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JCR Considers Modifying Methodology for Rating Regional Banks Consolidated with Mega Bank Groups

Japan Credit Rating Agency, Ltd. (JCR) is considering modifying a rating methodology as follows, and outline and background are provided below. JCR also announces the scope of rating which may be revised as a result of such modification and a time frame required for the revision.

1. Outline and Background of Modification under Consideration

JCR is currently considering modifying part of the rating methodology for banks as of March 26, 2012 (hereinafter, "Current Methodology"), mainly concerning regional banks affiliated with Japanese mega bank groups (hereinafter, "Affiliated Regional Banks"), in particular those as consolidated subsidiaries (hereinafter, "Consolidated Regional Banks"). JCR has previously viewed it difficult under Current Methodology to strongly incorporate support from parent banks in rating Affiliated Regional Banks; JCR is considering modifying this so that the new methodology will allow JCR to, when certain conditions are met, take into account possible additional support from parent banks in its rating decision.

Under Current Methodology, JCR assigns a rating to an Affiliated Regional Bank based on its own creditworthiness, which includes the effect of benefits provided by the parent bank on regular basis, such as the provision of products and services, knowhow, and sales channels, and customer referrals, but does not strongly incorporate possible additional support it may receive in the future, such as capital support. This reflects JCR's conventional view that strategic importance of the Affiliated Regional Bank to the parent bank is unclear and also that, historically speaking, the affiliation of a regional bank with a mega bank group in many cases was the result of capital support made at the time of disposal of non-performing loans, rather than due to a strategic decision.

However, JCR thinks that attention now needs to be paid to some factors regarding the relationship between the mega banks and Affiliated Regional Banks. First, regardless of strategic importance, ties between Affiliated Regional Banks, especially Consolidated Regional Banks, and parent banks have become increasingly stronger in terms of internal control, including sharing risk management-related information. This probably owes to the need of parent banks for reinforced internal control on a consolidated basis to meet Basel II and Basel III regulations. Second, it appears the fact that Affiliated Regional Banks share brands with parent banks is becoming widely recognized as they, Consolidated Regional Banks in particular, post the names of parent bank groups on their website. Brand sharing works as an incentive for the parent banks to provide support to maintain their reputation. Third, and most importantly, instances of additional capital support provided by parent banks mainly to Consolidated Regional Banks have been observed recently. Sumitomo Mitsui Banking Corporation (SMBC), for example, took part in recapitalization of its consolidated subsidiaries, Kansai Urban Banking Corporation (KUBC) and The Minato Bank, Ltd., in 2009 and 2010, respectively, and announced in March 2013 its measures to strengthen the capital of KUBC even more. JCR considers main focus of the new measures announced in March is to respond to Basel III regulations to be applied in the future. While the first two decisions were rather of a passive nature, i.e. to compensate for capital impairment resulting from a net loss, the latest announcement suggests SMBC's positive attitude to get involved in resolving financial issues faced by Affiliated Regional Banks, which deserves particular attention.

Based on these factors, JCR is considering assigning a rating on Affiliated Regional Banks under the new methodology as follows:

New treatment under consideration regarding Affiliated Regional Banks
With respect to regional banks affiliated with Japanese mega bank groups, JCR shall not determine the rating based on the creditworthiness of their parent banks or groups (hereinafter, "Parent Banks etc.") solely on the ground that they are under the umbrella of mega bank groups. In case where their strategic importance to Parent Banks etc. is unclear and, historically speaking, the affiliation was the result of capital support made at the time of disposal of non-performing loans in a financial crisis, rather than due to strategic importance, it is difficult to strongly reflect support from Parent Banks etc. into the rating. However, even when regional banks were in fact

affiliated with the groups in such a way, if it is judged that Parent Banks etc. will take reasonable responsibility for their business management, JCR shall take into account possible additional support from Parent Banks etc. in its rating decision. In so doing, JCR shall refer to whether or not the regional banks are consolidated with Parent Banks etc., degree of Parent Banks etc.'s involvement in ordinary business management, and use of Parent Banks etc.'s brands by the regional banks in their operations, while giving due consideration to actual support.

2. Scope of Rating Which May Be Revised As A Result of Modification and A Time Frame Required for the Revision

JCR plans to make a final decision on the modification by the end of September this year. In case that the abovementioned modification of the rating methodology is actually made, the rating on the following two banks may be revised as a result. The modification will affect the rating in a positive way, but JCR thinks the rating change will likely be by one notch or so for either bank. In any case, as soon as the final decision is made, JCR will reflect it in the rating.

Issuer: The Minato Bank, Ltd.
Long-term Issuer Rating: A- Outlook: Stable
Shelf Registration: preliminary A-
Subordinated Loan: BBB+

Issuer: Kansai Urban Banking Corporation
Long-term Issuer Rating: BBB+ Outlook: Stable
Short-term Issuer Rating: J-2

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