ALM

April, 2013

Quality for You
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The financial information used in this document was prepared in accordance with accounting standards generally accepted in Japan, or Japanese GAAP.
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Business environment and B/S
Japanese banks’ net gains (losses) on debt securities and interest income

Operational environment of Japanese banks

- Large deposit surplus continues due to growth in deposits and sluggish lendings
- Business practice of strategic shareholdings
  - Impairment arises when share prices fall
- Decrease in interest income due to declining market interest rates
- Acceleration in customers’ overseas expansion

Japanese banks’ securities and equities

Japanese banks’ deposits and lendings

(Source) Japanese Bankers Association
Large deposit surplus
- Increase in yen deposits and sluggish lending have seen large deposit surplus continuously expand.

Strategic equity holdings
- Despite progressive reduction of cross-shareholdings, strategic equity holdings are more than ¥2 tn. As a result, impairment risk persists when share prices fall.

Expansion of foreign currency B/S
- Support Japanese customers advance overseas.
- Aim to expand transactions with Japanese and non-Japanese customers under the medium-term business plan.
- Resulting in an increasing trend of our foreign currency B/S, led by the asset side.

Source and use of funds*
* FY12 H1 average balance

End Mar 09: ¥148 tn
- Loans ¥73 tn
- Securities ¥38 tn
- Others ¥36 tn

End Sep 12: ¥159 tn
- Loans ¥69 tn
- Securities ¥61 tn
- Others ¥43 tn

Characteristics of BTMU’s B/S (BTMU non-consolidated)
About ALM

• ALM primarily involves the comprehensive management of interest rate risk and liquidity risk inherent in the B/S

• Interest rate risk
  ■ Interest rate risk on the B/S for loans and deposits is concentrated in the ALM divisions via the Transfer Price (TP)
  ■ Appropriately controlling changes in revenue due to interest rate fluctuations while aiming to maximize earnings for the period by predicting B/S trends
  ■ Accommodating B/S structure through strategic TP management

• Liquidity risk
  ■ The risk of disability to maintain required level of funds, or being forced to fund at a much higher than normal interest rate, due to a duration mismatch between assets and liabilities, or unexpected fund outflows

ALM

Customer-facing divisions

Deposits/Lending, etc.

Concentrate interest risk in the ALM divisions via the TP

Manage interest risk and liquidity risk through market transactions

ALM divisions

Market
Market risk management framework

Market risk
The Executive Committee assigns to the Global Markets Unit the amount of market risk (VaR+Val) calculated from allocated economic capital and profit plan. Within the Global Markets Unit, the amount is allocated to operations and branches.

Loss limit
Managed on the basis of overall gains/losses (financial income + unrealized gains/losses) with soft limits, alarm points and triggers for consultation, based on stress tests.

Both calculated daily and reported to management.

Market risk management governance

ALM Committee under the Executive Committee meets monthly for in-depth discussion with management.

The Global Markets Unit and risk management divisions discuss the market risk situation on a weekly basis.

Market risk management in ALM business

ALM Committee
Risk management divisions
Global Markets Unit
ALM divisions
Trading divisions

Overall gains/losses
Profitability of ALM can be measured through net gains (losses) on debt securities, etc. and unrealized gains/losses.

<table>
<thead>
<tr>
<th>Securities</th>
<th>Financial income</th>
<th>Unrealized gains/losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest and dividend on securities (Excl. equities related)</td>
<td>Net gains (losses) on debt securities</td>
<td>Decrease or increase in unrealized gains/losses</td>
</tr>
<tr>
<td>Interest rate swaps</td>
<td>Net interest rate swaps income</td>
<td>Decrease or increase in deferred gains/losses</td>
</tr>
</tbody>
</table>
**NII (Net Interest Income)**

**NII curve**
- A NII curve is a plot of changes in net interest income caused by fluctuations of interest rates over a fixed period (one year, two years, etc.)
- Periodically calculated and monitored, aim to create a B/S with high revenue generation, increase resilience to interest rate fluctuation (monitored by ALM committee)

**How we consider the NII curve**
- When analyzing the NII curve its level and shape (sensitivity to interest rates) are important
- It’s shape (sensitivity) changes based on how interest rate risk is taken
- Asset sensitive: NII up if interest rate rise
- Liability sensitive: NII up if interest rate decline

**NII curve variation examples**

<table>
<thead>
<tr>
<th>Example</th>
<th>Level</th>
<th>Shape</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase in loans, widening of loan spreads</td>
<td>Up</td>
<td>Parallel</td>
</tr>
<tr>
<td>Decrease in loans, smaller loan spreads</td>
<td>Down</td>
<td>Parallel</td>
</tr>
<tr>
<td>Increase in long-term assets</td>
<td>Up</td>
<td>Flattening</td>
</tr>
<tr>
<td>Increase in long-term funding</td>
<td>Down</td>
<td>Flattening</td>
</tr>
</tbody>
</table>

**NII curve**

- The NII level and curve’s shape (sensitivity) are key

**NII level**

<table>
<thead>
<tr>
<th>Interest rate change from current level</th>
</tr>
</thead>
<tbody>
<tr>
<td>-50</td>
</tr>
<tr>
<td>±0</td>
</tr>
<tr>
<td>+50</td>
</tr>
</tbody>
</table>

**NII level variation**

- Asset sensitive
- Liability sensitive

**Interest rate change from current level**
Regarding BTMU’s B/ S and ALM

- **Yen ALM**
  - B/S management under large deposit surplus (decrease in lending, increase in securities investments)
  - Management of strategic equity holdings
  - Handling of JGB holding risk

- **Foreign currency ALM**
  - Strengthening and diversification of foreign currency funding
  - Sophisticate buffer asset management

- **Profits**
  - Net gains (losses) on debt securities
  - Net interest income

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**Debt securities investments balance**

- (¥tn)
- FY08: 64.4, 252.6, 249.0, 206.4, 1,203.8
- FY09: 67.0, 567.1, 1,308.1, 1,342.8, 1,303.8
- FY10: 43, 1,247.6, 1,203.8, 1,247.6, 1,342.8
- FY11: 45, 252.6, 567.1, 1,308.1, 1,342.8
- FY12H1: 43, 249.0, 567.1, 1,308.1, 1,342.8

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**Net gains (losses) on debt securities/Net interest income**

- (¥bn)
- FY08: 64.4, 67.0
- FY09: 206.4, 252.6
- FY10: 1,203.8, 249.0
- FY11: 1,203.8, 567.1
- FY12H1: 1,308.1, 1,342.8
**NII curve of BTMU**

1. **NII curve of BTMU**
   - BTMU’s NII curve slopes upward showing net interest income will increase if interest rates rise.
   - If NII is divided between ALM divisions (Global Markets Unit) and customer-facing units (Retail, Corporate, Global) it will be: ALM divisions: graph falls to the right Customer-facing units: graph falls to the left.
   - The shape of NII curves of customer-facing units is due to the liability side’s (mostly deposits) responsiveness to interest rate changes, being lower than the asset side’s (lending, securities, etc.).

2. **As the NII curve slopes fall to the left, interest income will decline if interest rate decline**
   - To mitigate the decline in net interest income due to falling deposits and lending interest rates, the ALM divisions hold interest rate-type products (bonds, interest swaps).
Business cycles and net gains (losses) on debt securities

(BTMU non-consolidated)

- **Relationship between business cycles and profits**
  - We hold assets, such as loans and strategic equity holdings, that have a high positive correlation to business cycles.
  - During a recession, costs will rise (credit costs, impairment) from these assets and depress revenues.
  - By utilizing JGBs, which is negatively correlated to business cycles, periodic profits or losses can be smoothed.
  - Under a recession, the investment efficiency of JGBs is better than lending or strategic equity holdings (both RWA and profits).

<table>
<thead>
<tr>
<th></th>
<th>Credit costs</th>
<th>Strategic equity holdings</th>
<th>Government bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Boom</td>
<td>+</td>
<td>+</td>
<td>-</td>
</tr>
<tr>
<td>Recession</td>
<td>-</td>
<td>-</td>
<td>+</td>
</tr>
</tbody>
</table>

- Portion of strategic equity holdings risk is transferred to the Global Markets Unit. Unified it with interest rate risk and management in front-office department.

### Stock prices and Interest rates

**Net gains (losses) on debt securities**

<table>
<thead>
<tr>
<th></th>
<th>FY08</th>
<th>FY09</th>
<th>FY10</th>
<th>FY11</th>
<th>FY12 H1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net gains (losses) on debt securities</td>
<td>64.4</td>
<td>67.0</td>
<td>206.4</td>
<td>252.6</td>
<td>249.0 (26.8)</td>
</tr>
<tr>
<td>Losses on write-down of equity securities</td>
<td>(498.2)</td>
<td>(393.4)</td>
<td>(378)</td>
<td>(166.1)</td>
<td>(125)</td>
</tr>
<tr>
<td>Credit costs</td>
<td>(111.2)</td>
<td>(65.8)</td>
<td>(185.6)</td>
<td>(125.3)</td>
<td>(111.2)</td>
</tr>
</tbody>
</table>

**Stock prices and Interest rates**

- Nikkei index (LHS)
- 10yr JGB (RHS)

<table>
<thead>
<tr>
<th>Year</th>
<th>Nikkei index</th>
<th>10yr JGB</th>
</tr>
</thead>
<tbody>
<tr>
<td>End Mar 08</td>
<td>64.4</td>
<td>400</td>
</tr>
<tr>
<td>End Mar 09</td>
<td>(498.2)</td>
<td>(393.4)</td>
</tr>
<tr>
<td>End Mar 10</td>
<td>(378)</td>
<td>(166.1)</td>
</tr>
<tr>
<td>End Mar 11</td>
<td>(125.3)</td>
<td>(111.2)</td>
</tr>
<tr>
<td>End Mar 12</td>
<td>(111.2)</td>
<td>(185.6)</td>
</tr>
</tbody>
</table>
Yen ALM

- Effects of holding securities such as JGBs in yen ALM
  - Perspective of NII: Stabilizing NII fluctuation risk (graph falls to the left sharply) stemming from deposits and loans on B/S
  - Perspective of market value accounting: Taking into account the negative correlation with business cycles can be used for risk control/hedging of strategic equity holdings, etc.
  - JGBs, corporate bonds (BOJ eligible collateral). To allow flexible response in our portfolio management, these are held in ‘other securities’
  - The source of funds for yen securities investment is deposits; after assessment of interest rate sensitivity and retention, part is designated as core deposits (in principle, leveraged investment is not implemented)
  - Securities held are also applied to BOJ collateral, etc. as part of normal fund operations management (Considering use for non-CCP margin requirements in future)
  - Comprehensively taking into account the scale of our deposit surplus and interest rate spread, securities and interest swaps are chosen to invest

Average balance of domestic excess deposits and securities investments

Net notional principal of interest rate swaps
Based on the current NII curve of BTMU, net interest income will decline, in case of continuous interest rate decline:

- Declining interest rate have a significant impact on not only customer-facing divisions but also Global Markets Unit
- Redemption of high-coupon bonds will be substituted by new low-coupon bonds
- ALM divisions try to strengthen deposits and lending with TP management in order to improve net interest income

Unrealized net gains (losses) improved, resulting from global monetary easing

Looking ahead, bond investment gains can be expected from:

- Roll down effect
- Trading gains from portfolio changes
Managing JGB holding risk

- **Risk analysis and early warnings**
  - Formulate scenarios in which JGB holding risk materializes, and conduct profit/loss simulations
  - Prepare for risk, both front-office and risk management divisions undertake checks at various fixed points and report to the ALM Committee
  - Aim to minimize impact when risk arises by strengthening early warnings management through broad-based preparation

- **In the event risk materializes**
  - A price fall in JGBs causes an increase in appraisal losses. Appraisal losses damage equity capital
  - However, future net interest income will improve
  - Because we generally do not leverage, as long as deposits do not flow out severely there is no need to rapidly shrink portfolio
  - Duration around 3 years; portfolio expected to recover in a comparatively short period

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**Early warnings (examples of fixed-point checks)**

<table>
<thead>
<tr>
<th><strong>Front-office divisions</strong></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Macro economic indices</strong></td>
<td>(International balance of payment, core inflation ratio etc.)</td>
</tr>
<tr>
<td><strong>Fiscal-related indices</strong></td>
<td>(Government debt, interest payment/tax revenue ratio, etc.)</td>
</tr>
<tr>
<td><strong>Money flows</strong></td>
<td>(B/S structure of banks, holders ratio of JGBs, etc.)</td>
</tr>
<tr>
<td><strong>JGB risk analysis</strong></td>
<td>(Rating trends, etc.)</td>
</tr>
<tr>
<td><strong>Market trends</strong></td>
<td>(JGBs, CDS, effective exchange rates, financial institution shares, etc.)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Risk management divisions</strong></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>BTMU’s B/S composition</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Impact on capital of interest rate increases</strong></td>
<td></td>
</tr>
<tr>
<td><strong>BTMU’s JGB market share</strong></td>
<td></td>
</tr>
<tr>
<td><strong>JGB market trends</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Liquidity risk</strong></td>
<td></td>
</tr>
</tbody>
</table>
Foreign currency ALM

(BTMU non-consolidated)

- Strengthen and diversify foreign currency sourcing to support increased assets resulting from increased overseas lending. Utilizing ample yen liquidity is key
  - Increase foreign currency deposits
  - Source funds using ample Yen assets (JGBs, etc.)
  - Issue foreign currency straight bonds
- Improving our buffer asset management, such as foreign bonds investments, to prepare for difficulties in market financing
  - Mostly U.S. government bonds and U.S. higher-rated mortgage bonds with eligible collateral with each countries’ central bank
  - In 2012, to supplement foreign currency liquidity we established a special-purpose subsidiary, BTMU Liquidity Reserve Investment Limited (upgraded buffer asset management)
  - Main overseas offices also invest in foreign securities as buffer asset (Americas, Europe, Asia)

Average balance of loans (international business) and foreign securities investments

<table>
<thead>
<tr>
<th>Year</th>
<th>Loans (¥tn)</th>
<th>Investment securities (¥tn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY08</td>
<td>14</td>
<td>7</td>
</tr>
<tr>
<td>FY09</td>
<td>14</td>
<td>8</td>
</tr>
<tr>
<td>FY10</td>
<td>13</td>
<td>9</td>
</tr>
<tr>
<td>FY11</td>
<td>15</td>
<td>10</td>
</tr>
<tr>
<td>FY12 H1</td>
<td>16</td>
<td>12</td>
</tr>
</tbody>
</table>

Buffer asset management

If market financing through Yen/U.S. dollar currency swaps, etc. becomes difficult (when liquidity is low, etc.) source funds through buffer asset holdings and continue customer transactions (lending)
Environment changes and future ALM/ market business
Economic and monetary environment

Changes in environment (Circumstances)

- Japan: Effects of Abenomics
- U.S.: Despite fiscal problems, economy is firm
- EU: Remains fragile as fiscal problems persist
- Asia
  - China’s economy decelerating, effects of worsening Japan-China relations
  - Continuing growth in ASEAN region
  - Regional geopolitical risk from North Korea, etc.

Status of BTMU (Company)

- Decline in net interest income
- Signs of domestic lending bottoming out
- Expansion of foreign currency B/S

Market and investors (Competitors)

- Western banks’ competitiveness recovering, rise of regional banks
- Strengthening of regulations, higher required compliance level
- Recovery of investors’ risk appetite

ALM

- Management with consideration for domestic/overseas risk
  - More prudence in ALM amid continuing ultra-low interest rates, long-term interest rate reversal risk
  - Employ flexible ALM while making consideration for various sources of risk

Sales & Trading

- Diversification of Japanese customers’ commercial flows
- Growing business with non-Japanese customers
- Expansion of emerging economies’ businesses
- Increase in market volatility
### Regulatory environment and higher compliance level

#### Regulatory trends
- No change in trend to strengthen global regulations
- Continued regulatory strengthening and more sophisticated risk management at various levels
- Difficult to conjecture about effects as numerous undecided elements remain, but the full financial impact is expected several years hence
- Taking capital and liquidity into account, the Japanese banks position will improve relatively

#### Higher compliance level
- Libor impropriety and AML issues arising
- Large fines, etc. would a large effect on finances
- Review customary market practices, reform Libor, etc.
- As G-SIFIs we must aim for the highest standards of compliance
- Need for continuous strengthening of internal controls

#### Major scheduled regulation

<table>
<thead>
<tr>
<th>Regulation</th>
<th>Impact on market business</th>
</tr>
</thead>
<tbody>
<tr>
<td>Push Out</td>
<td>○</td>
</tr>
<tr>
<td>Volcker Rule</td>
<td>○</td>
</tr>
<tr>
<td>Vickers/Liikanen</td>
<td>△</td>
</tr>
<tr>
<td>Recovery and resolutions plans (RRP)</td>
<td>△</td>
</tr>
<tr>
<td>Financial Transaction Tax</td>
<td>○</td>
</tr>
<tr>
<td>Shadow Banking</td>
<td>△</td>
</tr>
<tr>
<td>Basel 3</td>
<td>△</td>
</tr>
<tr>
<td>Single Counterparty Credit Limit</td>
<td>△</td>
</tr>
<tr>
<td>Intermediate Holding Company (IHC)</td>
<td>△</td>
</tr>
<tr>
<td>Risk Data Aggregation &amp; Reporting</td>
<td>△</td>
</tr>
<tr>
<td>Pay regulations</td>
<td>△</td>
</tr>
<tr>
<td>Non-CCP margin requirements</td>
<td>○</td>
</tr>
<tr>
<td>Transaction report archiving requirement, CCP requirement, Electronic transaction base</td>
<td>○</td>
</tr>
<tr>
<td>Benchmark interest rate reform</td>
<td>○</td>
</tr>
</tbody>
</table>
Strengthen administration practices and deepen cooperation

- **Strengthen administration practices**
  - Sophisticate internal controls
  - Correspond to regulations

- **Deepen cooperation**
  - Cooperation between businesses
    - Established Integrated Global Markets Business Group with the aim of strengthening sales and trading business through unified management of BTMU and MUSHD markets business (July 12)
  - Cooperation between units
    - Deepen cooperation with other units in order to maximize added value from every point of view, not only within Global Markets Unit
  - Cooperation between regions
    - Respond to the globalization of customers’ distribution channels, it is essential to strengthen the structure for cooperation between regions
    - Implementing organizational change to add a global matrix to the existing regional matrix
As ALM divisions' revenues decline if interest rates rise, it is necessary to establish a revenue base that is not influenced by interest rate trends.

Aim to strengthen the sales and trading business based on customer transactions under the medium-term business plan. Plan to shift earnings structure:

- Responding globally to customers' interest rate risk hedge needs associated with their fund sourcing and forex hedge needs arising from money flows.
- Provide advise as market professionals to increase added value.

(Note) Sum of customer-facing divisions and Global Markets Unit. Exchange rates: Those adopted in our new business plan ($/¥=83, etc)
Expansion co-managed offices

Expansion of offices co-managed with Global Business Unit

- In response to customers’ diverse needs, market related business at some overseas offices is being jointly managed by the Global Business Unit and the Global Markets Business Unit.

- Through joint management, increase in the level of business standards expected not only in sales and trading business, but also in ALM. Backed by Global Markets Unit’s market business know-how.

- Currently 6 offices under joint management.

- Operations at offices and markets’ growth will be considered comprehensively and expansion of co-managed offices examined. Also, promote strengthened internal control framework.
Appendix: Global Markets Unit/ ALM divisions

Global Markets Unit

- Retail Banking Business Unit
- Corporate Banking Business Unit
- Global Business Unit
- Global Markets Unit
- Corporate Services
- Corporate Center

ALM divisions

- Global Markets Planning Division
- Global Markets Operations Division
- Treasury and Investment Division
- International Treasury and Investment Division
- Strategic Investment Division
- Global Markets Trading Division
- Global Markets Marketing Division
- Global Markets Division for the Americas
- Global Markets Division for EMEA
- Global Markets Division for the ASEAN Region
- Global Markets Division for the East Asia Region

Shareholders Meeting
Board of Directors
Executive Committee

Global Markets Solution Office
Global Markets Compliance & Regulatory Affairs Office
Emerging Markets Trading Office
Japanese Customer Marketing Office
Global Customer Marketing Office
Securities Business Office
Appendix: J GB yield trend

![Graph showing the yield trend of 10yr J GB from End Mar 01 to End Mar 13. The graph displays fluctuations in yield with a peak around End Mar 05 and a decline towards End Mar 13.](image)
Appendix: Gap between deposits/lending and JGB holdings

City banks

Regional banks

(Source) Japanese Bankers Association