FitchRatings

08 Apr 2020 | Downgrade

Fitch Downgrades MUFG Group's Rating to 'A-'; Stable Outlook

Fitch Ratings-Tokyo-08 April 2020:

Fitch Ratings has downgraded to 'A-', from 'A', the Long-Term Issuer Default Ratings (IDR) of Mitsubishi UFJ Financial Group, Inc. (MUFG) and its subsidiaries - MUFG Bank, Ltd. and Mitsubishi UFJ Trust and Banking Corporation (together, MUFG group). The Long-Term IDR of Mitsubishi UFJ Morgan Stanley Securities Co., Ltd. (MUMSS) was also downgraded to 'A-' from 'A'. At the same time, Fitch has downgraded the Long-Term IDR of ACOM CO., LTD. to 'BBB+', from 'A-'. The Outlook is Stable. A full list of rating actions is below.

The downgrade reflects Fitch's assessment that a weaker and more challenging operating environment for the Japanese banks as a result of the coronavirus pandemic is likely to negatively affect MUFG's credit profile, although the extent of the economic and financial market implications are unclear. Fitch expects a deep global recession in 2020, with world economic activity to decline by 1.9% in 2020, with US GDP down by 3.3%, the eurozone down by 4.2% and Japan down by 2.7%, with further downside risk; see Global Economic Outlook - COVID-19 Crisis Update April 2 2020 at www.fitchratings.com/site/re/10116672

Mitsubishi UFJ Financial Group, Inc.; Long Term Issuer Default Rating; Downgrade; A-; RO:Sta
; Short Term Issuer Default Rating; Affirmed; F1
; Local Currency Long Term Issuer Default Rating; Downgrade; A-; RO:Sta
; Local Currency Short Term Issuer Default Rating; Affirmed; F1
; Viability Rating; Downgrade; a-
; Support Rating; Affirmed; 1
; Support Rating Floor; Affirmed; A-
----senior unsecured; Long Term Rating; Downgrade; A-
Mitsubishi UFJ Morgan Stanley Securities Co., Ltd.; Long Term Issuer Default Rating; Downgrade; A-; RO:Sta
; Short Term Issuer Default Rating; Affirmed; F1
; Local Currency Long Term Issuer Default Rating; Downgrade; A-; RO:Sta
; Local Currency Short Term Issuer Default Rating; Affirmed; F1
; Support Rating; Affirmed; 1
ACOM CO., LTD.; Long Term Issuer Default Rating; Downgrade; BBB+; RO:Sta
; Short Term Issuer Default Rating; Affirmed; F1
; Local Currency Long Term Issuer Default Rating; Downgrade; BBB+; RO:Sta
; Local Currency Short Term Issuer Default Rating; Affirmed; F1
; Support Rating; Downgrade; 2
Mitsubishi UFJ Trust and Banking Corporation; Long Term Issuer Default Rating; Downgrade; A-; RO:Sta

; Short Term Issuer Default Rating; Affirmed; F1

; Local Currency Long Term Issuer Default Rating; Downgrade; A-; RO:Sta

; Local Currency Short Term Issuer Default Rating; Affirmed; F1

; Viability Rating; Downgrade; a-

; Support Rating; Affirmed; 1

; Support Rating Floor; Affirmed; A-

MUFG Bank, Ltd.; Long Term Issuer Default Rating; Downgrade; A-; RO:Sta

; Short Term Issuer Default Rating; Affirmed; F1

; Local Currency Long Term Issuer Default Rating; Downgrade; A-; RO:Sta

; Local Currency Short Term Issuer Default Rating; Affirmed; F1

; Viability Rating; Downgrade; a-

; Support Rating; Affirmed; 1

; Support Rating Floor; Affirmed; A-

----senior unsecured; Long Term Rating; Downgrade; A-

----subordinated; Long Term Rating; Criteria Observation Removed; A-

----subordinated; Long Term Rating; Downgrade; BBB

Key Rating Drivers

IDRS, SUPPORT RATINGS, SUPPORT RATING FLOORS, VIABILITY RATINGS AND SENIOR DEBT

The downgrade of the Viability Ratings is driven by Fitch's assessment of the downward pressure on the operating environment for Japanese banks. The deep global economic downturn adds to domestic structural challenges, such as negative policy rates, intense competition, changing client needs and the country's ageing and shrinking population. This is reflected in Fitch's revision of outlook to negative on our operating environment factor mid-point 'a-'.

Fitch expects the challenging operating environment to pressure the group's ability to restore sustainable profitability and test the group's underwriting and risk management standards, particularly in its offshore markets, where we expect to see weaker asset quality. Higher credit costs and impairments on investments from market dislocation, such as the recently announced one-time amortisation of goodwill at MUFG's Asian banks, will further pressure its ability to improve profitability.

Failure to execute the medium-term business plan, including revenue growth and cost reduction, would undermine the long-term sustainability of earnings, which could pressure the group's ability to generate capital commensurate with its risk appetite. However, Fitch believes MUFG will maintain its capitalisation (common equity Tier 1 ratio of 12.2% at end-March 2019 and 12.6% at end-2019), as we expect the increase in risk appetite to be gradual, well-controlled and accompanied by loss-absorption buffers.

The group's ratings reflect Fitch's view that MUFG's strong company profile, which is characterised by solid franchises in the domestic market and geographical diversification, with a balanced and diversified risk profile, is under pressure from the operating environment challenges. It has become more difficult to maintain pricing and growth, including at its overseas businesses, in the face of low interest rates globally. We believe the Viability Ratings are sensitive to the downside.

The ratings are supported by MUFG group's sound liquidity and funding position, which is underpinned by abundant access to domestic deposits stemming from a sound franchise and diversified operations. Foreign-currency funding is strengthened via increasing foreign-currency deposits, foreign-currency borrowings and currency swaps.

The Long-Term IDRs are at the same level as the Viability Ratings and Support Rating Floors. The Outlook reflects the Outlook on the Japan sovereign (A/Stable). Fitch assesses MUFG and its subsidiaries on a consolidated basis.

MUFG group's Support Rating and Support Rating Floor reflect Fitch's view that, as a systematically important group in Japan, there is an extremely high probability that it will receive government support in case of need. The government can pre-emptively provide financial assistance to a solvent bank holding company when a serious system disruption is anticipated under Japan's Deposit Insurance Act. We do not believe support prospects have deteriorated, even though MUFG issued senior loss-absorbing debt through the holding company in response to the Financial Stability Board's global requirements. We equalise the ratings between the holding company and operating entities, as we expect support to equally benefit all entities.

The ratings on the senior unsecured debt issued by MUFG and MUFG Bank are at the same level as the entities' IDRs, in line with Fitch's criteria. MUFG's senior bonds, which are eligible as total loss-absorbing capacity, are also rated at the same level as its Long-Term IDR, as we believe the holding company's failure and senior-level default risk are similar to that of wholly owned operating banks, despite the notes' structural subordination features.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

MUFG Bank's Basel II Tier 2 instrument is rated two notches below its anchor rating, which is consistent with the base case in Fitch's Bank Rating Criteria published 28 February 2020. The instrument was downgraded by two notches to reflect a one notch downgrade on its anchor rating and one notch for poor recovery expectation based on the new criteria. The anchor rating for the instrument is the IDR because Fitch believes that support can be factored into such instrument ratings, as the government can pre-emptively provide financial assistance to systemically important financial institutions. The rating on the instrument have been removed from the Criteria Under Observation, on which it was placed following the publication of Fitch's updated Bank Rating Criteria; see Fitch Places One IDR, Debt Ratings of 26 APAC Banks Under Criteria Observation, published 4 March 2020, at www.fitchratings.com/site/pr/10113130

SUBSIDIARY AND AFFILIATED COMPANIES

The Long-Term IDRs of MUMSS, which is 60% indirectly owned by MUFG and 40% by US-based Morgan Stanley (A/Stable), are equalised with the IDR of its ultimate parent, MUFG. The ratings reflect MUMSS' key role in supporting the group's securities business. The company also engages in retail, investment banking, sales, trading and research. The Outlook is Stable, in line with MUFG's IDR.

The Long-Term IDRs of ACOM, a 40% owned subsidiary of MUFG, reflect ACOM's strategic role as one of Japan's leading providers of consumer finance services. Its rating is notched down one notch from the IDR of MUFG, which maps to a Support Rating of '2'. The Outlook is Stable, in line with MUFG's support-driven IDR.

RATING SENSITIVITIES

IDRS, SUPPORT RATINGS, SUPPORT RATING FLOORS AND SENIOR DEBT

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Any change in assumptions around lower propensity or deterioration in the sovereign's ability to provide timely support to MUFG could lead to negative rating action on the Support Ratings, leading to lower Support Rating Floors.

A downgrade of the sovereign ratings, which reflects a deterioration of the sovereign's ability to provide support, would lead to lower Support Ratings Floors and Support Ratings. A downgrade of the Viability Ratings would not immediately affect the IDRs, since the IDRs are underpinned by the Support Rating Floors.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Upgrade on the sovereign ratings could lead to positive rating action on the Support Rating Floors, support-driven IDRs and senior debt ratings. This is not our base case under a deep global recession.

An upgrade of the Viability Ratings above the Support Rating Floors would also result in similar rating action on the IDRs and senior debt ratings.

VIABILITY RATINGS

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Further challenges in the operating environment for the Japanese banks, such as a prolonged deep recession, could lead us to revise down the operating environment factor mid-point to 'bbb+'. This, in turn, would affect the benchmark mid-points on quantitative factors. Fitch's base case economic outlook is for a deep recession in 2Q20, with recovery from 3Q20, although with downside risk.

Negative rating action could be caused by a sharp deterioration in profitability or a lack of sustainable earnings improvement. This could follow from a dislocation in any of the group's larger overseas markets leading to deterioration of franchise strength, or from weaker asset quality. Deterioration in capitalisation could also lead to negative rating action.

A large increase in risk appetite, such as a significant rise in risky assets that exposes capital and earnings to higher volatility without commensurate increases in risk buffers, could lead to a downgrade. An increase in risky assets could stem from a rising exposure to riskier types of lending, especially late in the credit-cycle, or an increase in higher-risk investments. The common equity Tier 1 ratio consistently falling below 12% could lead to a downgrade, even if the operating environment mid-point remains at 'a-'. This could be due to a non-performing loan/total loan ratio consistently above 1.5% (2019: 1%), resulting in an operating profit/risk weighted asset ratio continuously below 0.9% (nine months ending December 2019: 0.93%, financial year ending March 2019 (FYE19): 0.88%, FYE18: 0.98%).

Failure to maintain double leverage below 120% or a change in the consolidated-base supervision approach by the regulator could lead to a downgrade of MUFG's Viability Rating.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Sustained recovery and stabilisation of the global and domestic economy could ease pressure on the operating environment. However, we expect domestic structural challenges to remain a constraint.

Successful execution of the management plan to continually improve capitalisation to meet its target, ensuring a sufficient buffer commensurate with risk, stable and sustainable profitability, with less reliance on volatile trading income, and maintenance of healthy asset quality could lead to positive rating action.

SUBORDINATED DEBT

Factors that could, individually or collectively, lead to negative rating action/downgrade:

-Downgrade of IDRs could lead to negative rating action on the subordinated debt rating.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

-Upgrade of IDRs could lead to positive rating action on the subordinated debt rating

SUBSIDIARY AND AFFILIATED COMPANIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

-Any negative rating action on MUFG could lead to negative rating action on MUMSS and ACOM.

-Deterioration in MUFG's ability or propensity to support MUMSS or ACOM, including due to a decline in ownership or their strategic importance to the group, could lead to negative rating action on MUMSS or ACOM.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

-Any positive rating action on MUFG would lead to positive rating action on MUMSS and ACOM.

Best/Worst Case Rating Scenario

Ratings of financial institutions issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit www.fitchratings.com/site/re/10111579

Summary of Financial Adjustments

Total assets and total liabilities exclude acceptances and guarantees from Japan's generally accepted accounting principles balance sheet to be globally comparable.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING
The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations
ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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Additional information is available on www.fitchratings.com

Applicable Criteria

Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

Non-Bank Financial Institutions Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Status

Endorsement Policy

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