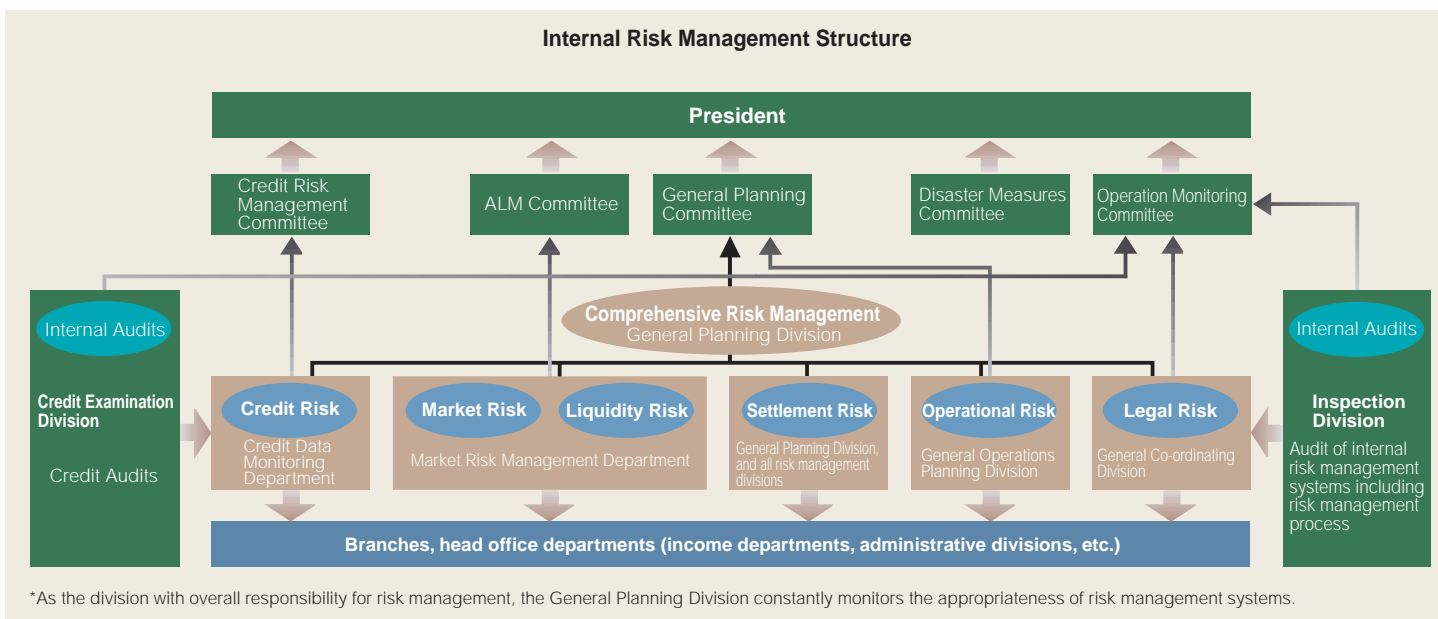


System to Ensure Proper Operations

Risk Management

Financial institutions are exposed to diverse and complex risk factors such as credit risk, market risk, liquidity risk and operational risk. This reflects the liberalization and internationalization of the financial sector, and advances in financial technology. It is critical for financial institutions to manage these risks appropriately in order to maintain their financial soundness while responding to the increasingly diverse and sophisticated needs of their customers.

In response to this environment, the Bank has strengthened its risk management systems by identifying departmental responsibility for the management of specific types of risk. Overall risk management is the responsibility of the General Planning Division, which constantly monitors the other departments to ensure that risk management procedures are being implemented properly, and works to improve and strengthen comprehensive risk management functions, including comprehension and management of overall risk.



Definitions of Risk

Credit Risk

The risk of loss due to the reduction or elimination of asset value due to such factors as deterioration in the financial position of the borrower.

Market Risk

The risk of loss resulting from fluctuations in asset values due to shifts in interest rates, exchange rates, or the prices of securities.

Liquidity Risk

The risk that cash flows will become insufficient due to the inability to secure the required funds (cash flow risk), and the risk that market transactions will become impossible due to market disruptions (market liquidity risk).

Settlement Risk

The risk of loss resulting from failure to settle by the due date

(categorized into credit risk, liquidity risk, operational risk and legal risk, according to the cause and characteristics of the problem).

Operational Risk

Operational risks are the risk of loss by financial institutions resulting from a failure, accident or fraud of management or staff (administrative risk), the risk of loss by financial institutions due to computer system failures, errors, and inadequacies (system risk), and the risk of loss due to serious threats such as leaks, fraudulent use, erroneous operations, and deliberate acts to the validity and reliability of essential information assets (information security risk).

Legal Risk

The risk of loss resulting from legal uncertainty about transactions or failure to comply with laws and regulations.

Credit Risk Management

The 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, such as the appropriateness of business and financial plans, repayment prospects, and collateral, 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 customers, the quality of their management, and the level of their technological skills.

Lending to venture businesses is subject to screening by the New Business Screening Committee. The Committee consists of outside members with industry expertise and the Bank's staff members who have skills in evaluating technology and knowledge of trends in specific industries.

Furthermore, the Bank uses self-assessment procedures to control and monitor credit risk. It has also introduced a 12-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 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. To ensure appropriate screening and control, the credit screening organization is completely independent from the branch banking division. The Bank is constantly working to maintain and improve the quality of its loan assets.

Overall credit risk management is coordinated by the Credit Data Monitoring Department, 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.

Employee training programs are designed to hone the credit screening skills of all staff at different levels.

Market Risk Management

Advances in financial technology such as 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 Bank's approach to risk management in this area is defined in the Basic Policy on Market Risk Management. This policy defines the organizational structures, commissions, and managing methods as it relates to the management of market and liquidity risk. This risk management structure complies with guidelines published by Japanese financial authorities and with the Accounting Standards for Financial Instruments, also known as mark-to-market accounting.

Asset and Liability Management (ALM)

The Bank uses funds raised primarily through long-term fixed-interest loans and five-year interest-bearing debentures to provide a variety of financing services, and a discrepancy between the terms over which funds are raised and invested causes an interest rate risk.

To maintain reasonable levels of revenue while managing these risks appropriately, the 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 on- and off-balance-sheet assets and liabilities.

The ALM Committee consists of senior management and meets every month to set policies to balance risk level with the pursuit of profit. 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- and off-balance-sheet transactions.

The Bank utilizes the following ALM management methods to measure interest rate risk, an important element of market risk.

1. Delta Analysis

This method provides an integrated measurement of interest rate risk in terms of changes in asset and liability values resulting from interest rate volatility.

(Delta = 10 basis point value)

Delta analysis can also be used to monitor interest rate risk for each calculation period on the basis of grid point sensitivity.

2. Simulation Analysis

The Bank monitors medium-term period losses and gains and trends in the market values of assets and liabilities by combining its plans for the procurement of funds through loans, debentures and other means, and interest rate forecasting scenarios.

is classified based on such factors as importance of specific information assets, which includes both information itself and information systems.

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

Improvement of Internal Auditing Systems

The importance of internal control systems to avoid losses is increasing with the growing complexity and sophistication of financial transactions. Internal auditing 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 Inspection Division and the Credit Examination Division, which operate independently of all other head office sections, monitor the Bank's internal management systems and conduct internal audits to ensure the effectiveness of internal controls.

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 rules 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, write-offs and reserves are appropriate, and credit ratings are accurate.

In fiscal 2000, the Bank established the Operation Auditing Committee. Its task is to discuss measures to improve operations and ensure compliance, based on the results of these internal audits.

The Bank is not subject to the statutory audit requirements set down in the Securities and Exchange Law and the Commercial Code Special Exception Law. However, it has commissioned ChuoAoyama Audit Corporation to review its self-assessment of loans and other assets and its accounting procedures for financial instruments.

Compliance Systems

As a public financial institution, the Bank fulfills an important role in society and has a special obligation to earn the confidence of the public by carrying out its activities fairly and appropriately. The Bank's operations must comply with all laws, regulations and rules. It ensures accountability by disclosing information and maintaining a high standard of transparency in its operations.

Reinforcement of compliance systems is an ongoing priority for the Bank. For example, it has developed a solicitation policy

based on the Law Concerning the Sale of Financial Products, which took effect in April 2001, has established procurement systems that comply with the Law Concerning the Promotion of Procurement of Environment-Friendly Products by the Government, which became fully effective in April 2001 and discloses information according to the Law Concerning Disclosure of Information Held by Public Independent Administrative Institutions enacted in October 2002.

The Meaning of Compliance

Compliance does not just mean strict observance of laws, regulations and rules, but also conformance with accepted social norms.

Thorough Awareness of the Importance of Compliance

The Bank is working to increase awareness of the importance of compliance among its management and staff. For example, the president regularly emphasizes the Bank's commitment to full compliance at branch manager meetings.

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 Bank.

Specific Compliance Initiatives

A compliance handbook has been published to thoroughly instill awareness of compliance-related issues in management and staff.

Compliance Officers have been appointed in every branch, and liaison and reporting systems have been established between the coordinating organization, head office and branches.

Group training programs and branch-level training programs have been established.

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 officers 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 Co-ordinating Division.

Compliance Inspections

Head office divisions and branches are required to conduct their own internal compliance audits. Our Inspection Division, which is independent from other head office divisions, also conducts thorough compliance inspections of head office divisions and branches.