



Mitsubishi UFJ Financial Group

ALM

April, 2013

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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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ALM

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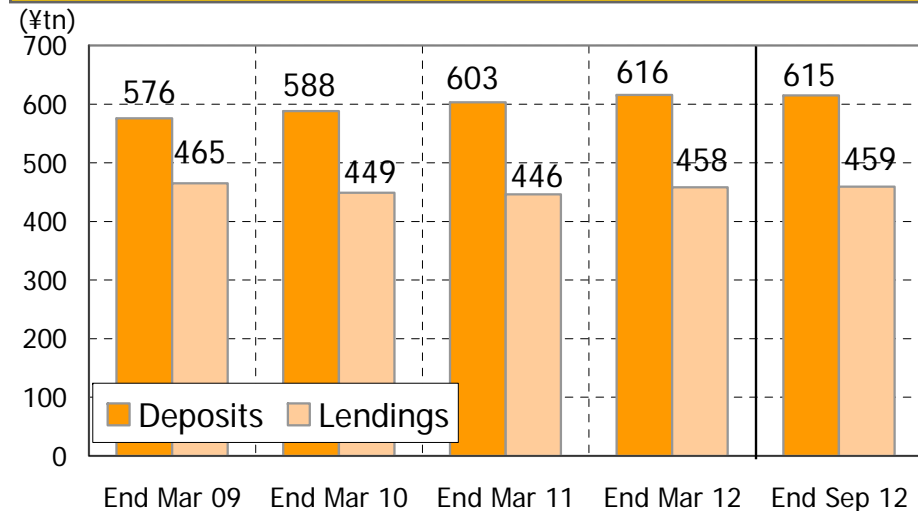
Business environment and B/S

Operational environment of Japanese banks



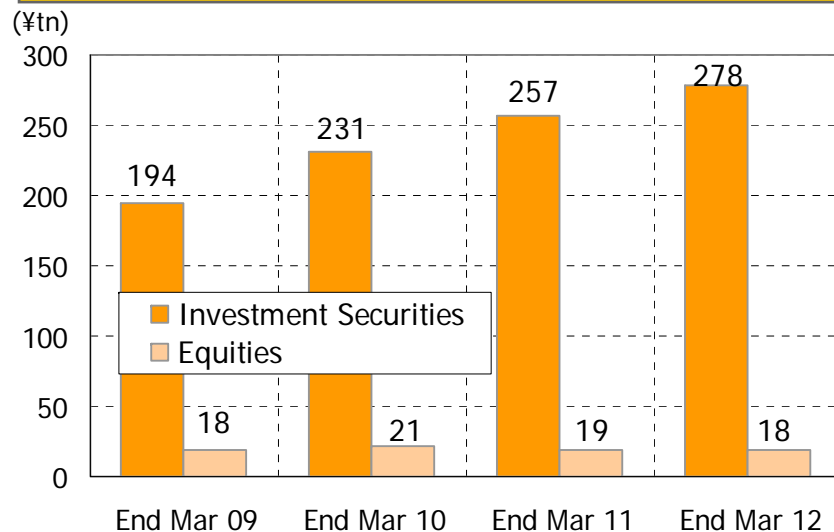
- Large deposit surplus continues due to growth in deposits and sluggish lendings
- Business practice of strategic shareholdings
 - Impairment arises when share prices fall
- Decrease in interest income due to declining market interest rates
- Acceleration in customers' overseas expansion

Japanese banks' deposits and lendings



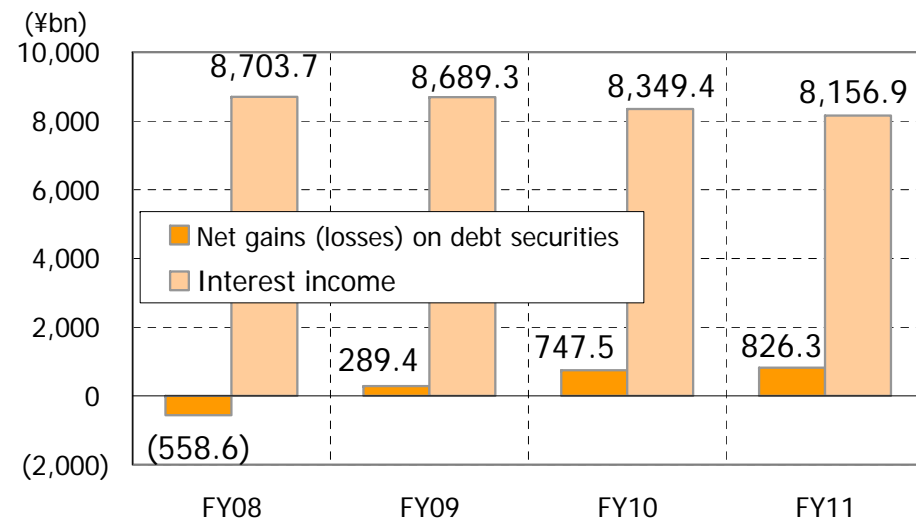
(Source) Japanese Bankers Association

Japanese banks' securities and equities



(Source) Japanese Bankers Association

Japanese banks' net gains (losses) on debt securities and interest income



(Source) Japanese Bankers Association

Characteristics of BTMU's B/S

(BTMU non-consolidated)



● 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

B/S (Sum of domestic and international business)

End Mar 09 : ¥148 tn

Loans ¥73 tn	Deposits ¥100 tn
Securities ¥38 tn	Others ¥43 tn
Others ¥36 tn	Net assets ¥5 tn

End Sep 12: ¥159 tn

Loans ¥69 tn	Deposits ¥107 tn
Securities ¥61 tn	Others ¥44 tn
Others ¥28 tn	Net assets ¥7 tn

Source and use of funds*

* FY12 H1 average balance

Domestic business

Loans ¥49 tn	Deposits ¥91 tn
Securities ¥48 tn	Others ¥16 tn
Others ¥13 tn	

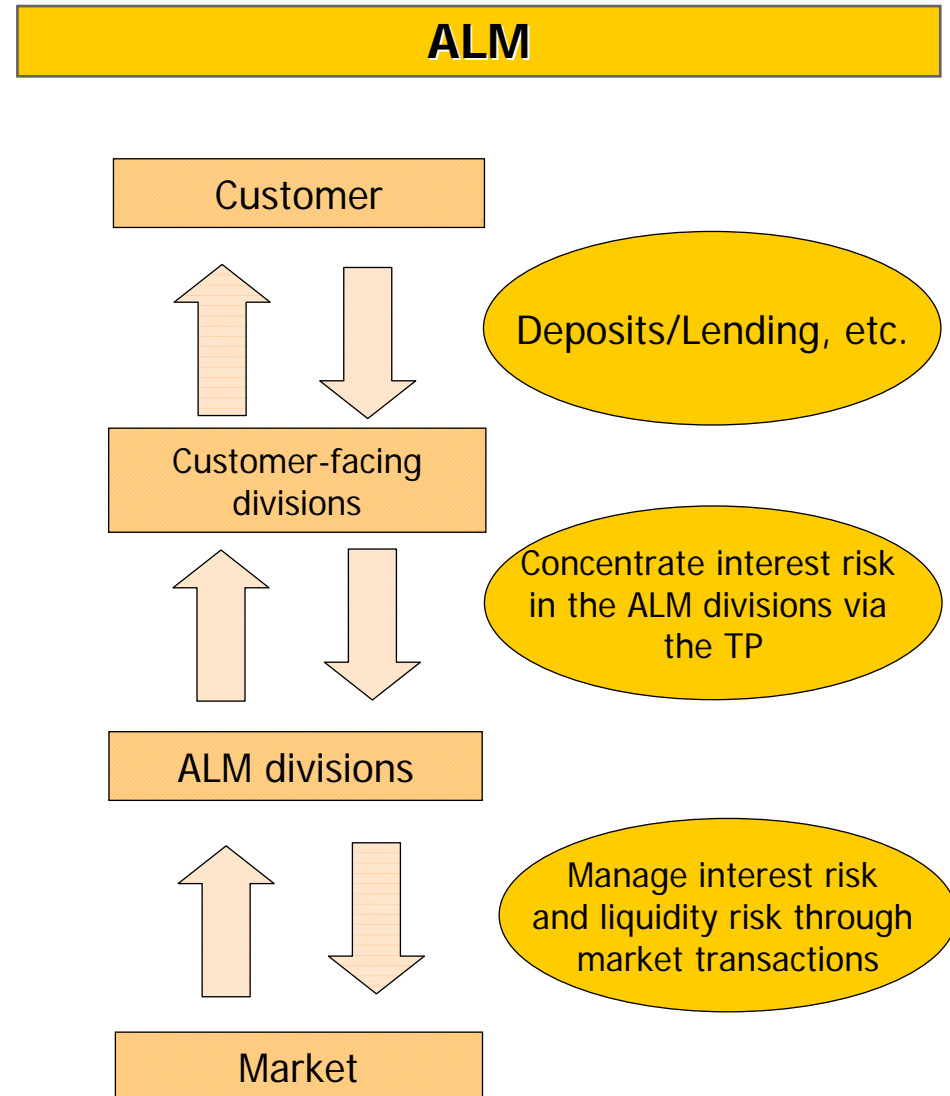
International business

Loans ¥16 tn	Deposits ¥13 tn
Securities ¥12 tn	CDs ¥6 tn
Others ¥6 tn	Others ¥17 tn

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



Market risk management in ALM business



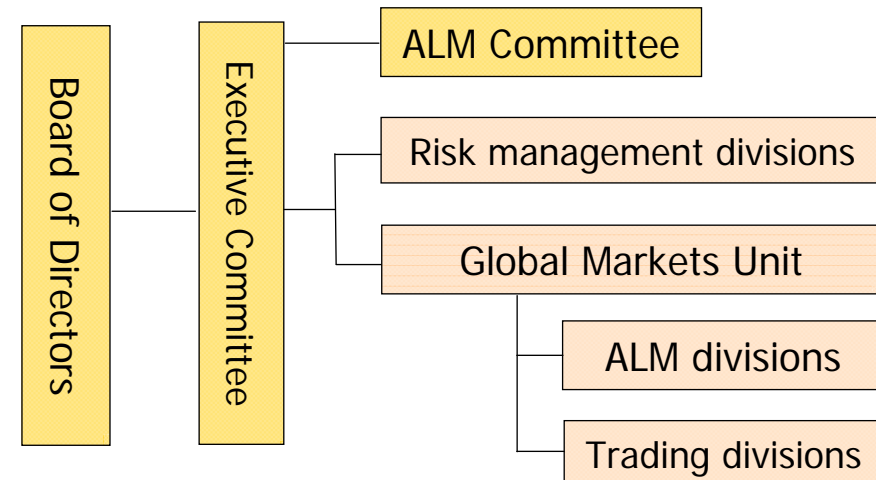
● Market risk management framework

- Market risk
The Executive Committee assign 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 framework



Overall gains/losses

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

	Financial income	Unrealized gains/losses
Securities	Net gains (losses) on debt securities Interest and dividend on securities (Excl. equities related)	Decrease or increase in unrealized gains/losses
Interest rate swaps	Net interest rate swaps income	Decrease or increase in deferred gains/losses

NII (Net Interest Income)

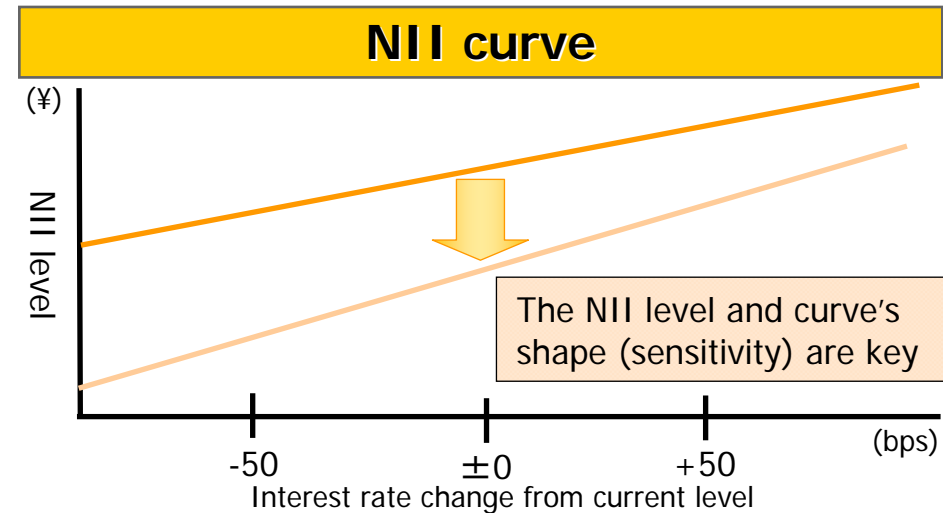


● NII curve

- 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)

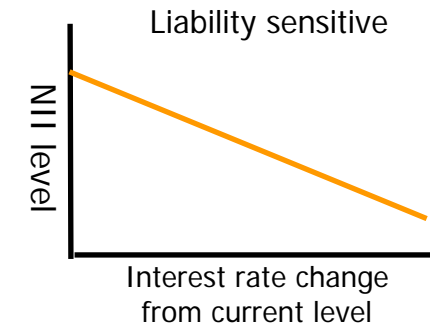
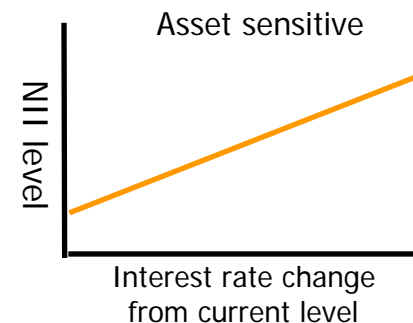
● How we consider the NII curve

- 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

Example	Level	Shape
Increase in loans, widening of loan spreads	Up	Parallel
Decrease in loans, smaller loan spreads	Down	Parallel
Increase in long-term assets	Up	Flattening
Increase in long-term funding	Down	Flattening



ALM

Regarding BTMU's B/S and ALM (BTMU non-consolidated)



●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

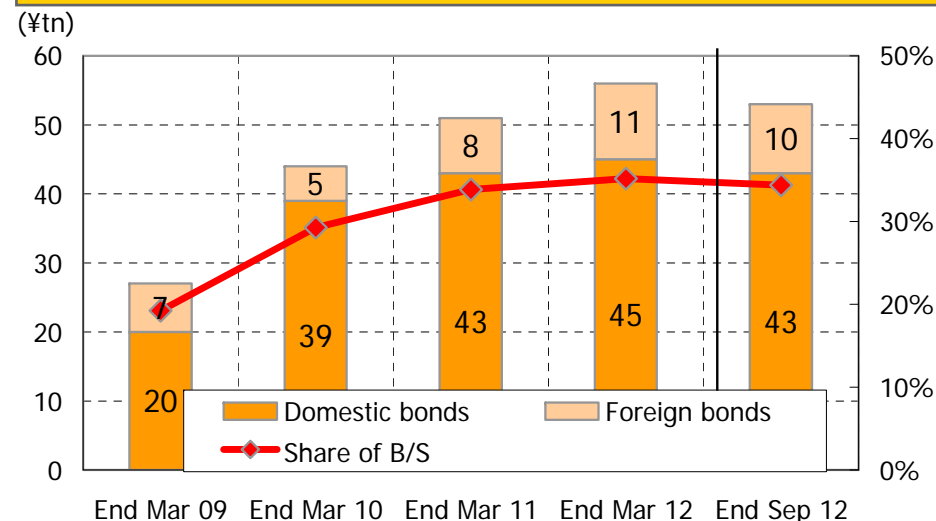
●Foreign currency ALM

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

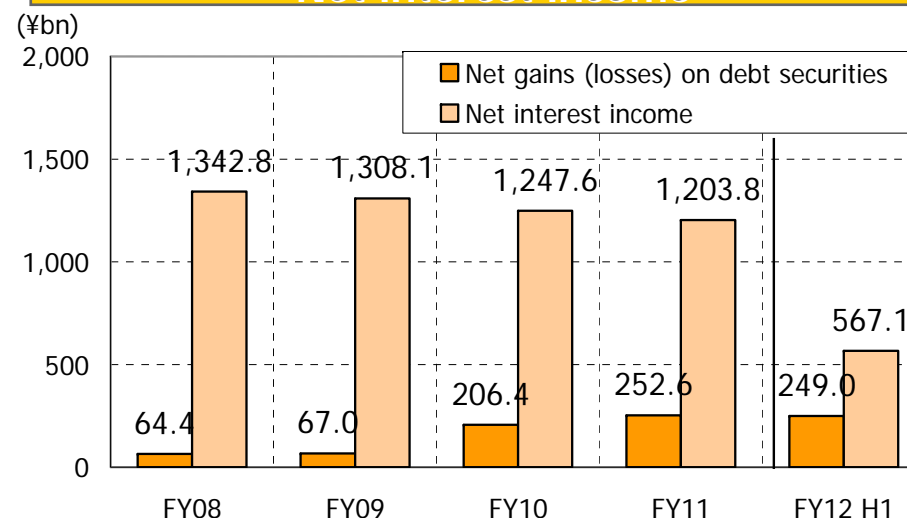
●Profits

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

Debt securities investments balance



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



NII curve of BTMU



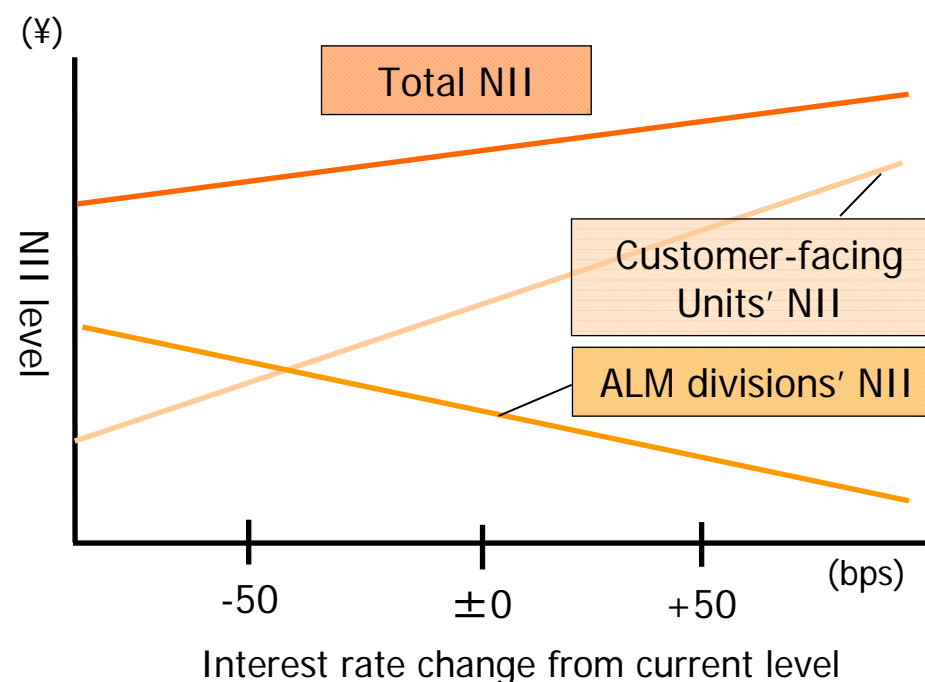
● NII curve of BTMU

- 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.)

● 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)

NII curve of BTMU (example)



Business cycles and net gains (losses) on debt securities

(BTMU non-consolidated)



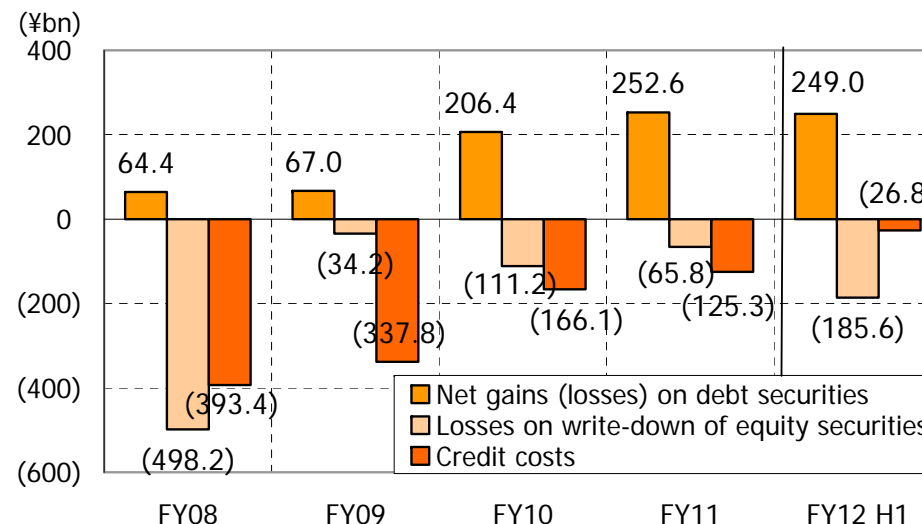
Relationship between business cycles and profits

- 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)

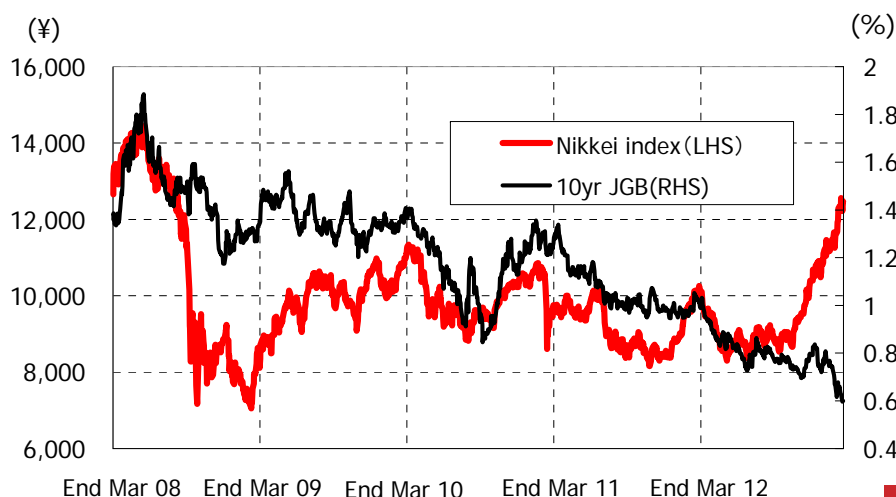
	Credit costs	Strategic equity holdings	Government bonds
Boom	+	+	—
Recession	—	—	+

- 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

Net gains (losses) on debt securities and credit costs/losses on write-down of equity securities



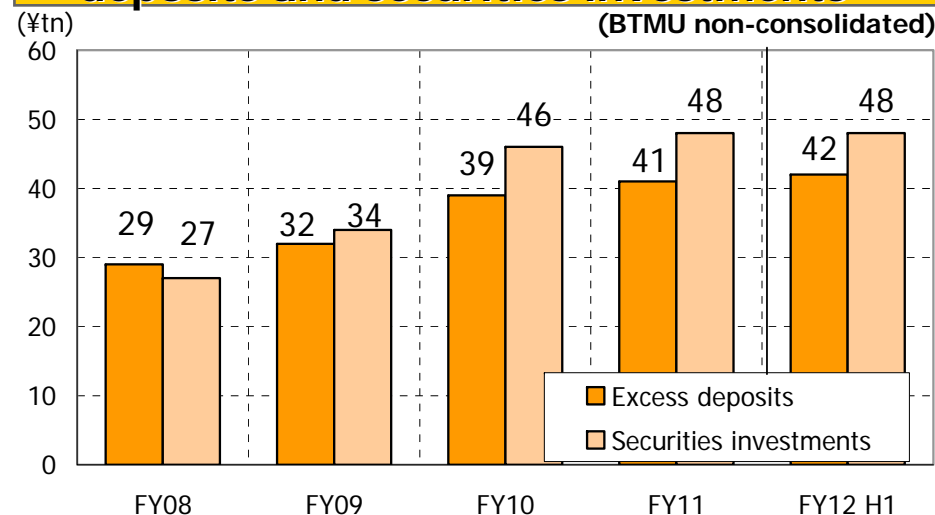
Stock prices and Interest rates



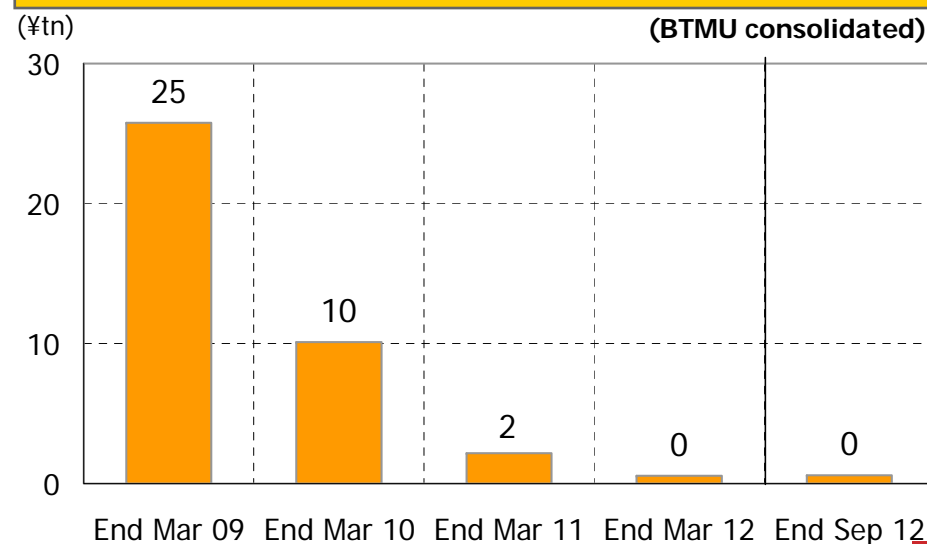
● Effects of holding securities such as JGBs in yen ALM

- 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



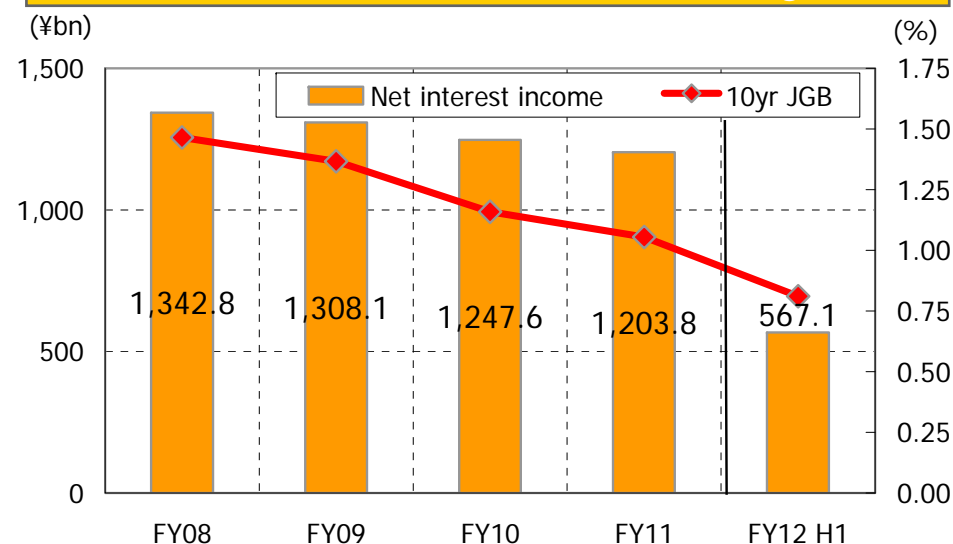
Net gains (losses) on debt securities/ net interest income

(BTMU non-consolidated)

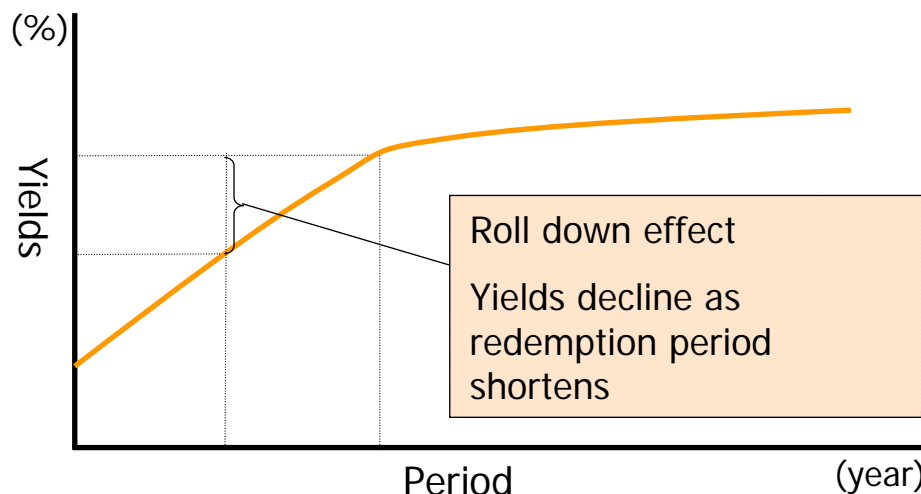


- Based on the current NII curve of BTMU, net interest income will decline, in case of continuous interest rate decline
 - Declining interest rate have a significant impact on not only customer-facing divisions but also Global Markets Unit
 - Redemption of high-coupon bonds will be substituted by new 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

Net interest income and JGB yield



Roll down effect



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

Early warnings (examples of fixed-point checks)

Front-office divisions	
	Macro economic indices (International balance of payment, core inflation ratio etc.)
	Fiscal-related indices (Government debt, interest payment/tax revenue ratio, etc.)
	Money flows (B/S structure of banks, holders ratio of JGBs, etc.)
	JGB risk analysis (Rating trends, etc.)
	Market trends (JGBs, CDS, effective exchange rates, financial institution shares, etc.)
Risk management divisions	
	BTMU's B/S composition
	Impact on capital of interest rate increases
	BTMU's JGB market share
	JGB market trends
	Liquidity risk

Foreign currency ALM

(BTMU non-consolidated)



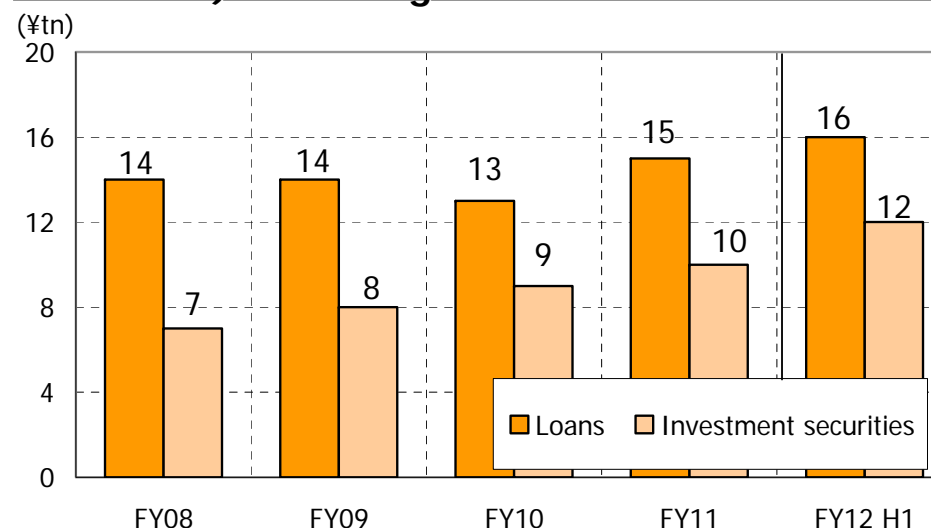
- **Strengthen and diversify foreign currency sourcing to support increased assets resulting from increased overseas lending. Utilizing ample yen liquidity is key**

- 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**

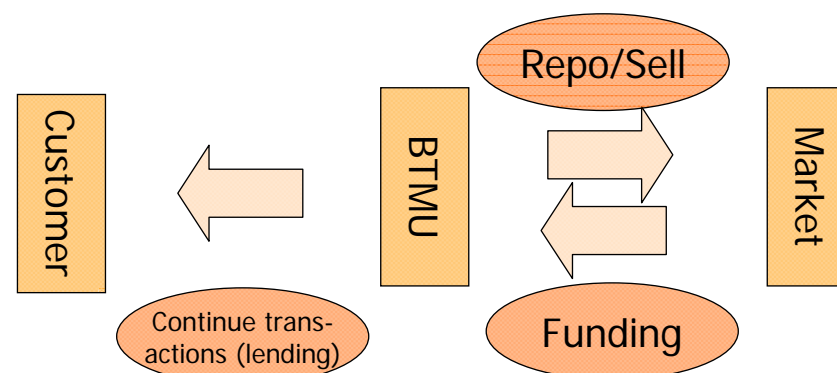
- Mostly U.S. government bonds and U.S. higher-rated mortgage bonds with (eligible collateral with each countries' central bank)
- In 2012, to supplement foreign currency liquidity we established a special-purpose subsidiary, BTMU Liquidity Reserve Investment Limited (upgraded buffer asset management)
- Main overseas offices also invest in foreign securities as buffer asset (Americas, Europe, Asia)

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



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

Regulation		Impact on market business
Macro	Push Out	○
	Volcker Rule	○
	Vickers/Liikanen	△
	Recovery and resolutions plans (RRP)	△
	Financial Transaction Tax	○
	Shadow Banking	△
Micro	Basel 3	△
	Single Counterparty Credit Limit	△
	Intermediate Holding Company (IHC)	△
	Risk Data Aggregation & Reporting	△
	Pay regulations	△
Transactions	Non-CCP margin requirements	○
	Transaction report archiving requirement, CCP requirement, Electronic transaction base	○
	Benchmark interest rate reform	○

Strengthen administration practices and deepen cooperation



● Strengthen administration practices

- Sophisticate internal controls
- Correspond to regulations

● Deepen cooperation

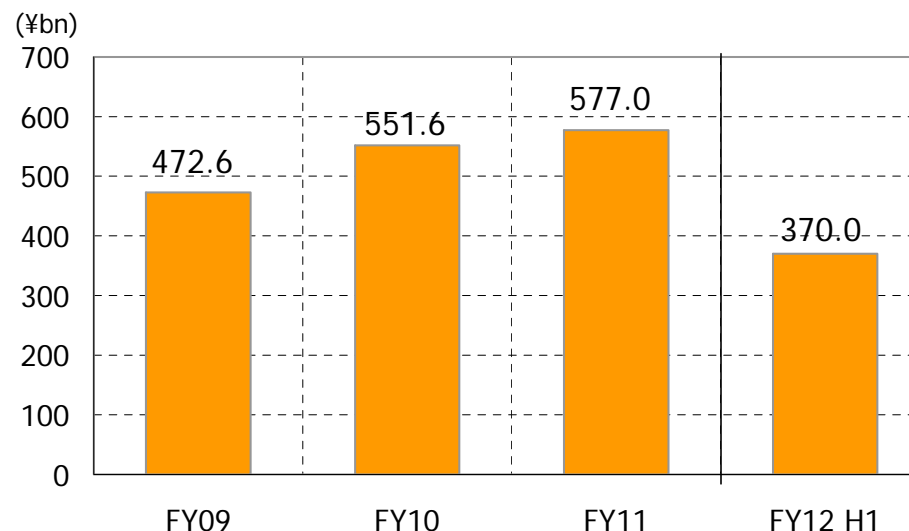
- Cooperation between businesses
Established Integrated Global Markets Business Group with the aim of strengthening sales and trading business through unified management of BTMU and MUSHD markets business (July 12)
- Cooperation between units
Deepen cooperation with other units in order to maximize added 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

Direction of the medium-term business plan (BTMU consolidated)

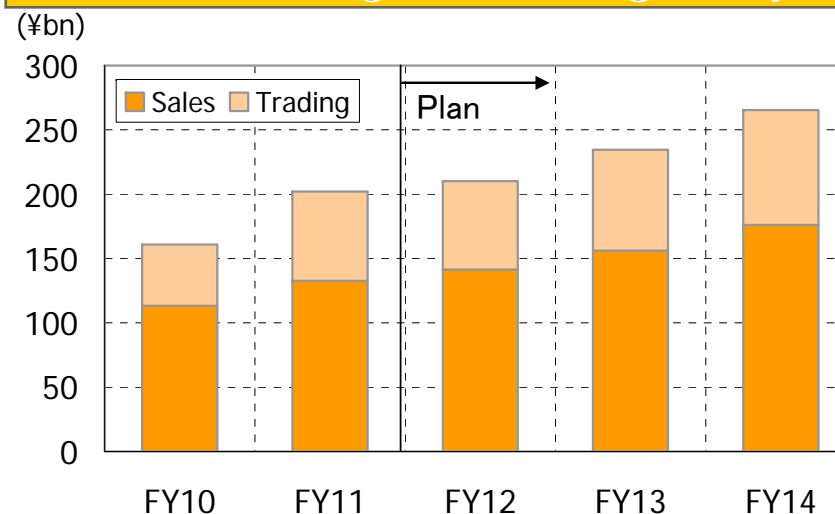


- As ALM divisions' revenues decline if interest rates rise, it is necessary to establish a revenue base that is not influenced by interest rate trends
- Aim to strengthen the sales and trading business based on customer transactions under the medium-term business plan. Plan to shift earnings structure
 - Responding globally to customers' interest rate risk hedge needs associated with their fund sourcing and forex hedge needs arising from money flows
 - Provide advice as market professionals to increase added value

Global Markets Unit gross profits



Sales & Trading business gross profits



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

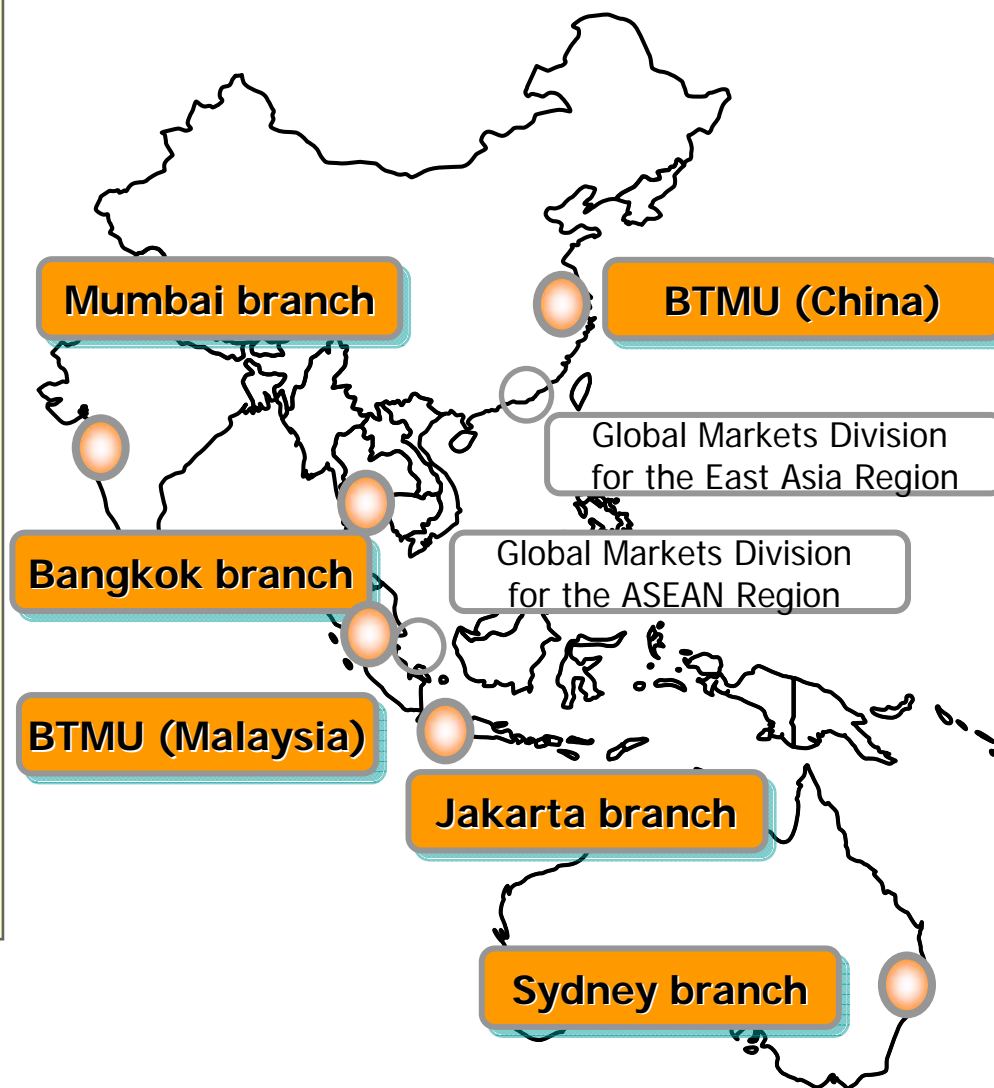
Expansion co-managed offices



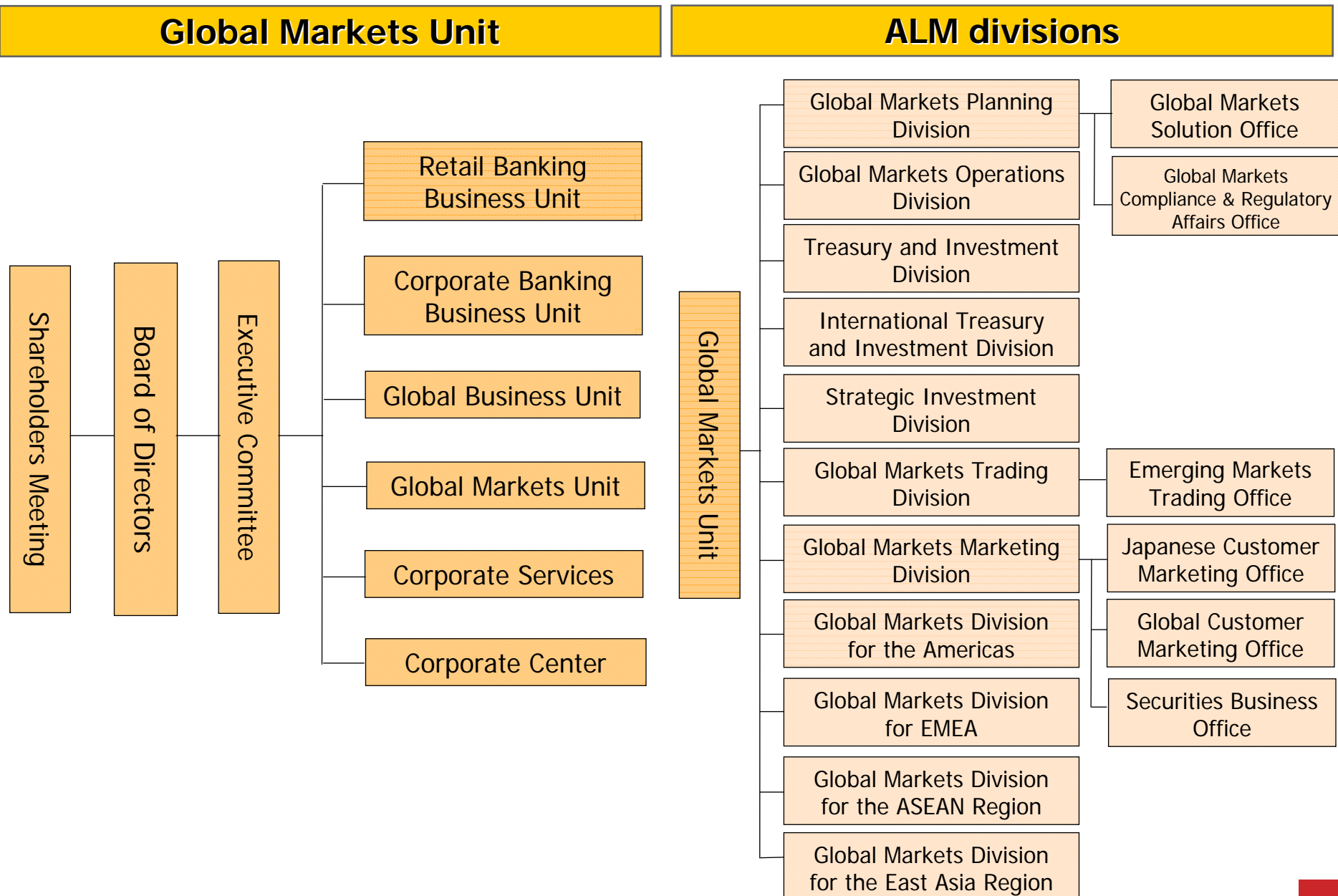
● Expansion of offices co-managed with Global Business Unit

- 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

Co-managed offices



Appendix: Global Markets Unit/ALM divisions



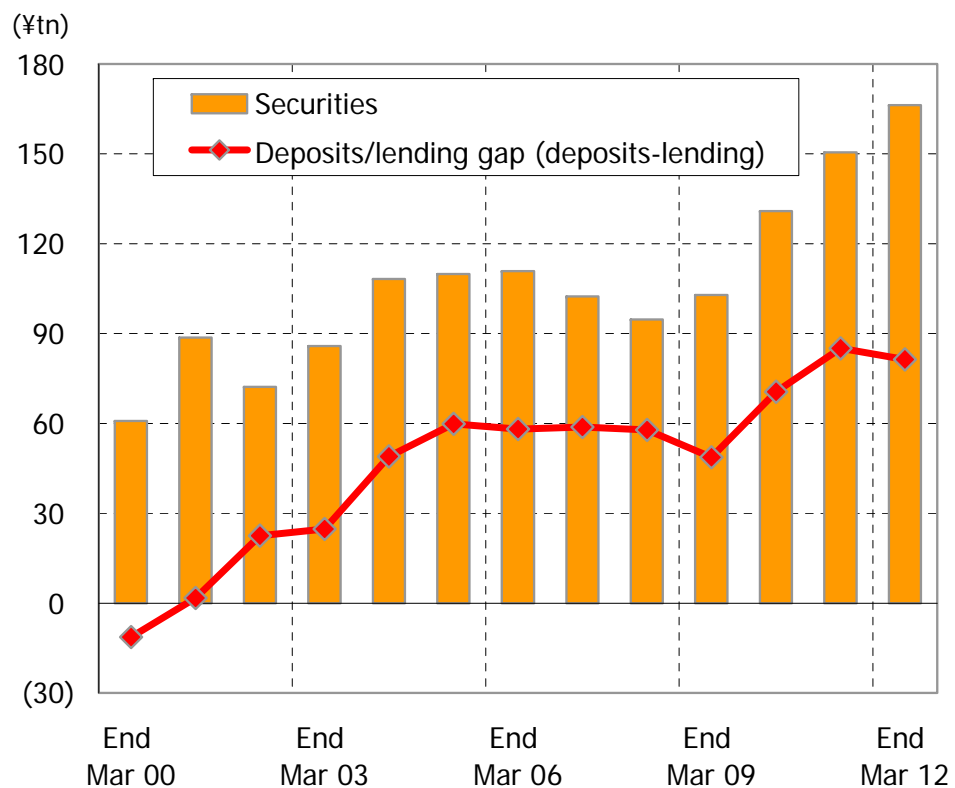
Appendix: JGB yield trend



Appendix: Gap between deposits/lending and JGB holdings

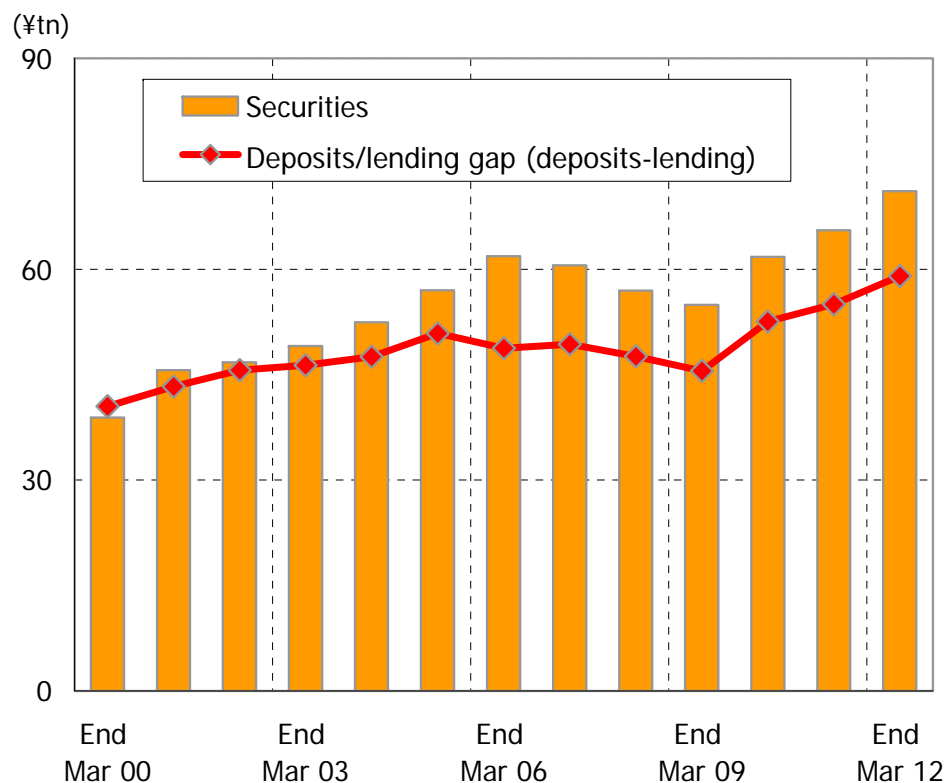


City banks



(Source) Japanese Bankers Association

Regional banks



(Source) Japanese Bankers Association