Principal Questions and Answers
Small Meeting for the First Half of 2024 (November 28, 2024)

[Deposits and loans]

Q. Could the deposit-fundraising environment constrain loan promotion? Would you consider holding bonds to maturity if you have ample deposits?

A. Loans are growing steadily, and the yen bonds have some time left until maturity, so their balance is expected to stay the same. However, the current capital position is not causing any problems. In the long term, deposits will become more important, so we will work to increase them.

・ Until now, our sales approach has been centered on lending. However, we are promoting deposit transactions commensurate with our share of loans, which has increased corporate deposit balances. As for deposits from individuals, our bank will promote the convenience and appeal of its mix of digital and face-to-face services to make it the bank of choice when it comes to opening an account.

・ With Japan's population expected to decline, if the race to hike interest rates to attract deposits intensifies further, our bank may also consider raising deposit interest rates. Before doing so, however, we need to reduce our less profitable investment assets.

・ Regarding the classification of bonds held, municipal bonds were classified as other securities. On the other hand, some privately placed municipal bonds, newly underwritten in a low-interest-rate environment, are now classified as bonds intended to be held to maturity. As for government bonds, we do not want to keep them to maturity, and would like to consider and decide whether to sell them if the environment suits doing so.

Q. Please tell us about your efforts to increase corporate deposits.

A. Our bank has instructed its employees to make a list of major borrowers with small deposits and promote deposit transactions commensurate with their lending balance. This practice effectively increased corporate deposits at the annual rate of about 6% in the previous fiscal year. Since our bank has not promoted deposit acquisition recently, many clients have deposited at other banks without giving the matter much thought. When our bank actively approaches these clients, however, they often agree to transfer their deposits to our bank.

・ Deposits from individuals account for a more significant proportion than those from corporations, so we are also focusing on attracting more deposits from individuals by increasing channels such as digital and face-to-face so that they will choose our bank as their daily account.

Q. Do you foresee a situation in which your bank will be forced to raise deposit interest rates to attract more deposits, and such increased interest rates will worsen its earnings scenario based on rising interest rates?

A. We have set a pass-through for the policy interest rate at 40% for liquid and 58% for term deposits. Yet we do not assume that this scenario will make it difficult for our bank to raise deposits. On the other hand, we are paying close attention to the level at which interest rates on term deposits rise, causing liquid deposits to start shifting to term deposits because this will also increase interest payments. In addition, there are concerns that interest rate rises will cause deposits to flow into yen-denominated life insurance, but this has yet to occur.

・ Furthermore, as our bank promoted the sale of bonds, the IRRBB ratio is above the regulatory value in the event of a downward interest rate shock. If the policy interest rate were to reach 1% and a shift to term deposits were to progress, core deposits would decrease, which could impact the IRRBB ratio. Acquiring deposits is key to preventing a decrease in core deposits. Our bank is considering raising deposit interest rates for local governments and large corporate clients as a policy measure to maintain deposit balances.

Q. Term deposits have declined slightly. What caused the decline?

A. The average balance of term deposits is currently 1.8 trillion yen, a decrease of about 10 billion yen from the previous period. Possible reasons for this decline include outflows to online banks with higher interest rates, a shift to investments related to the new NISA, and outflows outside our territory due to inheritance. Although the company has been consolidating and closing its branches, monitoring has shown that the reorganization would cause no shifts of concern.

・ To attract young customers, we propose debit cards, which unlike credit cards, even minors can create. We are also working to improve the Gungin App, which has been well received. These tools will encourage young customers to use our bank as their main account.

[Interest rate environment]

Q. What will the Bank of Japan's (BOJ's) terminal rate level be?

A. We estimate that the BOJ's terminal rate will be around 1% for now. Politics and the economy in the US will significantly influence the pace at which the terminal rate reaches that level. Although US interest rates will continue to fall, they will likely not drop significantly and will stop falling. In that case, the BOJ will likely raise interest rates in December or January of next year, as per market consensus, due to the issue of the weak yen arising from the interest rate differential between Japan and the US. We also assume that interest rates will continue to rise to 1% after that, depending on the timing. Our current main interest rate scenario is up to 0.75%, so this is a conservative preliminary calculation with 1% in mind.

[Net credit costs]

Q. If the policy interest rate rises to 1%, what level do you expect net credit costs to be?

A. We are applying stress tests of rising interest rates to our principal regular borrowers, such as those with a particular loan balance or those who have changed terms. Even if interest rates increase by 1%, only a limited number of borrowers will be downgraded, mainly due to increased interest payments. The impact of rising prices, the labor shortage, and lack of progress in price pass-through is more likely to be greater than that of rising interest rates. The number of bankruptcies at our bank is increasing, with 2023 reaching a level exceeding 2019 before the COVID-19 pandemic. This year's bankruptcies are also on track to exceed last year's level in the first nine months. Before the COVID-19 pandemic, most of the bankruptcies happened in the manufacturing industry. Recently, however, there have been more in the food, beverage, and service industries, mainly due to repayment of zerozero loans starting and a lack of successors. These impacts may be more significant for other business types, such as credit unions. At our bank, these bankruptcies do not substantially affect our net credit costs because individual loans are small and often come with credit guarantee associations. In the fiscal year ended March 2021, net credit costs were recorded correspondingly for ADR (Alternative Dispute Resolution) cases with large local borrowers, but there are currently no such concerns.

- In our current portfolio we are focusing on loans to real estate agents. While loans to real estate agents in the Keihin and southern Saitama areas are in a growth sector, the real estate industry is also prone to sudden bankruptcies. We are working to avoid sudden bankruptcies by carefully monitoring signs of deterioration in business conditions, such as inventory status.
- In addition, we are not concerned about structured finance because most transactions are senior loans. For cross-border loans, however, we will pay attention to each country's creditworthiness and thoroughly manage credit by shortening individual exposures.

[General management]

Q. Please tell us about the RORA management upgrade that your bank has embarked on ahead of the next Mid-Term Business Plan.

A. In the current Mid-Term Business Plan, we have focused on strengthening the banking business's profitability and finally achieved solid profits. In the next Mid-Term Business Plan, we will continue to boost profitability and work hard to promote initiatives for the region's future. From a broader perspective, we would like to strengthen our involvement in projects with startup companies. In addition to approaching our main clients, there are many potential needs we can meet, such as proposing business succession measures to deposit-only clients and offering various solutions to clients who mainly use other banks. We want to proceed with initiatives that realize a virtuous cycle of social value through problem-solving and economic value through increasing profits.

- Additionally, from a practical standpoint, we are working on upgrading the RORA calculation itself. The current system was designed when there were no deposit interest rates. Thus, RORA includes the income from deposit procurement, which is the difference between deposit interest and market rates. As a result, in the current interest rate environment, income from deposit procurement expands, resulting in a high RORA in the case of long-term variable-rate loans. We are considering refining the RORA calculation and separating deposit procurement income from RORA so we can adequately manage income even with credit spreads. Since October, we have been revising our operations and rigorously verifying whether credit spreads are being secured for loans to large companies in the Keihin area.

Q. If profits continue to grow steadily in a world with interest rates, are you considering inorganic strategies that take advantage of that surplus capital?

A. Inorganic strategies are a major deciding factor in greater risk-taking. There are various fields, but it would be easier to manage risk by expanding into closely related fields of finance rather than strengthening the digital field. For example, risk-taking is possible and practical if our bank manages and controls external assets rooted in local areas, as our leasing company can. We are always considering inorganic strategies from a broad perspective.

Q. Please tell us about your future policies for overseas branches.

A. Most of our New York branch's borrowers are Japanese local subsidiaries in the US. Many of these borrowers are overseas affiliated companies of automobile-related suppliers in Gunma Prefecture or those of large companies that do business with our Tokyo or Osaka branches. There is only a limited number of Japanese banks in the US, but the need for fundraising from Japanese banks is reasonably high. Our New York branch can provide loans at a relatively high level of RORA.

- The stability of foreign-currency funding is essential for increasing lending. Thus, the level of external ratings will be critical. Moody's currently has a long-term rating of A3 and a short-term rating of P-2 for our bank. If our ratings are upgraded in the future, our funding sources will expand to include the World Bank. Thus, we will communicate closely with the rating agencies.
- Included in our next Mid-Term Business Plan is increasing the New York branch's loan balance to 200 billion yen in yen terms and to improve the branch's current profit level of around 200 million yen to 500 million yen in the future.

[Capital policy]

Q. Are you considering any changes to your dividend or share buyback measures in the capital policy for the next Mid-Term Business Plan?

A. As page 12 of the IR materials shows, we have indicated our medium- to long-term direction in the capital allocation of our next Mid-Term Business Plan, and this basic policy will not change in the future. With the recent significant dividend increase, we have raised our dividend payout ratio to the level of other banks, which has been well received by the market. Thus, we assume that a dividend increase is an effective measure, and will continue to emphasize stable dividends. The current dividend payout ratio is expected to be around 40%. Although we could set a dividend payout ratio as a shareholder return policy, since the return rate indicated by the capital allocation is over 50%, we will continue to consider share buybacks to return profits to shareholders. Our current PBR is around 0.7 times. If we judge the stock price level to be undervalued in the future, we would like to carry out flexible share buybacks, as we did in August.