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JCR's Rating Review of Megabank Groups

JCR has reviewed the ratings of bank holding companies and core companies of Japan's megabank groups (Mitsubishi UFJ Financial Group, Mizuho Financial Group and SMBC Group). The rating viewpoints in this review are as follows. Please refer to the news releases dated today (23-D-0944, 23-D-0945 and 23-D-0946) concerning the reasons for the ratings of individual companies.

Rating Viewpoints

(1) JCR upgraded the issuer ratings of the bank holding companies of the megabank groups by one notch to equal the group creditworthiness, based on its judgment that the need to reflect the structural subordination of the holding company has lowered. JCR affirmed the issuer ratings of the core companies. The outlook on the ratings is Stable. The group's creditworthiness is supported by the fact that a certain level of net income is expected to be secured on a stable basis, backed by the group's overall strength and sound assets, and that the current level of capital is expected to be maintained under a disciplined capital policy.

(2) The issuer ratings of the bank holding companies of megabank groups have been set one notch below the group creditworthiness to reflect the structural subordination of the holding companies. This is because the double leverage ratio, on which JCR places importance in determining the degree of structural subordination, has remained at a relatively high level in the past, and JCR has considered the possibility that the ratio may increase due to large-scale M&As and other factors. However, the double leverage ratio has remained below a certain level over the medium term, and JCR believes that it is unlikely to significantly increase in the future, given the financial management policy of each group. Therefore, JCR has determined that a notch down due to structural subordination is not necessary. The single point of entry (SPE) approach is considered the "preferred resolution strategy" for megabank groups, and this may increase the possibility that creditors of the holding company will suffer losses before creditors of the subsidiary banks. However, JCR has previously decided not to notch down the issuer rating of a holding company solely because of the risk associated with bankruptcy resolution if the group creditworthiness is equivalent to "A" or higher.

(3) One of the factors supporting the creditworthiness of megabank groups is their diverse and deep business bases and management resources. Having entities with a strong presence in each of the following areas: banking, trust, securities, and leasing, they capture the diverse financial and non-financial needs of large and mid-sized companies from multiple perspectives. In particular, their having network, client base, human resources, and expertise that enable them to develop a global CIB (Corporate and Investment Banking) business, which provides financing and other solutions to large Japanese and non-Japanese companies through collaboration among banks, securities firms, and other entities, is a strength not found in other Japanese banking groups. Each group is working on strategies and measures in the U.S. capital market, which has a large market size, and in Asia, which has a large room for growth, and is in the process of further strengthening its business foundation. In the midst of a changing environment, including rising inflation in Japan and abroad and geopolitical risks, an increase in the weight of market-related operations and overseas business may increase the volatility of earnings, but JCR believes that the positive factors such as diversification of earnings sources and expansion of growth potential are stronger, considering the current business portfolio of each group.

(4) The earnings have been strong over the past few years, and their net business income before transfer to general allowance for loan losses has generally recovered to the level before the introduction of the Bank of Japan's negative interest rate policy. In the fiscal year ended March 2023, although earnings of market division deteriorated due to losses on foreign securities, reflecting the sharp rise in overseas long-term interest rates, the customer division increased earnings such as an improvement in the loan margin, mainly in foreign currencies, and growth in non-interest income, and megabank groups showed their resilience in terms of earnings. Although there has been continued downward pressure on interest income under the ultra-low interest rate environment, JCR believes that the earnings environment for interest related operations is turning around, as the domestic interest rate environment has reached a turning point.

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(5) Their asset quality remains sound. The non-performing loans ratio under the Financial Reconstruction Act of the core banks is low at around 1%, and credit costs have not yet put pressure on profits, even though they have been boosted by preventative provisions. Large and mid-sized companies in Japan, which are the megabanks' main customers, have made progress in reducing and controlling interest-bearing debt and building up capital over a long period of time, and their financial stress tolerance has significantly increased. Megabank groups also take basically a cautious stance on overseas lending, and asset deterioration has been limited due to the large number of highly rated borrowers. Some caution is required with regard to the fact that each group has a certain amount of large-lot credit risk, as well as the risk of being affected by economic slowdowns or recessions overseas, but so far there have been no signs of significant costs being incurred. Market risks are also being managed at a level commensurate with management strength. Although losses have increased over the past two years, mainly in foreign bonds, due to a sharp rise in overseas interest rates, such losses have been well within the range that can be absorbed in relation to the periodic profit and capital.

(6) The capital of each group is sufficient as a buffer against various risks, and the adjusted Tier 1 ratio (Tier 1 capital less accumulated other comprehensive income and other items), on which JCR places importance, is maintained at a level appropriate for the AA range. Under the risk appetite framework (RAF), which emphasizes balance among risk, return, and capital, megabank groups are promoting the use of capital, including shareholder returns and growth investments, while focusing on soundness. There are no particular issues with regard to liquidity of capital. Although the management of foreign currency liquidity is a challenge common to megabank groups, they do not have an unstable financing structure where funding of long-term investment is dependent on short-term financing from market.

Tomohiro Miyao, Ippei Koga

<Reference>

Issuer: Mitsubishi UFJ Financial Group, Inc.
Long-term Issuer Rating: AA Outlook: Stable

Issuer: MUFG Bank, Ltd.
Long-term Issuer Rating: AA Outlook: Stable

Issuer: Mitsubishi UFJ Trust and Banking Corporation
Long-term Issuer Rating: AA Outlook: Stable

Issuer: Mizuho Financial Group, Inc.
Long-term Issuer Rating: AA Outlook: Stable

Issuer: Mizuho Bank, Ltd.
Long-term Issuer Rating: AA Outlook: Stable

Issuer: Mizuho Trust & Banking Co., Ltd.
Long-term Issuer Rating: AA Outlook: Stable

Issuer: Sumitomo Mitsui Financial Group, Inc.
Long-term Issuer Rating: AA Outlook: Stable

Issuer: Sumitomo Mitsui Banking Corporation
Long-term Issuer Rating: AA Outlook: Stable

Japan Credit Rating Agency, Ltd.
Jiji Press Building, 5-15-8 Ginza, Chuo-ku, Tokyo 104-0061, Japan
Tel. +81 3 3544 7013, Fax. +81 3 3544 7026

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