**Rakuten Bank, Ltd.**

**Q&A Following FY2023 Q1 Financial Results Presentation on August 8, 2023**

1. **Credit costs: I understand that credit costs remained low but rose YoY in a healthy manner as investment assets expanded. However, please explain whether the credit cost ratio is rising as middle-risk assets increase, and what you consider to be an appropriate level.**

As you say, credit costs rose in tandem with the increase in investment assets. We consider the increase in credit costs to be due to the growth in assets while risks are controlled.

Going forward, we expect credit costs to continue to rise naturally in line with the expansion of investment assets. Regarding credit cost ratio, our basic policy is to gradually increase our ratio of middle-risk assets while expanding overall investment assets in a balanced manner. As we do so, we believe it is natural for the credit cost ratio to gradually rise. As the slide detailing investment assets shows, middle-risk assets is an investment category that includes card loans, investment property loans, ABL, monetary claims bought, and other items.

For investment property loans, we only offer loans to quality customers who are referred by large, reputable investment property companies. In addition, as we have said in the past, we only handle properties in urban areas near train stations. As a result, at present, our loan-loss ratio on investment property loans is almost the same as on housing loans. Given our current loan-loss ratio, we would not expect the credit cost ratio to increase significantly even if the balance of investment property loans rises.

Let us next consider securitized assets (ABL, and monetary claims bought: others). Some loans, including the underlying loans, bear a certain degree of risk. Even so, these products are relatively safe because, in principle, the originator takes the subordinated portion and we take the senior portion within the securitization structure. While it is true that the credit is risky, we do not believe the credit cost ratio will grow significantly because safety is provided by the structure.

We have indicated that our loan interest rate on card loans is above 10%, and the Bank controls risk to maintain an approximate loan loss ratio of 3%. That said, our current loan-loss ratio is less than 2%. While the Bank's ratio of credit costs to total investment assets is 0.03%, the loan-loss ratio on card loans is in the 1% to 2% range. Therefore, if card loans grow significantly and the ratio of card loans to total investment assets increases, the credit cost ratio will increase. Our card loan balance is currently around ¥300 billion. Although this balance could grow to around ¥500 billion or ¥600 billion, we are uncertain about whether it could rise as high as ¥1 trillion. It is unrealistic to think that our ratio of card loans will continue to rise while other investment assets grow significantly.

Given this situation, although we cannot guarantee that the credit cost ratio will not rise, we do not believe the ratio will grow significantly or go out of control even if middle-risk assets increase.

2. **Businesses that leverage data: I would like to hear about your progress on new businesses that leverage your wealth of data. In particular, I wonder if the data-based advertising business is likely to start generating a financial impact in the second half of this fiscal year or the next fiscal year.**

All the Bank's customers have undergone know your customer (KYC) procedures to ensure we know their accurate addresses. However, for our advertising clients, the value lies not only in knowing the customer's address, but also in the assurance that the person targeted with the advertisement is indeed real and is unmistakably that individual, as verified by KYC. When we explain to clients the types of customers we have and the identity verification processes we have in place, they show a keen interest. In other words, through our interactions with advertising clients, we have gained confidence in the effectiveness of our data for the advertising business. To translate this into tangible revenue and profits, we need to strengthen our sales team that interacts with clients and build a team of professionals to create platforms such as websites and emails for posting the advertisements received from clients. We are currently in the process of establishing this structure, and while we hope this business will start contributing to revenue and profits from the second half of this fiscal year, more realistically we expect to establish a solid roadmap by the second half and start achieving meaningful results next fiscal year.

Also, as we mentioned previously, we are using data in our marketing efforts to propose the most suitable services to our customers, and this is starting to show a significant impact. As a bank, we utilize smartphone apps and websites to suggest services to our customers. These platforms have limited space for information, so it is important to utilize this space effectively. We have already started monetizing our efforts to display services that each individual customer would be interested in based on the data, and efficiently converting them into service usage.

3. **Outlook for middle-risk assets: I have a question about middle-risk assets, explained on page 15 of the presentation materials. Were your Q1 results in line with your initial**

**expectations? What is your outlook going forward, including for card loans, investment property loans, and ABL?**

Overall, we think middle-risk assets performed well in Q1. As we did not disclose any initial forecast, we ask for your understanding that we cannot provide specific numbers. That said, card loans have trended upward as the impact of the COVID-19 pandemic has eased. This recovery is in line with our expectations. We will accelerate the accumulation of card loans going forward. Investment property loans performed slightly better than we had expected. As we mentioned earlier, we only deal with customers from major investment property sellers and only handle properties located near urban train stations. Thanks to this, we have earned the trust of companies that sell investment property loans, leading to an increase in the number of transactions executed. We believe that this trend will continue for some time. ABL and other monetary claims bought are assets generated from our securitization activities. However, these assets are contingent on the originators and may not necessarily increase according to plan. In Q1, we received inquiries from various originators and were able to close in some cases, resulting in the expected growth plus some additional gains.

Overall, we would say that card loans performed according to plan, while businesses in other areas met or exceeded our expectations.

4. **Thoughts on future yen bond investments: I understand that you currently purchase government bonds for purposes of collateral. It is possible that at some point the yen may begin to generate interest. As you have highly sticky customer deposits, as well as loans to the Ministry of Finance, do you plan to invest actively in JGBs and other yen bonds?**

Changes in the guidance targets for long-term interest rates have caused our thinking to shift slightly with regard to yen bond investments. We expect long-term interest rates to rise gradually, while short-term interest rates remain at or below 0%, although this is uncertain, even if the negative interest rate policy is lifted. Based on this interest rate outlook, we think profits can be made by investing in medium- to long-term yen bonds through short-term funding. We are currently discussing whether to change our policy on yen bond investment, as traditionally we have purchased government bonds only for collateral purposes. Meanwhile, there is a strong possibility of incurring unrealized losses if we invest in yen bonds and long-term interest rates rise. While we could just hold the bonds until maturity and profit from the carry, we are also considering how to approach the issue of potential unrealized losses. It is important to control unrealized losses within a certain range, and we are considering the balance between the opportunity to profit from yen bond investments and controlling unrealized losses.

5. **Risk outlook on investment property loans: Considering the economic environment during the period when this loan balance was expanding, I understand that the credit risk is not significantly different from that of housing loans. However, could a changing interest rate environment affect the risk outlook? Your approach to investment property loans seems different from that for housing loans. Does this mean risk is mitigated because investment property loans are guaranteed outside the Group? Please explain the differences in these stances.**

With regard to investment property loans, we explained that under the current circumstances, the credit cost ratio is not much different than on housing loans. This does not mean we think investment property loans and housing loans have the same level of risk. Investment property loans involve their own level of credit risk. That is why our bank only handles customers referred by reputable major providers. In the event that a customer becomes unable to make payments, we require the collateral property to have sufficient liquidity for foreclosure. For that reason, we only handle properties located near urban train stations. We believe that this policy will help us to control the risks associated with investment property loans to a certain extent. Currently, the loan-loss ratio for investment property loans is similar to that of housing loans. However, future interest rate increases could result in higher repayment amounts for customers, on both investment property loans and housing loans. As a result, some customers could face difficulties in making payments. We are aware of this possibility. However, we make investment property loans only to customers who are referred by reputable and stable institutions, have reliable employment and sufficient income, and can make repayments without relying solely on rental income from investment properties. While loan delinquencies could increase as interest rates rise, we believe that we can keep them within a manageable range.

The reason for the difference in our bank's approach between investment property loans and housing loans is that customers have a strong preference for low interest rates when it comes to housing loans. Behind this preference is the housing loan deduction, where customers can receive a deduction of 0.7% on their loans. Therefore, the lower the borrowing interest rate, the larger the amount that customers can keep in their own pockets. On the other hand, there is a myth in the banking industry that housing loans are safe assets, leading to intense interest rate competition among various banks. While we do engage in some competition as part of our business, we believe that providing housing loans to a wide range of customers at the current, abnormally low interest rates could mean we have more customers who will struggle with repayments when interest rates rise, leading to an increase in non-performing loans. Our bank has changed its policy regarding housing loans. Previously, we targeted middle- to high-income individuals. However, we have now tightened the criteria further and limited housing loan offerings to individuals who have a solid income and who can make payments even if interest rates rise. As a result, the number of housing loans executed has decreased. On the other hand, investment property loans are not eligible for housing loan deductions from the beginning. Of course, customers who are investing naturally want to borrow at the lowest possible interest rates. However, what is even more important is to purchase from a reliable and reputable company and receive proper support and service afterwards. Our bank has established strong relationships with major trusted companies, giving us access to new business opportunities. We can also maintain a high level of safety and expand our business. Our fundamental policy is to continue increasing our balance in accordance with our existing strict credit criteria, without loosening our credit standards. Due to these factors, we have implemented different policies for housing loans and investment property loans.

6. **Impact of lifting the negative interest rate policy: In a media interview, you mentioned that you might benefit more than other banks from the lifting of negative interest rates. If the negative interest rate policy is lifted and interest rates rise to 0%, can we assume the gross yield on monetary claims bought would increase by 10bp in a straightforward manner? Please explain your outlook given your assumptions of interest rate sensitivity.**

A very high proportion of both our types of investment assets (loans and monetary claims bought) have floating interest rates. Furthermore, the majority of our floating interest rate investment assets are based on TIBOR; only a very small portion is on a short-term prime rate basis. In other words, if negative interest rates were lifted and market rates were to rise by, for example, 10bp, the yield on our TIBOR-based investment assets, which make up the majority of our floating interest rate assets, would increase by the same 10bp. That is why we explained that our investment assets have a high interest rate sensitivity. It is worth noting that our proportion of investment assets subject to floating interest rates is 91% for monetary claims bought and 60% for loans, and the majority of these are based on TIBOR.

7. **Of monetary claims bought, trust beneficiary rights of Rakuten Card rose 26% YoY but were essentially flat QoQ. What are your thoughts on this point?**

Rakuten Card's business continues to experience high growth, even after becoming the industry leader. Its card receivables, which back the trust beneficiary rights our bank acquires to enhance liquidity, are growing steadily. The balance of trust beneficiary rights at the end of each month generally trends in line with the growth of card receivables. However, this balance can fluctuate depending on the funding situation of Rakuten Card at the end of the month and the number of days in the month. We do not believe that the trust beneficiary rights of Rakuten Card will stop growing just because the balance as of the end of June was not up significantly growth compared to the end of March. As the business of Rakuten Card itself is expanding smoothly, we expect that the balance at the end of each month will continue to grow in line with the overall expansion of Rakuten Card's business.

8. **Revisions to YCC: Housing loans are currently TIBOR-based, and I believe the shift from floating-rate to fixed-rate lending is still some ways away, but what is the level of customer interest? When the shift does occur, do you expect it to have a positive impact on your PL?**

Your understanding is correct with regard to YCC. The majority of our housing loans are floating interest rate loans, and those rates are based on TIBOR, so they are highly sensitive to interest rate changes. The current situation is that YCC has been adjusted, but there have been no changes in monetary policy with regard to short-term interest rates. Therefore, the YCC revision alone does not automatically lead to an increase in revenue from housing loans. Given this situation, there is currently very little shift from floating to fixed interest rates on housing loans. Existing customers have not been exercising the option to switch from floating to fixed interest rates, and almost all new customers are choosing floating interest rates. We doubt that many customers are so finance-savvy that they would think that long-term interest rates are likely to rise significantly while short-term interest rates remain largely unchanged. However, customers may choose a floating interest rate because switching to a fixed interest rate would cause their payment amounts to increase immediately. In other words, customers may prioritize lower immediate payment amounts over the potential future increase in interest rates. Although we do not currently see a trend towards converting to fixed interest rates, if customers were to switch, the spreads between floating and fixed rates are different, which would improve the profitability of our bank.

9. **Movement in the total deposit balance: Growth appears to be weakening for Money Bridge, but becoming stronger in other areas. What is your outlook for the future?**

We believe that the overall total deposit balance is growing steadily. The Money Bridge deposit balance rose significantly during the COVID-19 pandemic, as many customers opened accounts at both Rakuten Bank and Rakuten Securities. However, Money Bridge's rapid growth has eased since then. Overall, though, Money Bridge's deposit balance continues to grow steadily. Right now, the introduction of the new NISA program has sparked customer interest in securities companies. There are signs that this increased interest in investing may contribute to the growth of Money Bridge's deposit balance. If customers who have not previously invested much decide to open accounts with Rakuten Securities through the new NISA, they might find it convenient and beneficial to also have an account with Rakuten Bank and utilize Money Bridge. If investment funds flow into Money Bridge through these accounts, we anticipate that the growth of Money Bridge's balance will accelerate.

10. **Trends in the yield on interest-earning assets: Q1 yields seem to be up YoY, but there appears to be some seasonality. Results were strong in Q1—what are your thoughts on yields YoY?**

The key factor that significantly affects yields on interest-earning assets is the ratio of card loans. While other investment assets have yields ranging from around 0.x% to 2%, card loans have a yield of over 10%. As the ratio of card loans among investment assets increases, the yield on interest-earning assets also increases. Conversely, if the ratio of other investment assets increases, the yield on interest-earning assets decreases. Therefore, it is natural for the yield on interest-earning assets to gradually decline as investment assets expand. Taking this into consideration, we aim to gradually increase the ratio of middle-risk assets within the investment assets to help move the yield on interest-earning assets from stable to upward.