Summary of Q&A at the Briefing Meeting for the Financial Statements for the Financial Year ended March 31, 2017

Q1.

I would like to ask on two points about future business development. The first question is regarding the overdraft services linked to ordinary deposits indicated on page 11 of the material. I believe that this is aimed primarily at existing deposit account holders, but I would like to ask about the demand you expect to see. Furthermore, given the fact that the overdraft services are unsecured lending, could you explain your thoughts on the competitions you will be facing with other existing consumer lending companies and banks offering consumer loans and such.

The second question is about the breakdown of hedge funds categorized as alternative investments on page 12, for which balances are rising quite sharply at present. Are these investments on a yen or foreign currencies basis and are you investing in equities or bonds? In addition, please tell me whether you are planning to invest in individual stocks of publicly traded companies in the future.

A1.

On the first point:

At the time that we filed an application for permission, we have expected that the loan balance would be around ¥80bn in the fifth year after the launch of the services. We envision a loan limit of ¥500,000 per person, and the strategy is to aim for widespread use of the service in small amount by our deposit account holders of 120mn.

The general product features and strategy has already been designed, but before the launch of the service, it will require about 2 years due to the build-out of our IT systems. We would like to keep thinking about the interest rate setting until just before beginning the service.

In the area of unsecured lending, so far as we have investigated, many financial institutions offer consumer loans but not overdraft sevices. We have always been looking for products that are not in competition with other companies, and that is why we decided to launch the service. In the future, we are seeking to link these services to debit cards. Ideally, we would like to provide a settlement service as follows; our customers can set a ¥500,000 limit just before going on overseas trips, and they can enjoy shopping there with debit-card transactions.

On the second point：
The alternative investments in hedge funds are mainly investments in hedge funds outside Japan. Please let me refrain from commenting on their contents, but these investments are made upon a careful examination of the funds. From a risk asset perspective, the risk weight is about 700%, but if we cannot identify the content, an even higher risk weight should be applied. Therefore, we make our investments after looking through the contents to reduce risk assets.
On the third point:
Investment in individual stocks, this is of course about obtaining alpha. Internally, we have been conducting various reviews and research on a practical level, and we would like to begin this soon. In addition, we could invest in CDSs, for which a regulatory application has been filed, and domestic hedge funds in the future. I would like to proceed with investigations in these areas, and start investments in them in a matter of months.

Q2.

I would like to ask on two points. The first point is the earnings outlook for FY2018/3. In your medium-term plan, your net income forecast was ¥330bn, but it ended up being ¥20bn higher at ¥350bn. There are of course issues like reductions in tax rates and deposit insurance premium rates and other unexpected windfalls, but there must have also been large and unanticipated negative factors like the introduction of negative interest rates. What was the largest factor in pushing income above the expectations at the time of the medium-term plan despite these factors?
The second point is probably not one to be asked to your bank, but concerning the sale of additional shares, based on what is currently being reported, I believe that Japan Post Holdings will be coming out ahead. Given the forex gains scheduled to be realized in line with the redemption of the US treasuries, it seems that FY2018/3 and FY2019/3 are well-timed years for your bank to additionally dispose your shares considering the anticipated strong earnings expansions. From your position, have your thoughts changed at all in wanting your parent to quickly sell down its holdings until 50% or less?

A2.

On the first point:

When I first arrived at this bank, I thought there should be no other bank that was as careful managing its expenses. So when I proposed to review the expenses one more time, we discovered that we could cut about ¥10bn more than we had anticipated in the medium-term plan. This is one of the factors. Another factor is that the shift of investment assets to Satellite Portfolio is going well. We are a bank, but we might be more like a fund management company. Revenues from Satellite Portfolio are turning out to be higher than expected. The scale of Satellite Portfolio exceeded the ¥60tn target set in the current medium-term plan and has reached ¥70tn. There are no targets for the expansion of Satellite Portfolio but the fact that its scale has expanded beyond the medium-term plan is a major reason for the upside in profits. Realization of appraisal gains is also a factor. Naturally, we have no intention to use the unrealized gains without careful consideration, since this is front-loading profits, but fortunately our Investment Division managed to increase unrealized gains by about ¥200bn last year. Following discussions among the Corporate Planning Department and the Investment Division when formulating the business plan for this financial year, we decided to set this earnings forecast.
The major factors are as I have already described, but of course I believe it is also necessary to expand our domestic business. We are determined to co-exist with regional financial institutions. In the next medium-term plan, we will need to generate some profits through those efforts, and I believe that our success depends on it. With this resolve, we have withdrawn all of our previous regulatory application for new businesses, which were filed in 2012 and included loans to small and medium-sized enterprises and housing loans. Instead, we are moving to concentrate our management resources into the business field that I just now mentioned. I may have included more information than needed, but these factors I have described are the main reasons for having exceeded our target.
On the second point:
At present, 89% of our shares is held by Japan Post Holdings. Our thoughts and intentions are that we would like Japan Post Holdings to reduce thier holdings as soon as possible up to 50% or below because at that level we could launch our new services simply by notifying regulatory authorities of the plans and we would no longer need to obtain prior approvals for them. On the other hand, we are also a part of the Japan Post Group, so I believe that we will move forward by balancing consistency with the Japan Post's strategy.

Q3.

I would like to ask about two points. The first point is about dividends. While on the one hand, net income for this financial year of ¥350bn is at a higher level than that expected in the medium-term management plan, dividend per share is the same as last year, lowering dividend payout ratio just over 53%. I would like to ask for your comments on why you are not raising dividends, and what would be the conditions to raise your dividend per share?

The second point is about the business environment of the medium-term management plan. You said earlier that it has not yet been decided whether it will be a 3-year or 5-year plan, but when you considered the positive factors and negative factors, do you think that for the next medium-term management plan, the business environment would be positive on your earnings, and which did you think would have a greater impact, positive or negative factors? Could you tell me your thoughts?

A3.

On the first point:

Regarding the dividend payout ratio, our dividend policy has been to keep the ratio above 50%, so the current level is above this minimum requirement, and taking into consideration the sustainability of the Trump effect in the US and the financial conditions in Japan, we think that our earnings forecast is probably about the best we are able to achieve, and I don't think that we can count on any further growth under the current environment. Therefore, in order to maintain the sense of stability as management, I believe that the current dividend is appropriate.

On the second point:

Regarding the next medium-term plan, we are subject to the restriction on our lending businesses as well, so I don't believe that the financial environment on the whole is positive. We believe that this environment should be overcome, but we would still continue to be in an unstable situation. In addition, we would like to establish our robust domestic business and earn reliable income. Therefore, first we will proceed with a stable dividend, and afterwards, if we see some factors that add something extra, we would then like to think about additional returns to shareholders.

Q4.

In FY2017, you are scheduled to book about ¥250bn in gains on foreign exchange in the Satellite Portfolio (SP). If this is the case, does that mean that almost no increase in revenues in SP is expected other than this? Furthermore, regarding the pace of reductions in revenues in the Base Portfolio (BP) in the future, in FY2017 it is to fall by ¥180bn. Can you tell us about what you envision for after that?

A4.

Concerning the current situation, there will be about ¥250bn per year in gains on foreign exchange in line with redemptions of foreign bonds for 4 years. Other than this, we will also of course increase our investments in foreign securities, so including this we are aiming to achieve even more.
Concerning BP, which has been focused mainly on Japanese government bonds (JGBs), JGB redemptions were about ¥16tn in FY2017/3 and will likely be about ¥10tn in FY2018/3 and about ¥8tn in FY2019/3. As you know, it is a severe interest rate environment where we cannot reinvest adequately in JGBs.
I think that this is a management issue imposed on the whole Japanese banking industry, and how can we get through this? Of course we will be increasing investments in foreign securities, but we also have to carefully consider maintaining balance in relation to capital and risk management. In this sense as well, we will continue looking for various measures including international diversification of investments and cooperation with domestic regional financial institutions.

Q5.

I would like to ask about two points. First, I would like you to tell us about policies concerning the utilization of unrealized gains (timing of their utilization, whether it is foreign or domestic securities, maturities, etc.) if they have been decided.
Second, an extremely high amount of commissions were paid to Japan Post Co., Ltd.; over ¥600bn. Is it possible to reduce this amount?

A5.

On the first point:
Regarding how we will make use of unrealized gains, I can only say that it would depend on the situation. We would see the realization of capital gains on redemptions and/or sales of securities, where we might intend to rebalance our portfolio or to meet some earnings target. We will think about them as part of balancing the overall picture. We carried out these operations in the

past fiscal year as well, but even so, we have increased our unrealized gains by ¥200bn.

On the second point:

Commissions we paid to Japan Post Co. are about ¥600bn, the calculation formula of which has been set as a fee to the service agency. I will leave out the details, but since we can reflect the cost reduction effect at our own direct branches to the commissions, I think the best way for us to reduce the commissions is probably by making efforts in cutting our own costs such as improving efficiency by introducing IT in operation support centers and administration service centers.

Also, what I would like you to understand is that although Japan Post Co. have been showing their abilities in various areas, up until now they have been operating in a banking business culture that is focused mainly on deposits. This culture is something to be changed, and we are in discussions about shifting incentives from deposits to investment trust products. We don't think this will change so quickly, but we are slowly but steadily changing it. This is the current thoughts of our management on how to reduce the ¥600bn cost of commissions paid to Japan Post Co.

Q6.

I would like to ask about two points. The first point is about the outlook for the contribution of the 3,500 ATMs to be installed in FamilyMart stores to the fees and commissions. Could you tell us the rough picture you have in mind? Also, could you please tell us whether it is safe to assume that at this time you are not considering installing ATMs in addition to these 3,500 units?

The second point is regarding the pace of expanding the alternative investment business. There was a balance of over ¥600bn in FY2017/3. Are you aiming to end up having about ¥5tn–¥6tn within the next five years? Furthermore, could you please confirm which asset classes other than hedge funds you anticipate to invest in, and what kind of targets you have set for returns?

A6.

On the first point:

We are on the way to installing the 3,500 ATMs in about two years, so this effort won't contribute to fees and commissions immediately. We are installing our ATMs in newly opened FamilyMart stores. Furthermore, in Gifu and Aichi prefectures, we are replacing ATMs formerly operated by Zerobank.

Beyond this, at this point, there are no specific plans for the future. At the present, this is where we are.
On the second point:
Regarding alternative investments, while we would like to quickly build up positions in private equity and real estate rather than in hedge funds, we have to carefully examine and sort out potential investment destinations, and this will take time. Until then, hedge funds will lead, but this won't be the permanent condition.
Furthermore, until now we have entrusted to third-party experts with extensive experience in the form of investment trust, but we are thinking that going forward we would like to make investment decisions in-house as well.
Regarding the scale of alternative investment in the future, we do not have any specific target.