

# Who Will Bail Out Japan's Farmers? Coop Bank Meltdown After Toxic Debt Investments

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Yamada Hiroshi, a carnation grower in Shizuoka prefecture, is one of 3.2 million Japanese farmers and fishermen who depend on Norinchukin Bank for financing and support. Now the Tokyo-based bank, hit by losses on holdings backed by overseas property loans, is asking him for help.



Norinchukin has racked up at least 816 billion yen (\$8.3 billion) in realized and unrealized losses on investments in securitized products, including collateralized debt obligations, making the 85-year-old cooperative bank the

biggest loser in Asia from the credit contagion gripping the global economy. It wants its nationwide network of co-ops to come up with 1.9 trillion yen of financial support.

"It's unbelievable what's happening," Yamada, 42, said in an interview at his farm, perched on a hill overlooking the sea on the Izu peninsula, southwest of Tokyo. "The fallout isn't apparent yet, but this will take its toll."

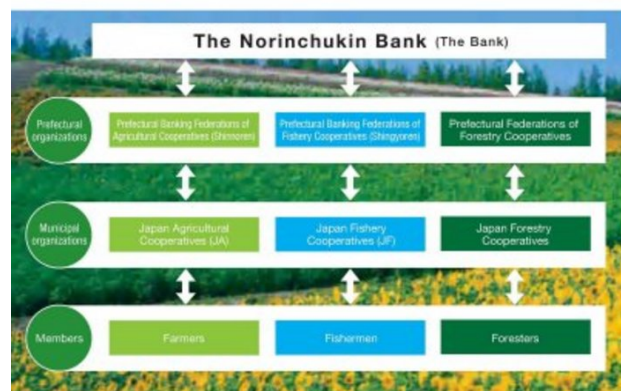
Yamada relies on his local co-op for production advice, marketing and delivery of fuel oil to heat his greenhouses. Employees haul the fuel by truck up a steep, winding road to his farm. Now, after his earnings fell 10 percent last year, he's concerned that Norinchukin will return less profit to the co-op.

More pain may be in store: the bank, which raised its bets on securitized products even after they brought down New York-based Bear Stearns & Cos. and triggered record losses at Merrill Lynch & Co., held 6 trillion yen of such investments at the end of December. Should it need more money, members may balk, threatening its ability to serve Japan's agricultural sector as the nation heads into its worst postwar economic slump.

### Agricultural Stress

"Norinchukin's large exposure to international financial markets will continue to negatively impact revenue and earnings," said Yamamoto Tetsuya, a senior analyst at Moody's Investors Service in Tokyo. "They may face pressure to raise money again, in which case it will be difficult to win acceptance, especially if they

won't pay dividends."



**Norinchukin Bank organization**

While Norinchukin plans to guarantee returns on the assets it manages for members for the next four years, the bank may not pay a dividend in 2009, Deputy President Kono Yoshio, who becomes CEO on April 1, said at a press briefing last month. That would be the first time since World War II that Norinchukin fails to pay shareholders, which include about 3,000 farm, fishing and forestry cooperatives.

Japan's farming cooperatives depend on Norinchukin to subsidize an increasingly unprofitable industry, said Yamashita Kazuhito, a former official in Japan's agriculture ministry and now a senior fellow at the Research Institute of Economy, Trade & Industry in Tokyo. Without the returns, the country's decades-old system of agricultural financing may collapse, he said.

### 'Melt Down'

"The system is going to melt down," Yamashita said.

Norinchukin spokesman Yuyama Koji said

farmers will still be supported. The bank is dispatching additional staff to help co-ops and is trying to boost car and home lending, he said.

"They shouldn't be worried," Yuyama said.

That doesn't appease Watanabe Yoshinori, a 59-year-old lobsterman in Shimoda, at the tip of the Izu peninsula, who said he has doubts about whether his co-op can maintain its level of support. The cooperative lent him 50 million yen to open a guesthouse and it also buys lobsters from him.

Watanabe said he keeps 30 million yen at Japan Post Bank, compared with 5 million yen in a co-op account, because he's concerned about losing his deposits if Norinchukin fails.

"I don't blame Norinchukin for the loss," Watanabe said. "Everyone is suffering. Even Toyota has problems."

### Appetite for Debt

Financial firms around the world have posted more than \$1.2 trillion of credit losses and writedowns since mid-2007, when the U.S. subprime collapse froze the market for securities backed by assets such as mortgages and car loans, according to data compiled by Bloomberg.

In Asia, the biggest loser may turn out to be Norinchukin, followed by Mizuho Financial Group Inc., Japan's second-largest bank by assets, which has reported 809 billion yen in realized and unrealized losses on securitized products, and Mitsubishi UFJ Financial Group Inc., the biggest lender, with 720 billion yen, Bloomberg data show.

Norinchukin's remaining investments in securitized products add up to more than twice the 2.62 trillion yen of such assets held by Mitsubishi UFJ as of Dec. 31. Among them are

2.15 trillion yen of CDOs and 1.3 trillion yen of securities backed by commercial and residential real estate loans.

## Looking Overseas

Norinchukin, founded as a government-controlled bank for the nation's cooperatives in 1923 and privatized in 1959, managed 38.3 trillion yen of deposits at the end of September. Its main banking unit, JA Bank, held 10.5 percent of all Japanese retail deposits as of September, the third-largest share, according to a report from the bank.

Charged with earning returns on those deposits in the face of near-zero interest rates and declining bond yields at home, Norinchukin began buying structured investment products overseas in 1998. The bank was under pressure to generate gains to support its members, said Otsuki Nana, an executive director and senior investment research analyst at UBS AG in Tokyo.

"It was difficult for it to meet its goals by just investing in low-return products," Otsuki said.

For years, the risk-taking paid off as the bank built up Japan's largest holdings of foreign asset-backed securities. It more than doubled net assets to 4.4 trillion yen on a non-consolidated basis in the four years ended March 2007. Net income more than tripled in the same period.

## Fannie, Freddie

International operations accounted for 75 percent of consolidated ordinary income in fiscal 2007, up from 56 percent in 2001, according to company reports. By March 2008, Norinchukin had 6.04 trillion yen in securitized products.

The bank also bought about 5.6 trillion yen of bonds issued by Fannie Mae and Freddie Mac,

the mortgage-finance companies seized by U.S. regulators in September. Norinchukin cut those holdings to 3.2 trillion yen as of Dec. 31 and posted a valuation gain of 110.7 billion yen on the investment.

The risky investment strategy contrasts with Norinchukin's image as a conservative company, said Haga Makoto, president of Tokyo-based hedge fund Wing Asset Management Co. To many Japanese, the bank is known for its sponsorship of Sazae-san, a family-oriented animated TV show that has aired since 1969.

"The bank has a crusty image," Haga said. "Yet, it's a risk-taker."

## Raising Bets

When the market for asset-backed securities started to collapse in 2007 amid a surge in U.S. subprime mortgage defaults, Norinchukin didn't flinch.

The company said in October 2007 that it would further boost investments in asset-backed securities because price declines made them attractive. Futaoka Toshiyuki, Norinchukin's former global head of strategic asset allocation, said at the time that the bank aimed to increase such holdings, including debt backed by credit cards and auto loans in the U.S. and Europe, by about 3 trillion yen.

After Bear Stearns collapsed and was sold to New York-based JPMorgan Chase & Co. in March 2008, Norinchukin raised its holdings of securitized products by about 782 billion yen to 6.82 trillion yen over the next six months, company reports show.

Norinchukin didn't expect the credit crisis to be as severe as it has been, said Yuyama, the company's spokesman.

Norinchukin posted a 186.9 billion yen loss for

the year ended March 2008 from its holdings of assets such as subprime-backed securities. Even with the loss, the company reported a 7.8 percent increase in full-year consolidated net income, and Hirofumi Ueno, who's stepping down as CEO at the end of the month, said he didn't expect further subprime losses.

## Buying Binge

Japan's Asahi newspaper reported in July that Norinchukin bought 500 billion yen of securitized products from New York-based Citigroup Inc., which by then had disclosed more than \$42 billion of credit losses and writedowns. The purchase was initiated in January 2008 and included debt instruments for credit card and auto loans, the report said, citing unidentified Norinchukin officials.

Norinchukin's Yuyama declined to comment on the report.

Moody's cut the outlook for Norinchukin's Aa2 credit rating to "negative" in November because of the bank's "increasing impairment risks due to its relatively large exposure to foreign securitized financial products."

## Mounting Losses

That month, the bank booked another 81.5 billion yen of losses on securitized products in the fiscal first half ended Sept. 30, causing net income to plummet more than 90 percent in the period, while unrealized losses on the investments widened by 70 percent to 758.4 billion yen. The company cut its full-year pretax profit forecast to 100 billion yen from 350 billion yen and said it would need to raise capital.

In December, Standard & Poor's cut its bank fundamental strength rating on Norinchukin by one grade to C+, citing "material" pressure on capital. Norinchukin's consolidated Tier I capital-adequacy ratio under Basel II

standards, a key measure of financial strength, dropped to 6.83 percent as of Dec. 31 from 9.39 percent on March 31.

On Feb. 20, as Norinchukin asked its members for 1.9 trillion yen to boost the capital ratio, CEO Ueno said the company may post a full-year loss and announced he would resign effective March 31 to take responsibility. Kono, his replacement, said executives at the company would take a 20 percent pay cut.

## 'Huge' Portfolio

While Norinchukin's Yuyama said the bank isn't considering raising more funds, UBS's Otsuki said the worst may not be over.

"The bank's portfolio is huge," she said. "If the market deteriorates further, it may possibly need to raise more capital."

Norinchukin's crisis comes as Japan heads for its worst recession in six decades. Gross domestic product shrank at an annual 12.1 percent pace during the final three months of 2008 as the stronger yen and recessions in the U.S. and Europe stifled demand for Japanese exports, which plunged by a record 45.7 percent in January.

The nation's farming and fishing industries also have been in decline. Agriculture receipts, excluding forestry and fisheries, fell to 8.3 trillion yen in 2006 from 11.5 trillion yen in 1990, according to the agriculture ministry.

Yamada, the carnation farmer, said his business is being squeezed by the strengthened yen, which is driving down prices for imported flowers. Earnings at his company, which grows about 600,000 carnations a year for the domestic market, fell about 10 percent last year, Yamada said.

## 'Social Climber'

Norinchukin lost sight of its core mission of supporting and developing Japanese agriculture, he said.

“They became a social climber,” said Yamada. “They’ve got to go back to basics.”

That may not be an option, according to Yamashita, the former agriculture ministry official. The declining farm economy and a shrinking and aging rural population mean Norinchukin can’t go back to its roots, he said.

“They have no outlet in the domestic market,” he said.

The number of full-time farmers in Japan fell to 2 million last year from 3.7 million in 1985, according to the agriculture ministry. The number of fishermen was 204,330 in 2007, down from 325,000 in 1993. Another 1 million people rely on agriculture as their primary income source, according to government data.

More than half of farmers’ income in Japan is attributable to government support, including price supports and import barriers, according to the Organization for Economic Cooperation and Development.

## Agricultural Reform

With the farming and fishing industries unable to count on dividends and returns from Norinchukin, pressure may build to reform agricultural policies to make them more efficient and competitive, said Yamashita, who advocates such reforms.

Reforms may include dismantling the current nationwide cooperative model in favor of smaller, independent organizations, he said.

Moody’s Yamamoto also said Norinchukin’s subprime damage raises questions about its future ability to offer financial incentives, services and support to its members.

“There is a possibility that the importance of Norinchukin as a central institution for Japan’s agricultural, forestry and fishery cooperatives could be reduced,” he said. “If so, it would be a trigger for a ratings downgrade.”

Serita Satoru, head of management planning at JA Ceresa Kawasaki, a farm cooperative with 48,000 members and 1.15 trillion yen in deposits, said he’s already considering how to make the co-op less dependent on Norinchukin.

## ‘Without Thinking’

The Kawasaki-based cooperative hands about two-thirds of its funds to a Norinchukin unit and manages the rest on its own, investing in securities, including Japanese government bonds.

“We just put money into Norinchukin every year without thinking about it,” said Serita, 57. “Yet Norinchukin has become a risk. Now, we all have to think about how each co-op can run its business in an independent manner.”

Yamamoto Noritaka, a branch office manager at the JF fisheries cooperative in Izu, said co-ops can’t be expected to prop up the bank.

With the economy and fish stocks declining, marine cooperatives are struggling, said Yamamoto, 56. His co-op hasn’t given its officials a pay raise or bonus in at least four years and cut staff by five positions to 33 last year, Yamamoto said.

“If Norinchukin asks its regional banking units to inject capital into the bank, the units will ask cooperatives to invest money,” Yamamoto said. “I don’t think we’ll do so. We can’t afford to.”

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