look into the causes, etc., all while receiving comments from Individual BE, an accounting employee, about the occurrence of large-amount settlements.

In addition, on March 5, 2015, Individual CO, who at that time was working at JR Kyushu Housing after having been seconded from JR Kyushu, sent to employees in charge in the Design Department and the Construction Department, including Northern Sales Office Sales General Manager BI, an e-mail indicating that “amounts and details are being altered after approval by JR Kyushu Housing supervisors (other departments).” This e-mail indicated that, in pre-built housing operations, orders for work not included in the approved details were being freely received and placed. The relationship between this activity and inappropriate loan applications is not necessarily clear-cut, but the e-mail made it clear that JR Kyushu Housing’s internal contract management operations were faulty. However, Northern Sales Office Sales General Manager BI ignored this e-mail and did not implement any type of investigation, fact-finding, or recurrence prevention measures.

Looking at the actual situation, in practice there was a certain degree of division of labor, with Marketing & Sales Department General Manager BJ supervising sales and design operations and Northern Sales Office Sales General Manager BI supervising renovation operations. However, even considering those circumstances, the fact that the Northern Sales Office Sales General Manager was entirely unconcerned about compliance in sales operations is completely impermissible. His lack of concern is difficult to believe. In addition, as described above, there is sufficient evidence that Northern Sales Office Sales General Manager BI was aware that inappropriate loan applications were being implemented, or of the possibility that these applications were being implemented. Considering these circumstances, even if it is possible that Northern Sales Office Sales General Manager BI’s awareness was not as detailed as the awareness of Director BA and Marketing & Sales Department General Manager BJ, it has been confirmed that Northern Sales Office Sales General Manager BI gave tacit approval to the existence of inappropriate loan applications.

6 Former Representative Director and President CF

From the JR Kyushu Condominium Development Department, Individual CF was appointed to the position of Representative Director and President of JR Kyushu Housing in June 2012, and he retired in June 2018.

Like Director BA and others, in regard to the two examples of post-contract discounts described in **No. 3, 2(4) above**, Individual CF received and approved drafts related to the discounts. In addition, in regard to the case of Individual BU, as described in **No. 3, 6 above**, Individual CF was consulted by Director BA about the disciplinary action plan and was aware that Individual BU had prepared a non-genuine construction contract and submitted it to a consumer finance company, thereby obtaining a large-amount settlement exceeding ¥4 million.

Furthermore, there were instances in which Individual CF himself attended sales progress meetings. Even given the fact that it is possible that Individual CF did not receive detailed reports, the committee believes that he had a certain level of awareness about the existence of cases that could lead to inappropriate loan applications, such as customers struggling with housing loan applications.

Considering these circumstances, even if it is possible that Individual CF's awareness was not as detailed as the awareness of Director BA and Marketing & Sales Department General Manager BJ, the possibility that Individual CF gave tacit approval to the existence of inappropriate loan applications cannot be denied. Note that, in regard to Individual CF, the committee did not conduct interviews, taking into consideration his current relationship with JR Kyushu Housing.

7. Individual BH (former real estate general manager)

Individual BH was seconded to JR Kyushu Housing from JR Kyushu's Condominium Development Department in 2006. After working as the General Manager of the Real Estate Department and in the Marketing & Sales Department, Individual BH is currently working in the Strategy Management Department on a part-time contract. While employed by JR Kyushu Housing, Individual BH's work was basically centered on the procurement of land, but there was a period in which he managed sales operations, centered on pre-built housing.

It has not been confirmed that Individual BH himself was directly involved in giving instructions or participating in cases subject to examination. However, when Individual BH was assigned to the Real Estate Department, he had responsibility for sales operations in pre-built housing, and he was in a position to receive periodic reports regarding pre-built housing from Individual BJ (currently, General Manager of the Marketing & Sales Department). In this setting, it has been confirmed that, in regard to the case of Individual Y described in **No. 3, 4 above**, Individual BH received a report from Individual BJ (currently, General Manager of the Marketing & Sales Department) indicating that Individual Y's wishes would be addressed through an application for an excessive loan incorporating a car loan, and that Individual BH received and approved a draft regarding this case. Furthermore, in addition to Individual Y's case, Individual BH also received and approved a draft regarding a discount in another case involving a post-contract discount (conclusion of a memorandum with the customer). Accordingly, there were sufficient clues to recognize the fact, or the possibility, that inappropriate loan applications were being implemented.

Given these circumstances, even though it is possible that Individual BH's awareness was not as detailed as the awareness of Director BA and Marketing & Sales Department General Manager BJ, at the least, it has been confirmed that Individual BH gave tacit approval to the existence of inappropriate loan applications at JR Kyushu Housing.

Section 3. ANALYSIS OF CAUSES

The causes of the frequent occurrence of inappropriate loan applications at JR Kyushu Housing are described below. However, looking at the circumstances at JR Kyushu Housing, the investigation did not identify active causes that strongly encouraged these applications. It has basically been confirmed that the causes are factors that might be considered to be typical at a for-profit company, such as pressure to achieve results, incentive compensation, etc. However, the committee does not believe that these causes operated in a strong and active manner to create the current situation at JR Kyushu Housing. Rather, the committee believes that the following scenario is likely. The pressure to achieve results, incentive compensation, etc., created a certain degree of undercurrent, and in this environment, there was a lack of compliance awareness and a misguided “customer-first” concept that were permitted due to faulty, insufficient management systems (inadequate internal procedures and manuals, harmful effects from group personnel rotations, etc.) Also, an inadequate auditing function was broadly utilized, and the situation reached a point at which widespread inappropriate loan applications were created, permitted, and tacitly approved. In other words, it was this type of corporate culture at JR Kyushu Housing Company that was the direct cause of the widespread inappropriate loan applications. Detailed explanations for each item are provided below.

No. 1. Lack of compliance awareness

As described above, many of the salespeople at JR Kyushu Housing were involved in inappropriate loan applications. In addition, the directors and other executives and the management supervisors connected with sales were also aware of inappropriate loan applications, or, at the least, could have been aware. Nonetheless, they did not implement measures to prevent inappropriate loan applications. Rather, they left in place an environment that made it simple to implement inappropriate loan applications. In this way, all of the people involved in sales operations at JR Kyushu Housing lacked a fundamental understanding related to the original purpose of housing loans (a system for low-interest loans for the acquisition of housing). They fostered a situation in which there was a marked lack of compliance awareness and an extremely low level of ethics in regard to housing loan application operations.

1. Lack of compliance awareness among executives and management supervisors

As concluded in **Section 2, No. 4 above**, at the least, it has been confirmed that Director BA, Northern Sales Office General Manager BI, Marketing & Sales Department General Manager BJ, Deputy General Manager BS, and Individual BH had a certain degree of specific awareness of inappropriate loan applications through the draft approval process, etc.

In addition to the matters indicated heretofore, circumstances indicating a lack of compliance awareness among the executives and management supervisors of JR Kyushu Housing include

the following.

- At JR Kyushu Housing, the Corporate Ethics Committee meets once per year in accordance with the Corporate Ethics Committee regulations. The President, the director in charge of the Administration Department, other full-time directors, and the general managers of the Northern Sales Office and the Southern Sales Office participate in meetings of the Corporate Ethics Committee. The committee deliberates on matters related to corporate ethics and legal compliance. At a meeting of the Corporate Ethics Committee held on March 17, 2014, discussion topics included the case of Individual BU, described in **Section 2, No. 3, 6 above**. It was reported to the executives at that time (Individual CF, Director BA, and Individual CG) that “a renovation loan was used as funds for the purchase of a residence.” However, that report was not used as an opportunity to further investigate Individual BU’s case or to take steps in response, such as investigating the existence of other inappropriate loan application cases, etc.
- As described in **No. 4, 2 below**, in a group internal audit conducted by JR Kyushu’s Auditing Department in the fiscal year ended March 31, 2015, guidance was received in regard to non-compliance with approval authority, failure to make an entry in the seal record book when using a seal, etc. Nonetheless, the situation was left alone without steps being taken to address these matters. In addition, in a group internal audit conducted by JR Kyushu’s Auditing Department in the fiscal year ended March 31, 2018, a further recommendation was received in regard to these matters, but a thorough response was not implemented. As described in **Section 2, No. 1, 1(3) above**, until the pending case was discovered, the seal of the Sales General Manager and the seal of General Manager of the Marketing & Sales Department, which were used on contract documents (real estate sales contracts, construction contracts, account settlement statements), were kept in circumstances that, in practice, enabled anyone to use them. Seal management was extremely careless.

There was no sense of crisis in regard to these seal management conditions, and in addition, no action was taken in response to comments from internal audits. These are both examples that clearly show the lack of compliance awareness.

2. Lack of compliance awareness among salespeople and employees involved with other sales operations

As described in **Section 2, No. 4, 1 above**, inappropriate loan applications were basically implemented in line with the individual judgment of each salesperson.

A wide range of methods were used for inappropriate loan applications, including alteration of contracts, preparation of non-genuine contracts, inflation of estimates, changes to contracts, implementation of post-contract discounts, etc. Of these, commonplace practices included the

use of the seal of the Sales General Manager and other seals without permission, non-compliance with the approval work-flow, destruction of documents that had been altered, etc., and others. Furthermore, the committee believes that information about inappropriate loan application methods, etc., was being exchanged among the salespeople. The lack of compliance awareness among JR Kyushu Housing salespeople was extremely serious, and the committee feels that the situation was almost as if, essentially, the salespeople had no sense of having done anything wrong in regard to the implementation of inappropriate loan applications.

Furthermore, the lack of compliance awareness was not limited to the salespeople but also included other employees who worked with the salespeople. For example, at the Northern Sales Office and the Southern Sales Office, the people in charge of accounting were involved in the preparation or approval of account settlement statements and were aware that there were many large-amount settlements exceeding ¥1,000,000. Accordingly, it is difficult to believe that they did a thorough job of raising issues internally in regard to those practices. When the settlement funds reached the level of several million yen, there were instances in which the people in charge of accounting felt that this was exceptional under ordinary conditions and obtained confirmation from Director BA and the salesperson. However, as a result the settlement process was advanced in a perfunctory, superficial manner, without thorough efforts to find the causes, and it is not possible to conclude that accounting fulfilled its checking function. Moreover, no reports of misgivings were made to the hotline, etc. The person in charge of accounting at the Southern Sales Office was told by salespeople that they “want a sample of a contract that to show to customers,” and he consented, without reservations, to what seemed to be an unreasonable request. He personally filled in construction contracting amount, used the seal of the Sales General Manager to stamp the contract without permission, made a copy of a revenue stamp that was in the inventory of the sales office, and affixed the copy.

No. 2. Misguided “customer-first” concept

In the investigation, during interviews salespeople and other employees often gave the explanation that inappropriate loan applications were done “for the customer.” According to these employees, inappropriate loan applications were implemented to address the wishes of customers and to work for their benefit to the greatest extent possible. Also, the implementation of large-amount settlements without any type of confirmation was based on the principle that “the settlement funds are essentially money that belongs to the customer, so we need to provide reimbursement as soon as possible.” However, it is clear that these reasons do not in any way justify inappropriate loan applications.

In the final analysis, the “customer-first” proposition, which the employees unanimously stated, is nothing more than an excuse used to diplomatically justify a lack of compliance awareness. It is difficult to deny that, in practice, the salespeople were aware that concluding contracts by addressing the wishes of customers bolstered the salespeople’s own sales results (or, that they

would not be reprimanded for losing sales). It is also difficult to deny that the accounting employees who did not stop the large-amount settlements had a principle of avoiding actively raising issues themselves.

Note that, considering how salespeople engaged in the alteration of contracts and the preparation of non-genuine contracts, as described in **Section 2, No. 3, 6 above**, it can be inferred that the “customer-first” proposition is nothing more than a perfunctory excuse.

No. 3. Faulty, insufficient management systems

1. Inadequate, pro forma approval rules (weak seal management)

(1) Inadequate approval rules

As described in **Section 2, No. 1, 1(1) and (2) above**, in the operational flow at JR Kyushu Housing, there were standard approval process rules for use when real estate sales contracts and construction contracts were concluded. However, there were no clear rules for the approval process in regard to housing-loan related operations, conclusion of changed contracts, etc., which inevitably accompany or develop from these activities. The people with decision-making authority were not necessarily able to recognize or understand these situations, which contributed to the implementation of inappropriate loan applications.

Specifically, as described in **Section 2, No. 3, 2(2) above**, the inflation of estimates submitted to financial institutions was a major method used for inappropriate loan applications. For this kind of estimate, a clear approval process had not been established. Estimates that were based on the “past experience” of each salesperson and had no objective justification were submitted to financial institutions. When implementing finalized applications for housing loans, in addition to concluded construction contracts, etc., it was common practice to submit rough estimates and funding plans pertaining to housing-related expenditures. Decisions on housing loan amounts are based on these rough estimates and funding plans, and consequently the establishment of approval process rules for the conclusion of genuine contracts, by itself, is not a sufficient means of managing the operational flow to prevent problems such as inappropriate loan applications.

Also, as described in **Section 2, No. 3, 2(3) above**, another method for inappropriate loan applications that was used at JR Kyushu Housing involved concluding changed contracts with customers ex post facto. With this method, work that had been planned to be conducted by JR Kyushu Housing was removed from the construction contract, thereby reducing the cost. There were no clear rules for the approval process necessary when concluding these types of changed contracts. As described in **Section 2, No. 3, 2(3) above**, in regard to situations in which the customer considered competitive bids, etc., and as a result selected a contractor other than JR Kyushu Housing, the committee thinks that it is possible that there were many cases in which actual expenses were held to a lower amount than was initially envisioned (with that being the very reason why the customer directly commissioned a third-party contractor without placing an order with JR Kyushu Housing). It should be acknowledged that this was an environment that promoted excessive loans. As such, it can be said that advance approval process rules for the conclusion of changed contracts should have been put in place.

In this way, JR Kyushu Housing has the following problem in sales operations for the custom-built housing business and the pre-built housing business. Despite the fact that housing-loan related operations naturally accompany these businesses, there were no approval rules for processes in which it was obvious that methods for inappropriate loan applications could be used.

(2) Weak seal management and other pro forma approval rules

At JR Kyushu Housing, even when approval process rules had been formulated, they were pro forma. The most conspicuous example is the use without permission of the seals of people with decision-making authority. Rigorous management of the use of those seals was not implemented.

(a) Weak seal management

The document management regulations at JR Kyushu Housing stipulate that it is the Sales General Manager who has overall responsibility for the management of the seal of the Sales General Manager, and that no one else can handle the seal, other than those people who have been specifically designated by the Sales General Manager to handle the seal. However, in the Northern Sales Office, the seal of the Sales General Manager was stored in a drawer in his desk, and the drawer was not locked. (Or, the drawer was locked, but employees knew that the key was in the drawer immediately above.) Anyone could use the seal. In fact, the employees of JR Kyushu Housing were using the seal of the Sales General Manager when needed, without the permission of the Sales General Manager. When using the seal, the employees were entering the purpose of the use in the seal record book, but there was no framework for guaranteeing those entries. The results of an internal audit conducted by the JR Kyushu Auditing Department indicated that, for all practical purposes, “no entry is made in the seal book at the time when the seal is used.” It can be inferred that the use of the seal of the Sales General Manager without making an entry in the seal record book had become the normal state of affairs. Among the inappropriate loan applications, the preparation of non-genuine contracts through the use without permission of the seal of the Sales General Manager was a method that took advantage of this state of affairs as an opportunity.

In addition, in the Southern Sales Office as well, the seal of the Sales General Manager was kept on top of a desk in the Marketing & Sales Department. If related information was entered into the seal record book (or, even if no entry was made), anyone could freely use the seal.⁴⁰ Note that, in consideration of the pending case, at each sales office the system has been changed, and the seals are now stored in a safe.

⁴⁰ There were cases in which the seal of the Sales General Manager was used when the only justification was a verbal report from the salesperson stating that “the General Manager has approved this.”

(b) Other pro forma approval rules

Like the use of seals without permission, other than those situations in which the approval process was completely ignored, the committee found situations in which the approval process was inadequately implemented and pro forma.

As described in **Section 2, No. 1, 1(1)(c) and Section 2, No. 1, 1(2)(c) above**, the original rule for account settlement statements was that after approval by the Sales General Manager the statements were to be stamped with the seal of the Sales General Manager. However, in practice, in the Northern Sales Office, the Sales General Manager was not included in the approval process, and the salespeople themselves used the seal of the Sales General Manager after approval by the General Manager of the Marketing & Sales Department, as described in **(a) above**. Also, in the Southern Sales Office, Individual BV, who was the person in charge of accounting, used the seal of the Sales General Manager. This kind of operation means that the issue was not simply a lack of compliance with the approval process by the salespeople. Rather, it was that the approval process itself, which was set up as the rules, was only functioning on a pro forma basis.

In the internal audits performed by the JR Kyushu Auditing Department, there were also comments that the approval rules were inadequately implemented. For example, in regard to the advance circulation of drafts related to construction contracts, etc., there was no remaining evidence of approval, and drafts of contracts were not appended to documents that were circulated in advance.

This type of operation demonstrates pro forma implementation of the approval process, which extends over multiple layers that have been determined in advance. It became a reason why the processing of large-amount settlements was overlooked, and a reason for the occurrence of inappropriate loan applications.

Moreover, the committee believes it is likely that, accompanying the pro forma implementation of the approval rules described above, the inadequate seal management naturally became the normal state of affairs. However, it can be said that this type of faulty seal management fostered an environment that promoted a worse type of behavior, which was the deliberate preparation of non-genuine contracts by salespeople.

2. Faulty document management

Document management regulations had been established at JR Kyushu Housing, but those regulations were applied solely for contract documents, accounting documents, etc. The management of documents not included in that category, such as exchanges with customers, documents related to housing loan applications submitted to financial institutions, etc., was entrusted to the judgment of individual salespeople, and appropriate management was not

implemented.⁴¹

Specifically, in regard to exchanges with customers, there were many cases in which materials were prepared by writing the customer name, salesperson, meeting details, etc., on carbonless copy paper. However, this practice was not made an internal, uniform rule, and decisions on whether it was necessary to prepare and store these materials were left up to the judgment of the individual salesperson. In addition, the rules regarding the sales progress status reports, which record the status of negotiations with customers, were ambiguous with regard to the person making the entries, the person managing the reports, etc. In fact, the committee came across examples of discrepancies between these reports and the actual state of affairs, such as reversal of the dates showing the status of progress. The management was faulty. In these circumstances, it was not possible to conduct detailed verification after the fact in regard to whether or not exchanges had been conducted between the salespeople and the customers. This became a reason for overlooking the fact that agreements were reached with customers at the discretion of the salespeople, etc. (which also could lead to inappropriate loan applications).

Furthermore, there were no rules regarding the storage of documents pertaining to housing loan applications submitted to financial institutions. This was left up to the judgment of individual salespeople. (Note that it seems that the Southern Sales Office was destroying documents in a shredder one year after the completion of the construction work.) When inappropriate loan applications were prepared through the techniques of alteration of contracts or preparation of non-genuine contracts, there was a possibility of discrepancies between the materials held by salespeople and the documents submitted to financial institutions. However, there were no rules pertaining to materials submitted to financial institutions. This made it difficult for people with decision-making authority to verify matters after the fact, and it made concealment easy. It is possible that this created a situation that promoted wrongdoing by the salespeople.

3. Unclear settlement procedures

At JR Kyushu Housing, the rules for the style and entries of account settlement statements were not standardized, and different salespeople used different methods of making entries. In these circumstances, this practice resulted in a lack of clarity about the justification for the payment of settlement funds (such as difficulty in verifying if the amount reimbursed to the customer was actually the customer's own money or was the proceeds from a housing loan), and it became a reason for overlooking inappropriate loan applications.

⁴¹ Note that JR Kyushu Housing had not established contract regulations pertaining to the preparation and management of contracts. The process of formulating those regulations is currently underway, but the institution of decision-making by authorized organizational units has not yet been completed.

4. In sales operations, lack of standardized rules, guidance, education, and handover procedures when someone retired

JR Kyushu Housing did not have an operations manual that stipulated specific procedures and points to note, and that salespeople had to observe and comply with. In addition, there was absolutely no educational curriculum or business-related training for entry-level hires and mid-career hires. Moreover, in the Marketing & Sales Department, there was no culture or practice of having supervisors and senior employees systematically provide guidance and education to new employees. Accordingly, when salespeople had previous experience in the real estate industry but no experience in sales of pre-built housing or custom-built housing, or when salespeople had absolutely no previous experience in the real estate industry, there was no acquisition of the necessary knowledge through training, etc., and employees were simply put on the front lines of sales operations.

In this way, some salespeople had limited experience and did not have a clear understanding of what naturally should be done and should not be done. When those salespeople faced intense competition to acquire customers (combined with the pro forma approval process described above), it is not difficult to imagine a situation in which it was easy for those salespeople to get involved in wrongdoing, such as inappropriate loan applications, etc. In particular, the situation is even worse when there are senior employees and colleagues engaged in the same behavior nearby. This was certainly the situation for Individual BN, who was in charge of the pending case.

In addition, when JR Kyushu Housing salespeople retire, there are no standardized rules or activities related to the handover of operations. The committee found examples in which no appropriate operational handover was conducted for some salespeople. Under ordinary circumstances, the existence of appropriate operational handover procedures has the effect of promoting the discovery of wrongdoing, and it also has the effect of preventing wrongdoing. Consequently, the committee believes that the lack of handover-related rules or activities, combined with the faulty document management described in **2 above**, became a reason why inappropriate loan applications were overlooked.

The committee believes that, in this way, the lack of standardized rules, guidance, education, and handover procedures when someone retires became one reason for the commonplace preparation of inappropriate loan applications.

5. Harmful personnel rotations in the JR Kyushu Group

As described in **Section 2, No. 2, 5(2) above**, a large majority of the officers and employees of JR Kyushu Housing, in particular the officers and managers, have been seconded from JR Kyushu. They were not seconded simply to support the seamless promotion of the business of

the JR Kyushu Group. They also play an important role in supporting group governance. However, it cannot be said that they have fulfilled that role.

(1) “Belief in avoiding trouble” among seconded employees

Among JR Kyushu Housing officers and employees, those who have only been temporarily transferred from JR Kyushu can be broadly categorized as long-term secondees and short-term secondees.

The long-term secondees are typically people who have been at JR Kyushu Housing since its establishment in 2000, such as Director BA, Northern Sales Office Sales General Manager BI, Deputy General Manager BS, etc. On the other hand, the short-term secondees are, in principle, seconded to JR Kyushu Housing for three years, and it seems that they are entirely full-time directors, general managers, etc.

The long-term secondees, as people who have been at JR Kyushu Housing since its establishment, play central roles in the company. However, over the long period of time spent at JR Kyushu Housing, their compliance awareness weakened, and, as described in **No. 1, 1 above**, they lost their motivation to focus attention on and improve compliance-related issues, including inappropriate loan applications. In addition, the committee does not believe that these secondees sufficiently understood the front line activities and operational circumstances of the salespeople, and it seems that they lost their motivation.

On the other hand, it seems that the short-term secondees were anticipating their return to JR Kyushu itself, and during their time at JR Kyushu Housing, their attention was focused on the short-term results of JR Kyushu Housing, and they fell into a “belief in avoiding trouble,” in accordance with which they pretended not to notice compliance-related problems (until they occasionally reprimanded subordinates from their viewpoint in a senior position). In addition, these short-term secondees were often seconded from related departments at JR Kyushu. Nonetheless, these related departments were not necessarily well-versed in the business of JR Kyushu Housing (in particular, custom-built housing cases closely connected to housing-loan-related operations). For example, Marketing & Sales Department General Manager BJ had experience in the JR Kyushu Condominium Development Department but only limited operational experience related to custom-built housing.

In this way, people who were seconded from JR Kyushu as officers and managers were lacking in operational management capability and motivation, or they executed operations with an extremely short-term viewpoint in order to increase sales during their seconding period. This fact was grasped by full-time, regular employees of JR Kyushu Housing, and consequently communication between those people seconded from JR Kyushu and full-time, regular employees of JR Kyushu Housing became inadequate. This seems to have led to the

relaxation of compliance awareness as they thought that the inappropriate loan applications would probably not become a problem. The secondees include some people who, from their viewpoint in a senior position, sometimes put large amounts of pressure on salespeople. There were examples in which this became a trigger for the accumulated discontent and resignation of salespeople.

In the manner described above, the people seconded to JR Kyushu Housing, including both long-term and short-term secondees, did not function effectively in the areas of compliance and group governance. This dysfunction was damage caused by JR Kyushu Group personnel rotations, and it seems to have been one reason for the commonplace use of inappropriate loan applications and for the delayed discovery those applications.

(2) Part-time directors

As described in **Section 1, No. 2, 4 above**, two part-time directors are dispatched from JR Kyushu to JR Kyushu Housing.

Formerly, the part-time directors were selected from the JR Kyushu Track & Facilities Department, which was the parent organization of JR Kyushu Housing. However, the business and personnel ties between these two organizations weakened, and consequently it seems that recent selections have been made from the JR Kyushu Business Development Headquarters, Administration Department, which is responsible for JR Kyushu Housing, or from the JR Kyushu Condominium Development Department, which has links to JR Kyushu Housing through the real estate business.

However, the principal work of the part-time directors is to participate in ordinary meetings of the Board of Directors, which are largely held once per month, and extraordinary meetings of the Board of Directors. Otherwise, they almost never go to JR Kyushu Housing.⁴² Accordingly, even supposing that the part-time directors had some degree of understanding about the general business activities of JR Kyushu Housing before their appointment to the Board of Directors, after their appointment it seems that they did not deepen their understanding to the point where they could grasp the state of business affairs and detect compliance-related problems.

Moreover, when new part-time directors were appointed at JR Kyushu Housing, there were no transfers, handovers, etc., from the previous part-time directors. Consequently, even supposing that, during the period of their appointment, the previous directors had developed

⁴² In particular, JR Kyushu Housing was subject to monitoring by the JR Kyushu Business Development Headquarters, and periodically officers were called to the JR Kyushu head office for monitoring meetings. In conjunction with those meetings, meetings of the JR Kyushu Housing Board of Directors were typically held at the JR Kyushu Head Office. This further reduced the opportunities for the part-time directors to go to JR Kyushu Housing itself.

an understanding of the business of JR Kyushu Housing, or had recognized problem areas, there was no sharing or communication of that information, which was lost.

(3) Part-time Audit & Supervisory Board Members

As described in **No. 4, 1 below**, there is always one part-time Audit & Supervisory Board member dispatched from JR Kyushu to JR Kyushu Housing. However, the Audit & Supervisory Board member audits have become pro forma.

No. 4. Inadequate auditing function (Audit & Supervisory Board member audits/internal audits)

1. Audit & Supervisory Board member audits at JR Kyushu Housing

One part-time Audit & Supervisory Board member is posted to JR Kyushu Housing, and an Audit & Supervisory Board member audit is implemented each fiscal year.

In accordance with Audit & Supervisory Board member audit regulations, JR Kyushu Housing Audit & Supervisory Board members formulate an audit policy and audit plan from around July to August, and make a report to the JR Kyushu Housing Representative Director or Board of Directors. In the preparation of this audit policy and audit plan, the Audit & Supervisory Board members establish priority items as important auditing issues.

Based on the above audit policy and audit plan, the Audit & Supervisory Board member audit is principally implemented in the second half of the fiscal year (from October). The principal audit methods are attendance at meetings of the Board of Directors; on-site audits at sales offices, etc; inspection of important documents; interviews with executives and employees; and auditing of business reports, financial statements, etc. In regard to the results of the Audit & Supervisory Board member audit, an audit report is prepared, the Representative Director is notified, and a report is made to the shareholders' meeting.

In regard to the selection of people to be Audit & Supervisory Board members, it is not necessarily the case that the selection reflects consideration of audit effectiveness based on the business activities of JR Kyushu Housing. Also, among successive generations of Audit & Supervisory Board members, other than audit reports for past fiscal years (which are nothing more than the prescribed forms containing only the minimum amount of details required under the Companies Act), there is no sharing of understanding related to JR Kyushu Housing's business affairs or of recognized problem areas, risks, etc. It seems that each time new Audit & Supervisory Board members take up their position, the audits are started from zero. New Audit & Supervisory Board members do not devote the time and effort to understand JR Kyushu Housing's business affairs and inherent risks, and they do not take steps to implement ongoing

audits and cultivate a deep understanding of risk items. Consequently, the auditing function is not being implemented in an adequate manner.

In addition, in regard to the audit policy and audit plan determined by the Audit & Supervisory Board members, past years' audit policies and audit plans, are followed and there are no major changes to the content. The priority items are abstract and general, and it cannot be said that the distinctive risks of JR Kyushu Housing's business affairs, etc., are given consideration.

Each of the Audit & Supervisory Board members was a part-time Audit & Supervisory Board member who also had other concurrent job responsibilities within the JR Kyushu Group. Consequently, even though there were unavoidable issues, the audit methods were restricted to superficial, limited methods, and there are doubts as to whether the methods can be called effective. For example, interviews were principally conducted only with officers and management supervisors, and interviews with salespeople and other people working on the business front lines were not conducted very frequently. For on-site audits, Audit & Supervisory Board members visited JR Kyushu Housing several times a year. The principal subject of these audits was the Northern Sales Office, and on-site audits at the Southern Sales Office were not conducted frequently. In addition, in the inspection of important documents, advance circulation documents (drafts) were confirmed with the objective of confirming compliance with approval procedures. However, practical matters, such as the processes for examination and stamping with a seal, were not necessarily confirmed.

2. Group internal audits (audits by the JR Kyushu Auditing Department)

Group internal audits of JR Kyushu Housing are conducted by the Auditing Department of JR Kyushu, the parent company.

Group internal audits are conducted on an approximately three-year cycle,⁴³ and audits of JR Kyushu Housing were conducted in the fiscal year ended March 31, 2015 and fiscal year ended March 31, 2018. When conducting Group internal audits, an auditing procedures manual is prepared and priority audit items are selected in accordance with a risk-based approach.

The Group internal audits of JR Kyushu Housing conducted in the fiscal year ended March 31, 2015 and fiscal year ended March 31, 2018 both extended over a period of about three months and had three people in charge. The principal audit method was to inspect forms related to priority audit items and to interview employees, etc.

In regard to the results of Group internal audits, an audit report is prepared, a report is made to

⁴³ Currently, to focus the allocation of auditing resources on units for which improvement is necessary and on units with high levels of risk, with consideration for the most-recent auditing results, the auditing cycle is set at 2 to 5 years (for subsidiaries, in principle, 3 years).

the JR Kyushu Representative Directors, and JR Kyushu Housing is notified. The notification to JR Kyushu Housing focuses on the degree of risk and audit results (status of development, status of utilization) for each priority audit item. Each item is evaluated as “satisfactory,” “guidance needed,” or “improvement recommended.” Of these, for those items that received the “improvement recommended” evaluation, an improvement plan report is required within one month of the audit result notification, and improvement implementation status reports are required every three months.

In the fiscal year ended March 31, 2015 Group internal audit results, the “guidance needed” evaluation was received for such items as non-compliance with approval authority, failure to make entries in the seal record book when using a seal, etc. There is no doubt that all of these items are potential causes of the non-genuine loan applications that have become a problem. However, the JR Kyushu Auditing Department did not conduct any particular follow-up on these items, and JR Kyushu Housing left the situation alone without implementing any particular response. Subsequently, in the fiscal year ended March 31 2018 Group internal audit results, it became clear that there had been no improvement in the items described above, and an evaluation of “improvement recommended” was given. As described above, improvement plan and improvement implementation status reports were required, and a provisional report from JR Kyushu Housing was prepared. However, it cannot be said that the response was sufficient to discover the pending case. In regard to the auditing methods, interviews were principally conducted only with officers and management supervisors, and an on-site audit was not conducted at the Southern Sales Office.

In this way, looking at the Group internal audits conducted by the JR Kyushu Auditing Department, to a certain extent the audits covered basic risk items, but there were also restrictions in time and personnel, and in the end only limited audits were conducted. Consequently, the audits did not reach the depths of risk items. There was no follow-up on the items that were evaluated as “guidance needed,” and only perfunctory reports on the items that were evaluated as “improvement recommended.” It seems that there was only a limited ability to bring about improvement.

3. Summary

In this way, neither the audits of JR Kyushu Housing by the Audit & Supervisory Board members nor the Group internal audits of JR Kyushu Housing by the JR Kyushu Auditing Department were sufficiently effective. In particular, as seen in the inappropriate loan application in this case, the auditing system was dysfunctional in regard to the discovery and improvement of the company’s distinctive problem areas on the sales front lines.

In addition, there was no clear division of roles between the Audit & Supervisory Board member audits and the Group internal audits, and information sharing was only conducted on a

quarterly basis. The cooperation was less than perfect.

No. 5. Pressure to achieve results

1. Agreement related to performance targets

As described in **Section 1, No. 2, 5(1)** and **Section 2, No. 1, 2 above**, in the JR Kyushu Group, each fiscal year, subsidiaries are assigned performance targets, in the form of missions, from JR Kyushu. Based on these missions, each Group subsidiary determines quotas (targets) for each sales office, organizational unit, and salesperson.

JR Kyushu Housing, first, individuals determined their own performance targets and discussed them with their supervisors. Then, those targets were totaled up to determine quotas (targets) for each sales office, organizational unit, and salesperson. However, looking at the actual progress of plans, there was an unspoken rule or practice of deciding on numbers for each individual that were slightly higher than those in the previous fiscal year. It is highly probable that, in the end, the numbers were adjusted so that they were slightly higher than those in the previous fiscal year.

2. Executives

For JR Kyushu Housing executives, the degree of achievement of their missions has an influence on the amount of their compensation. It also seems to have a certain level of influence on personnel issues when their tenure at JR Kyushu Housing is over and they return to JR Kyushu.

If that is the case, then the degree of achievement of their missions is a matter of significant concern for JR Kyushu Housing executives. In fact, in the second half of the fiscal year, when JR Kyushu Housing's performance starts to become clear, the degree of achievement of missions is confirmed at each meeting of the Executive Committee and other internal committees. In the event that missions have not been achieved, measures targeting the achievement of missions are discussed.

In addition, through each Deputy General Manager, executives provide instructions calling for the rigorous execution of duties to achieve the missions. In sales, there were also cases in which executives personally participated in weekly sales progress meetings to motivate employees. It cannot be denied that this type of speech and behavior from executives could end up putting strong pressure on each Deputy General Manager and employee.

Furthermore, as described in **Section 2, No. 4, 3** above, Director BA, while aware that JR Kyushu Housing was involved in inappropriate loan applications, gave priority to acquiring

contracts and recording sales, did not implement prevention measures, and gave instructions to advance cases. It is possible that this behavior of Director BA, which was based on the principle of giving the highest priority to sales, ended up putting strong pressure on each Deputy General Manager and employee (especially salespeople).

3. Deputy General Manager

The Deputy General Managers participated in meetings of the Executive Committee, where they received instructions from executives calling for the rigorous execution of duties to achieve the missions. Also, the work results of Deputy General Managers at JR Kyushu Housing seem to have a certain level of influence on personnel issues when their tenure at JR Kyushu Housing is over and they return to JR Kyushu.

If that is the case, the degree of achievement of their missions is a matter of significant concern for Deputy General Managers. In fact, at weekly progress meetings, etc., they conducted detailed confirmation and gave instructions regarding contract progress status, results, etc., and they continued to put pressure on employees.

Furthermore, as described in **Section 2, No. 4, 2 above**, Marketing & Sales Department General Manager BJ, as General Manager of the Marketing & Sales Department, while aware that JR Kyushu Housing was involved in inappropriate loan applications, gave priority to acquiring contracts and recording sales, did not implement prevention measures, and gave instructions to advance cases. It is possible that this behavior of Marketing & Sales Department General Manager BJ, which was based on the principle of giving the highest priority to sales, ended up putting strong pressure on each salesperson.

4. Salespeople

At JR Kyushu Housing, the quotas for individual salespeople are only targets, and there are no penalties for not achieving the quotas.

However, the atmosphere was such that when JR Kyushu Housing failed to meet its overall target, or when it recorded a loss, the blame fell on those that were not able to meet their quota (especially, the Marketing & Sales Department and the salespeople).

In regard to sales, as described in **Section 2, No. 4, 2; Section 2, No. 4, 3; and Section 2, No. 4, 6 above**, executives and the General Manager of the Marketing & Sales Department conducted detailed confirmation and gave instructions at weekly sales progress meetings. They also gave instructions to record sales, even if that required ignoring or changing normal schedules and procedures. In this way, salespeople especially were subject to strong pressure from executives and Deputy General Manager, and it cannot be denied that this was one cause

of inappropriate loan applications.

No. 6. Incentive compensation

As described in **Section 2, No. 1, 3 above**, an incentive compensation system was used for salespeople at JR Kyushu Housing. This system was not linked with the quota system described in **Section 2, No. 1, 2 above**. In addition, in interviews with JR Kyushu Housing officers and employees, none of the interviewees stated clearly that incentive compensation was a motivating factor for the commonplace use of inappropriate loan applications.

However, incentive compensation was certainly not low in comparison with the salary levels of salespeople at JR Kyushu Housing. (In both custom-built housing and pre-built housing, the incentive compensation for the conclusion of a contract for 1 building was comparable to or greater than the monthly base salary of the salespeople.) If so, it cannot be denied that this type of incentive compensation is a possible cause for the inappropriate loan applications.

No. 7. Lack of “awareness” regarding past problem cases

As described in **Section 2, No. 3, 6**, at the renovation loan application stage, Individual BU expected to commission JR Kyushu Housing for only a small amount of work, and to directly commission contractors outside of JR Kyushu Housing for other work, purchase of fixtures, etc. To raise those funds with a single low-interest renovation loan, JR Kyushu Housing prepared a contract indicating that it would handle work equivalent to ¥5,040,000. In the end, after the subtraction of the construction contracting amount that had to be paid to JR Kyushu Housing, Individual BU received a reimbursement of ¥4,178,125. This case was also seen as a problem within JR Kyushu Housing, and as a result of an investigation of the facts related to the case, a disciplinary action plan was prepared, comprising a stern warning for Individual BS (currently, Deputy General Manager), who had been aware of and approved the case in advance, and a reprimand for Individual BU, but in the end no disciplinary action was taken.

In other words, approximately five years before the occurrence of the pending case, a case similar to the actions in the pending case was seen as a problem within JR Kyushu Housing and, to say the least, senior managers Director BA and Individual BS (currently, Deputy General Manager), had a clear awareness of this case. Nevertheless, in the end, Individual BU's case was ignored for no rational reason. There was no investigation of the existence of similar cases other than this case, and there are no indications that a company-wide warning was even issued.

The discovery of Individual BU's case was an excellent opportunity to raise issues regarding the existence of inappropriate loan applications at JR Kyushu Housing. Nevertheless, that opportunity was lost due to the weak response of Individual CF, Director BA, Individual BS (currently, Deputy General Manager), and others. Rather, it seems that steps were taken to conceal the case

for some reason. Furthermore, it is possible that the fact that Individual BU's case was, in effect, tacitly approved spurred a reduction in compliance awareness among officers and employees, especially at the Southern Sales Office, including Individual BU, who had already become involved in inappropriate loan applications. In any event, despite the existence of this opportunity for definite "awareness," the fact that no effective countermeasures were implemented seems to have been one reason for the commonplace use of inappropriate loan applications and for the delayed discovery of those applications.

Section 4.

OPINIONS REGARDING MEASURES TO PREVENT A RECURRENCE

No. 1 Rigorous compliance education (true “customer-first” philosophy)

As described above, there was a notable lack of compliance awareness among officers and employees at JR Kyushu Housing, including both salespeople and management supervisors. Accordingly, there is a need for rigorous compliance education.

Specifically, this education should not be limited to generalities about legal compliance throughout the entire JR Kyushu Group. It should include the identification of risk items in line with the business activities of JR Kyushu Housing, and the implementation of practical compliance education on that basis. In other words, ideally, the education should not end with compliance as simply a subject. It should comprise specific action guidelines that address the problematic situations that are encountered by employees in the course of their daily work. (For instance, although it is an extreme example based on this case, the education should address situations such as a customer who proposes that “If you allow me to apply for a housing loan that includes the remaining debt on my car loan, then I will place the order with JR Kyushu Housing.”)

There is a need to promote awareness that, for a company to sustain and grow its business over the medium to long term, it must give priority to legal compliance and ethics over sales and profits. In particular, for JR Kyushu Housing’s customers, a home is a large, once-in-a-lifetime purchase. The revision of the excessive principle of giving the highest priority to sales, and the fostering of thorough compliance awareness, will protect not only employees but also customers, and this will lead to a true principle of working “for the customer.” It is essential that this is understood at JR Kyushu Housing.

In addition, among JR Kyushu Housing officers and employees, people seconded from JR Kyushu account for a large share of managers. As described above, the lack of compliance awareness among these secondees was also a factor that contributed to the commonplace use of inappropriate loan applications. It seems that, from the viewpoint of the secondees, there are many major differences between JR Kyushu and JR Kyushu Housing in terms of the corporate culture, including the thoroughness of compliance. However, it will also be necessary for JR Kyushu to implement reinforced compliance education so that a high level of ethical standards can be maintained, without people being confused by the different sensibility and taking the easy way out.

No. 2. Strengthening and enhancement of management systems

1. Enhancement of operational flow / sales manual and unification of educational initiatives

JR Kyushu Housing needs to fundamentally revise and enhance its operational flow and sales manual and, on that basis, to unify its educational initiatives. In the same manner as with compliance education in **No. 1 above**, providing specific action guidelines for employees for use in advancing their work will enable the prevention of situations in which they get involved in wrongdoing as a result of mistaken individual judgment. In regard to the real estate industry to which JR Kyushu Housing belongs, and especially to the salespeople, there is a high degree of mobility among human resources, and there is a large inflow of people who have worked in different environments. Consequently, there are situations in which those people have brought in improper methods that were used at other companies and low levels of compliance awareness. The existence of a clear operational flow, etc., will fulfill the roles of making employees who have been transferred in from other companies break away from any past improper experience at those other companies and of protecting full-time, regular employees at JR Kyushu Housing from adverse influences.

In addition, the process of formulating this type of operational flow, etc., will itself contribute to the identification of risks distinctive to JR Kyushu Housing's business activities, etc. It will also be possible to further update risk awareness by periodically revising the operational flow, etc., that has been formulated.

2. Rigorous seal management

In other words, the enhancement of the operational flow refers to rigorous compliance with approval authority and procedures. Accordingly, rigorous seal management must be implemented, and steps must be taken to ensure that seals are not used by anyone other than those who are authorized to do so.

As described in **Section 3, No. 3, 1(2) above**, at JR Kyushu Housing, the fact that the seal of the Sales General Manager was used without permission was one cause of the commonplace use of inappropriate loan applications. JR Kyushu Housing has already started lock-based management of the seal of the Sales General Manager, which heretofore was being freely used without permission. Rigorous seal management is a primitive method for preventing the preparation of non-genuine documents, but the implementation of fixed procedures for the use of seals at each critical point in the operational flow will also foster the cultivation of compliance awareness in regard to internal procedures.

3. Rigorous document management

To enhance the operational flow, it will be essential to be able to conduct verification in an ex post facto manner. In other words, it will be essential to retain traces that the operational flow was implemented. Accordingly, it will be necessary to implement rigorous document management.

As described in **Section 3, No. 3, 2 above**, the existing document management regulations covered only contract documents, etc. For other documents related to housing loan applications, account settlement statements, records of exchanges with customers, etc., there were absolutely no rules, and decisions were entrusted to the salespeople. More-rigorous management is also needed for these documents.

By implementing rigorous document management, salespeople will have a stronger sense of responsibility regarding document production, and it will be possible to create an environment that makes it difficult to engage in alteration or other wrongdoing. Also, in the same manner as with rigorous seal management, this will foster the cultivation of compliance awareness in regard to internal procedures.

In addition, document management will make it possible to accurately leave traces of the status of employees' work. This should also have the effect of making it easier to discover past wrongdoing with the timing of retirements and rotations.

4. Revision of incentive compensation

As described in **Section 2, No. 1, 3**, the salespeople at JR Kyushu Housing have a system for the receipt of incentive compensation comparable to their monthly base salary when they conclude a contract. It cannot be denied that this kind of incentive compensation system could have been one reason for the non-genuine loan application in this case. Given the distinctive characteristics of the work of salespeople, it is reasonable to have a certain level of incentive elements in their salary structure. This is also necessary from the viewpoint of securing highly capable human resources. However, in consideration of the fact that there are also circumstances, etc., that salespeople cannot control through their own efforts, such as market conditions, etc., it is important to always search for the optimal incentive compensation scheme that does not become an excessive contributing cause of wrongdoing.

No 3. Cooperation between secondees from JR Kyushu and regular, full-time employees of JR Kyushu Housing

The dispatch of secondees from JR Kyushu to JR Kyushu Housing periodically brings in new outside viewpoints and contributes to the enhancement of governance.

However, as described in **Section 3, No. 3, 5(1) above**, currently, both long-term and short-term secondees at JR Kyushu Housing consistently follow a principle of avoiding actively raising issues themselves, thinking that it will be alright as long as there are no problems during their own seconding period. It seems that they are not necessarily highly motivated to improve the current situation at JR Kyushu Housing. First, it is important for JR Kyushu to send personnel who have a

sense of urgency and tension about the growth of the subsidiary. In addition, it is important that secondees are generally suitable for the company to which they are seconded, and it is also important that personnel have knowledge not only about the business affairs of JR Kyushu Housing but also about risks inherent in those businesses (or, personnel who are motivated to acquire this knowledge). JR Kyushu Housing's full-time, regular employees quickly grasped the fact that the people who have been seconded as managers were not well versed in the business and had a weak commitment to JR Kyushu Housing. As a result, there was a breakdown in communication between the secondees and the full-time, regular employees, and that breakdown became a cause of careless management and delayed discovery of wrongdoing. It is extremely important to enhance and strengthen communication between secondees and full-time, regular employees and to build a bright, open corporate culture.

Furthermore, it is important to recognize that the practice of periodically dispatching secondees from JR Kyushu as management supervisors has a potential disadvantage. It is possible that this practice takes promotion opportunities from full-time, regular employees of JR Kyushu Housing and reduces their motivation. If there are full-time, regular employees who are well-versed in the business affairs of JR Kyushu Housing while being highly capable and conscious of norms, then consideration should be given to promoting them to senior positions. Increasing the motivation of full-time, regular employees will likely be useful in eliminating antipathy toward secondees, and in turn, strengthening company-wide unity and teamwork.

Note that, in the Southern Sales Office, a "Galapagos" effect developed, due primarily to geographic factors. In other words, a distinct work style took root, and that style was not necessarily consistent with JR Kyushu Housing's compliance requirements. Due to concerns about becoming an environment that promotes wrongdoing, a certain level of attention is needed, including from a personnel perspective.

No 4. Effective auditing

1. Enhancement of Group internal audits by JR Kyushu

Given that JR Kyushu Housing's internal resources for auditing are not necessarily adequate, Group internal audits by the JR Kyushu Auditing Department will continue to play a central role in audits of JR Kyushu Housing, and accordingly those Group internal audits should be enhanced.

In addition to reevaluating audit frequencies, numbers of people, and other auditing arrangements, it will be important to enhance the Group internal audit plans. It will be necessary to implement audits that look more carefully at risks that are characteristic of each subsidiary's business activities, etc., without limiting the audits to common audit items that are the same for all subsidiaries.

In addition, with the objective of increasing audit efficiency, the current practice is to implement audits after conducting an advance meeting. However, in accordance with circumstances, it is also conceivable that audits could be conducted without advance notification.

2. Enhancement of Audit & Supervisory Board member audits, cooperation with Group internal audits at JR Kyushu Housing

From the viewpoint of addressing the shortage of resources for Group internal audits by the JR Kyushu Auditing Department, there is a need to more-effectively utilize Audit & Supervisory Board member audits at JR Kyushu Housing.

JR Kyushu Housing Audit & Supervisory Board members are part-time, but in comparison with the JR Kyushu Auditing Department, they have frequent opportunities to visit JR Kyushu Housing. Heretofore, audits of JR Kyushu Housing by Audit & Supervisory Board members were simply repetitions of routine audits based on auditing plans that were the same every year. Accordingly, there is some degree of uncertainty as to their effectiveness. In that regard, there is a need to further enhance communications, such as handover communications from predecessors, etc. If the company establishes an environment in which audits address the matters discovered by predecessors and then go further, the audit accuracy will gradually increase.

Moreover, cooperation with Group internal audits by the JR Kyushu Auditing Department is also important. It will be possible to increase the effectiveness of Group internal audit plans by having the Audit & Supervisory Board members and the JR Kyushu Auditing Department cooperate more closely, exchange information, and share awareness of problems and risks. In addition, the limits on Group internal audits could be addressed by having Audit & Supervisory Board members take over items that could not be included in Group internal audits, and by more clearly entrusting to Audit & Supervisory Board members the follow-up on items that were pointed out in Group internal audits.

No 5. Promoting awareness of and strengthening hotlines

JR Kyushu has formulated the JR Kyushu Group Code of Ethics, which calls for the rigorous observance of laws and social norms, the provision of safety and peace of mind, the creation of an open corporate culture, and an emphasis on fair business administration. In this way, JR Kyushu aims to establish corporate ethics and rigorously implement legal compliance. In addition, the Group has established the JR Kyushu Group Corporate Ethics Hotline as a contact point that enables employees of subsidiaries to shine a light on issues regarding corporate ethics, laws, etc., and engage in consultation or notification when they have doubts about business administration or

the actions of officers or employees.

However, there were no reports through the hotline about the pending case or other cases of inappropriate loan applications.

If someone at JR Kyushu Housing had made a report, then corrective action probably could have been taken at an early stage.

The effective functioning of the hotline (internal reporting system) is the starting point for the prevention of wrongdoing and for compliance for the entire JR Kyushu Group.

At a small-scale company like JR Kyushu Housing, even if employees discover wrongdoing, it is not necessarily easy psychologically to point that out publicly. However, if employees of subsidiaries are confident that reports to the parent company hotline will be responded to in an appropriate, timely manner, then the hotline will be used and will function effectively.

Accordingly, it will be necessary to ensure that this system is common knowledge among employees of subsidiaries and to increase their confidence that the company will ensure their anonymity and prevent disadvantageous treatment or retaliation in the event that a report is made. It would also be useful to establish an external hotline so that reports can be made to attorneys other than the company's legal advisors when there is an incident of wrongdoing. In consideration of this case, JR Kyushu should work together with subsidiaries to implement reevaluation and verification initiatives in order to strengthen the functioning of the hotlines.

End