

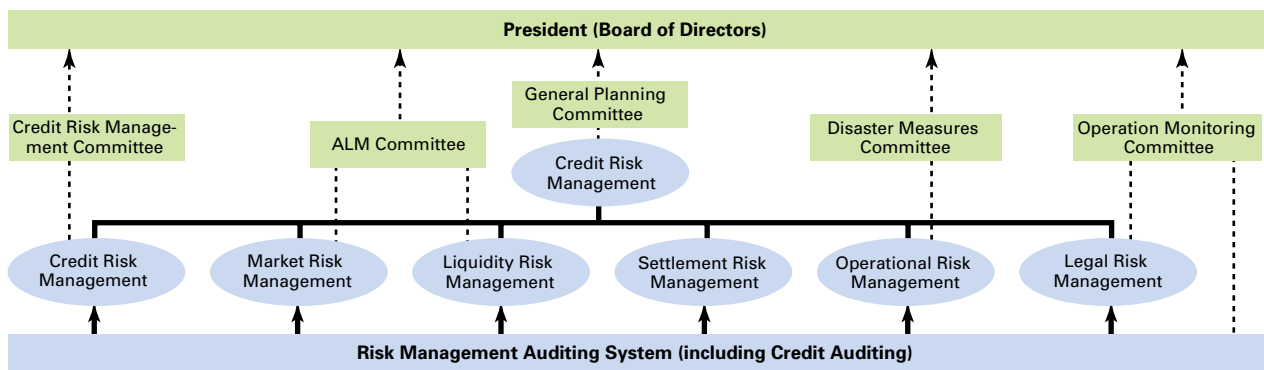
RISK MANAGEMENT

There has been a considerable increase in the diversity and complexity of the risk factors facing financial institutions, including credit risk, market risk, liquidity risk and operational risk. These changes in the risk environment reflect the liberalization and internationalization of the financial sector, advances in financial technology, and the impact of the “Japanese Big Bang” financial reform package, which is now entering its final stages. Financial institutions need to manage these risks appropriately so that they can maintain their financial soundness while responding to the increasingly diverse

and sophisticated needs of their customers.

The Shoko Chukin Bank has strengthened its risk management systems by establishing departments responsible for the management of specific types of risk. Overall risk management is provided by the General Planning Division, which constantly monitors the other departments to ensure that risk management procedures are being implemented properly. The result is a robust and comprehensive risk management structure that provides total monitoring of the Bank’s risk exposure.

Risk Management Structure



Credit Risk Management

The Shoko Chukin Bank bases its credit risk systems on expertise gained through many years of experience in working with SMEs. It is working to maintain and improve the quality of its loan assets by setting appropriate lending criteria and by ensuring that screening systems are properly applied.

Individual loan applications are screened under various criteria, including the appropriateness of business and financing plans, repayment prospects and security, as well as the future potential of the enterprise concerned. Each proposal is considered from a comprehensive range of perspectives, including the business and financial situations of cus-

tomers, the quality of their management and the standard of their technology.

Lending in new areas of activity, such as venture businesses, is subject to screening by the New Business Screening Committee. The Committee includes outside members with specialist knowledge and experience relating to industry trends, technology evaluation and other aspects. Furthermore, the Shoko Chukin Bank uses self-assessment procedures to control and monitor credit risk. It has also introduced a 10-tier credit system based on its self-assessment criteria. This highly detailed system allows the Bank to assess the creditworthiness of SMEs using the most appropriate set of financial indicators selected from

the many indicators available. The Shoko Chukin Bank's extensive experience of lending to SMEs is reflected in the system, which is designed to eliminate arbitrary decision-making by basing qualitative assessment on a uniform scoring system.

Credit screening is carried out by the Credit Group, which consists of Credit Divisions I, II and III and the Credit Data Monitoring Department. To ensure appropriate screening and control, the credit screening organization is completely independent from business divisions. The Shoko Chukin Bank is constantly working to maintain and improve the quality of loan assets.

Overall credit risk management is coordinated by the Co-operative Finance Planning Division, which monitors credit screening and credit portfolios and works to enhance credit risk systems. At senior management level, the Credit Risk Management Committee analyzes credit portfolios from various perspectives, including creditworthiness and industry sectors. The aim of this committee is to maintain and improve the soundness of assets, mainly by distributing risk. Credit rating and self-assessment techniques are being used to develop increasingly sophisticated approaches to risk quantification and management.

Employee training systems include programs designed to maintain and improve the credit screening abilities of all employees at all levels.

Market Risk Management

Advances in financial technology, including the development of derivatives, and the expansion of market transactions have increased the exposure of financial institutions to a variety of market risks, including fluctuations in interest rates, exchange rates and share prices.

The Shoko Chukin Bank's approach to risk management in this area is defined in the Basic Policy on Market Risk Management. This clarifies the organizational structures, authority chains and management methods involved in the management of market risk and liquidity risk. This risk management structure complies with guidelines published by the Japanese financial authorities, and with the accounting standards for financial products, which are based on market price accounting.

• Asset and Liability Management (ALM)

The Shoko Chukin Bank uses funds raised primarily through long-term fixed-interest loans and 5-year interest-bearing debentures to provide a variety of financing services. Mismatching between the terms over which funds are raised and invested is a source of risks, including interest rate risk.

To maintain reasonable levels of income while managing these risks appropriately, the Shoko Chukin Bank uses a variety of asset and liability management (ALM) techniques. Assets and liabilities are analyzed from various perspectives, and swaps and other instruments are used to ensure integrated management of both off-balance-sheet and on-balance-sheet assets and liabilities.

The ALM Committee, which is made up of senior management, meets each month to set policies designed to control the level of risk and balance risk against income. The Committee takes into account the state of the economic and financial environment, the interest rate outlook, and the overall level of market risk affecting the Bank's on-balance-sheet and off-balance-sheet transactions.

• Market Business Operations

Market operations, including derivative transactions, play an important role in the control of ALM risk,

and in the provision of various financial services to customers. There are two categories of market operations. First there are banking operations relating to asset and liability management under the Bank's basic market risk management policy. Second, there are trading operations. The ALM Committee regularly monitors banking operations according to risk tolerances, and trading operations according to risk limits that determine the maximum allowable loss. All operations are regularly monitored to ensure that these policies are being applied properly. The Shoko Chukin Bank uses trading operations primarily to meet the market transaction needs of its customers.

The Shoko Chukin Bank has established a system of reciprocal checking between front office departments, which are responsible for implementing transactions, and back office departments, which handle administrative tasks. In March 1998 it further strengthened the risk management structure by establishing a specialist department, the Market Risk Management Department to play a "middle office" role.

The Market Risk Management Department monitors, quantifies and manages market risk using integrated risk management indicators, including delta and value at risk. In addition, it constantly monitors operations to ensure that the risk limits established by the ALM Committee are being applied properly. The Department reports regularly to senior management.

Managing Operational Risk

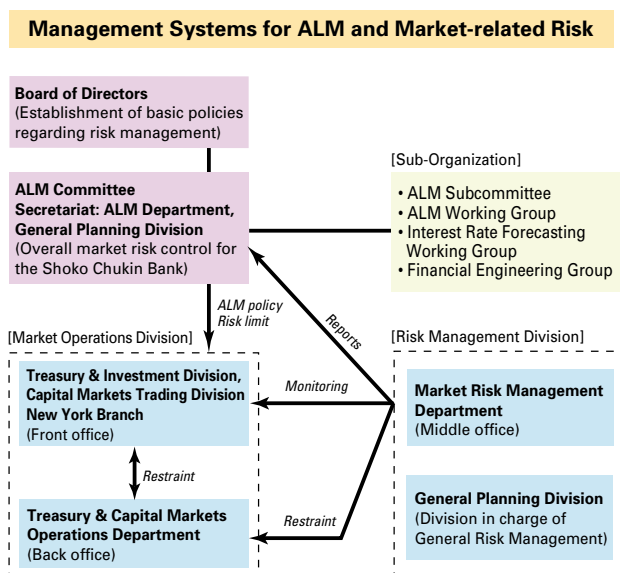
The definition of operational risk encompasses administrative risk, system risk and information security risk. The Operations & Systems Planning Division is responsible for the management and minimization of this type of risk.

The Shoko Chukin Bank is working to reduce administrative risk by introducing mechanized processing for the increasingly diverse range of products handled, and by using sophisticated auditing systems. It also provides in-depth employee education.

System risk is managed through efforts to ensure the stable operation of computer systems. Countermeasures include system redundancy, the establishment of back-up centers, and the implementation of breakdown drills.

The Shoko Chukin Bank has a basic policy, specific criteria and administrative procedures concerning countermeasures against information security risk. To ensure an appropriate response, risk is classified according to such factors as importance of specific information assets, including information and information systems.

The Bank's contingency plans set clear operational priorities, starting with the safety of customers and employees, in the event of a disaster or other emergency.



Internal Auditing Systems

The importance of internal control systems to avoid losses is increasing with the growing complexity and sophistication of financial transactions. Internal control systems are also an effective way to ensure that operations are being implemented efficiently and effectively in accordance with the directions set by management. The Shoko Chukin Bank has established an effective internal auditing system based on the Credit Examination Division and the Inspection Division, which operate independently of all other head office sections. These two divisions monitor the Bank's internal management systems.

The Inspection Division verifies the effectiveness of internal management systems by inspecting the operations of branches and head office departments, and by auditing computer-related systems. These inspections cover a number of perspectives, including compliance with laws and internal regulations, the effectiveness of reciprocal checking systems based on internal inspections at the department and branch levels, and the adaptation of internal regulations to environmental change. The aim of these inspections is to improve operations and prevent problems.

The task of the Credit Examination Division is to audit credit management procedures to ensure that self-assessment is being applied properly, and that credit ratings are accurate. In addition to these internal audits, the Shoko Chukin Bank has also introduced auditing by an external audit corporation.

In fiscal 2000, the Shoko Chukin Bank established the Operational Audit Committee. Its task is to discuss measures to improve operations and tighten compliance, based on the results of these internal audits.

Compliance Systems

As a policy-based financial institution, the Shoko Chukin Bank plays an important role in society. It therefore has a special obligation to earn the confidence of the public by ensuring fairness and propriety in the implementation of its activities.

The Bank is also required to comply with numerous laws and rules, including the Organized Crime Act of February 2000, the Law Concerning the Sale, etc., of Financial Products, which was promulgated in April 2001, and the Law Concerning the Promotion of Procurement of Environmentally-Friendly Products by the Government, etc., which became fully effective in April 2001. We therefore place considerable importance on the development and enhancement of compliance systems to ensure full compliance with all requirements.

- **Establishment of Coordinating Organization**

The General Co-ordinating Division has been designated as the organizational structure responsible for ensuring compliance through coordination of compliance-related matters. The Division has the tasks of planning and managing basic aspects of compliance. It is working closely with other divisions to develop a compliance structure for the Shoko Chukin Bank.

- **Appointment of Compliance Officers and Establishment of Checking System for Internal Rules**

Compliance officers have been appointed in each head office division. When internal rules, which are essential for the performance of the Bank's operations, are created or amended, these people ensure that the rules comply with laws and regulations. They also compare the Bank's rules with accepted social norms. When necessary they seek advice from the relevant departments or outside experts and consult with the General Coordinating Division.