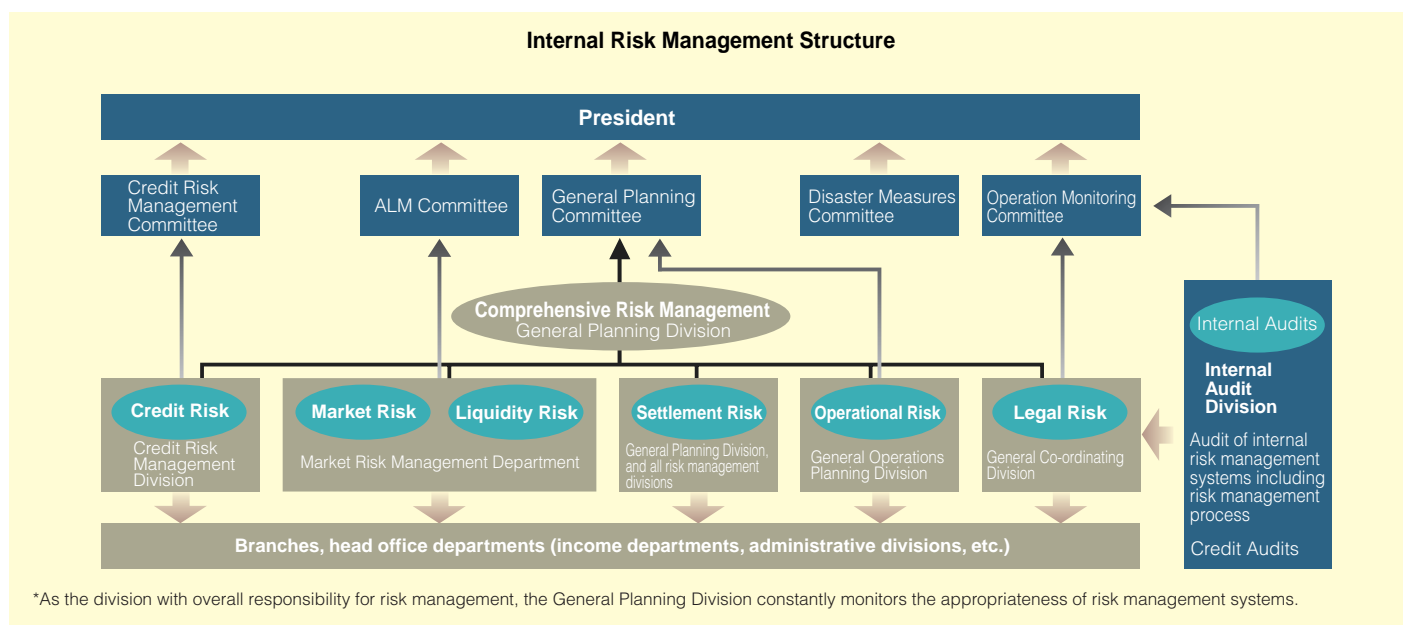


# System to Ensure Proper Operations

## 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

Based on expertise gained through many years of experience in working with SMEs, the Bank's credit risk management system is designed to maintain and improve the soundness of its loan assets by setting appropriate lending criteria and ensuring that screening systems are properly applied.

### Credit Risk Management System

The Credit Data Monitoring Division is responsible for coordinating overall risk management throughout the Bank and works to enhance the credit risk management system by monitoring credit portfolios and quantifying risk. At senior management level, the Credit Risk Management Committee analyzes credit portfolios from various perspectives, including credit rating, business sector and geographical region, as it aims to distribute risk as a means of maintaining and improving asset soundness.

Credit screening is the responsibility of the Credit Group, which consists of Credit Divisions I, II and III and is complete independent of the Branch Banking Division. The Credit Group works to maintain and enhance the soundness of the Bank's loan assets through appropriate screening and management. In fiscal 2003, the Bank set up the Department for Business Restructuring to provide customers with better support for management improvement and revitalization.

### Screening

Individual loan applications are screened under various criteria, such as the viability of business and financial plans, repayment prospects, and coverage by 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, their management quality and their technological skill levels. In screening loans to venture firms and other original, new businesses, the Bank draws on its own expert knowledge of sectoral trends and technology evaluation skills as well as the talents of the New Business Screening Committee, which includes outside specialists and people of experience and academic standing.

Furthermore, the Bank implements asset self-assessments to identify and control credit risk in an appropriate manner, and has introduced a 12-tier credit rating system based on self-assessment criteria. Out of the many financial indicators available, this credit rating system uses those that are most appropriate for assessing the creditworthiness of SMEs. 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. Employee training programs are designed to maintain

and enhance the credit screening skills of all staff at different levels.

## Market and Liquidity Risk Management

The Bank has laid down basic policies on market and liquidity risk management which define organizational structures, authority and management methodologies and form the basis of strict operational management and control.

### Risk Management Structure

In the area of market operations, the Bank has established a system of checks and balances between the front office departments, which execute transactions, and the back office departments, which handle administrative tasks. It has also established the Market Risk Management Department as a middle office specializing in managing market risk. Once the ALM Committee has deliberated and reached a decision on important matters pertaining to market and liquidity risk, the Market Risk Management Department identifies, quantifies and manages this risk while monitoring market operations on a daily basis to ensure strict compliance with risk limits. It reports to senior management on a regular basis. This risk management scheme complies with the risk management guidelines published by the Japanese financial authorities, and "Accounting and Auditing Treatment of the Application of Accounting Standards for Financial Instruments in the Banking Industry" (JICPA Industry Audit Committee Report No. 24).

### Asset/Liability Management (ALM)

To secure stable earnings while managing market and liquidity risk appropriately, the Bank analyzes assets and liabilities from various perspectives and uses swaps and other instruments in integrated ALM of its overall assets and liabilities both on and off the balance sheet. More specifically, the ALM Committee meets each month to set policies for controlling risk exposures while maintaining a balance with profit. It bases these policies on the economic and financial environment, the interest rate outlook, and the overall level of market risk to which the Bank is exposed through transactions on and off the balance sheet.

The Bank employs the following methodologies to measure interest rate risk, an important element of market risk.

#### (1) Delta Analysis

Delta analysis provides integrated quantification of the interest rate risk "delta" in terms of the changes in the market values of assets and liabilities that arise from interest rate fluctuations. Delta analysis can also be used to identify interest rate risk for each calculation period on the basis of grid point sensitivity.

#### (2) Simulation Analysis

The Bank identifies medium-term period losses and gains

and trends in the market values of assets and liabilities by combining its operating plans for fund procurement through loans, debentures and other means with interest rate forecasting scenarios.

### Market Operations

The Bank engages in market operations, including derivative transactions, with a view to providing customers with a variety of financial services and controlling the risks referred to above in the section on ALM. Market operations are classified into banking operations associated with ALM, and trading operations, and managed accordingly. The Bank uses trading operations primarily to meet customers' market transaction needs.

### Operational Risk Management

The General Operations Planning Division is responsible for managing and minimizing operational risk, which is defined as administrative risk, system risk, and information security risk.

The Bank is endeavoring to reduce administrative risk by preparing an office manual that clearly stipulates how each operation should be handled. Head Office also provides operational guidance and in-depth education for management and employees, and is installing various types of office equipment with a view to reducing errors.

System risk is managed through efforts to ensure the stable operation of computer systems by building in system

redundancy, establishing back-up centers, and carrying out breakdown drills.

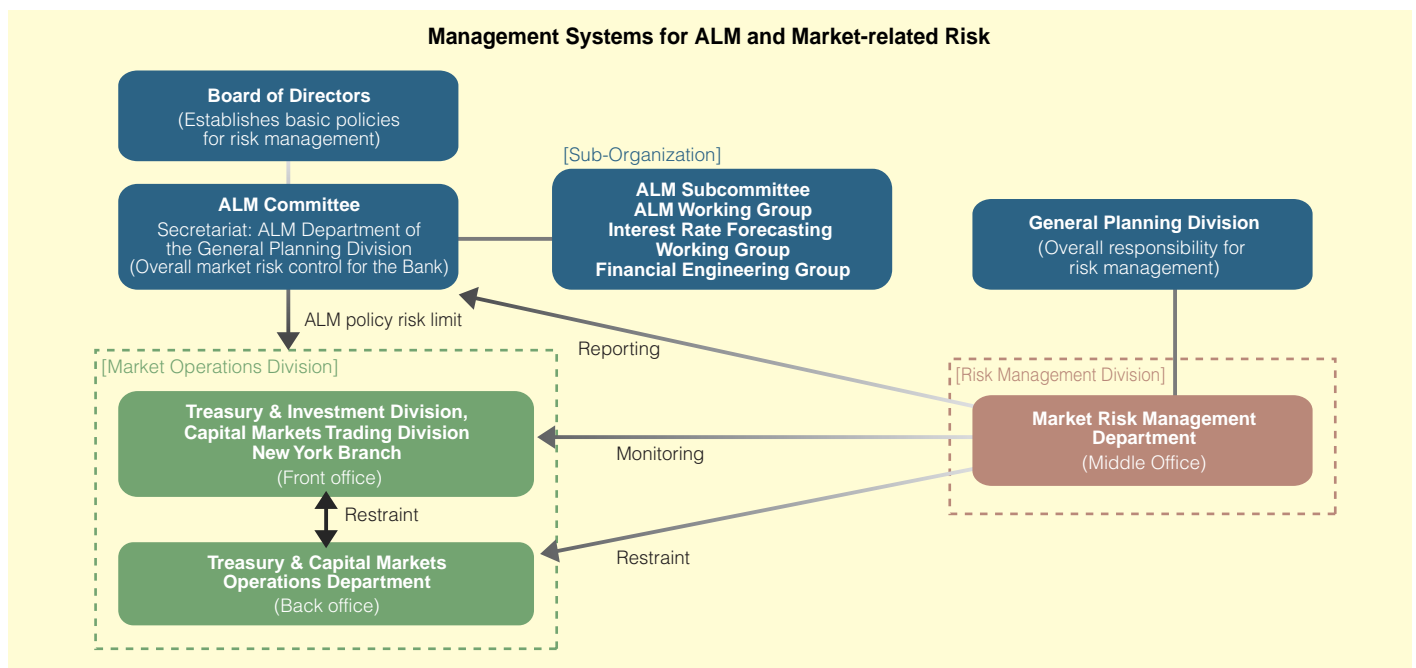
In the area of information security, the Bank has formulated countermeasures against information security risk, specific criteria and administrative procedures, and is endeavoring to devise appropriate responses using classifications and risk evaluations according to the importance of Bank information assets, including 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 disasters or other emergencies.

### Improvement of Internal Auditing Systems

The growing complexity and sophistication of financial transactions means that internal control systems play an increasingly important role in avoiding losses. Internal auditing systems also play a vital role in monitoring whether operations are being implemented efficiently and effectively in accordance with the directions set by management. The responsibility for auditing the Bank's internal management systems to ensure that internal controls are functioning effectively falls to the Internal Audit Division, which operates independently of all other head office sections.

Operational audits verify the effectiveness of internal management systems by inspecting the business operations of branches and head office departments, and auditing computer-



related systems. These inspections are designed to further improve operations and prevent problems, and seek to confirm whether operations are in compliance with laws and internal regulations, whether the checks and balances inherent in self-audits at the department and branch levels are functioning as expected, and whether internal rules are adapting to environmental change.

Asset audits look into whether self-assessments, write-offs and reserves are appropriate, and whether credit ratings are accurate.

The Operation Monitoring Committee discusses the results of these internal audits and determines measures to improve business operations and ensure that compliance is rigorously observed.

The Bank is not subject to the statutory audit requirements set down in the Securities and Exchange Law and the Law Concerning Special Exceptions to the Commercial Code Concerning Audit, Etc. of Joint-Stock Corporations (Kabushiki Kaisha). However, it has commissioned ChuoAoyama Audit Corporation to review its self-assessment of loans and other assets and its accounting procedures for financial instruments. The Bank will introduce financial audits from fiscal 2004.

## Compliance Systems

Ensuring full compliance is one of the key issues facing the Bank because of its considerable public responsibilities as a government-affiliated financial institution and its obligations to fulfill its duties fairly and earn the confidence of society.

In all its business operations and other activities, therefore, the Bank must comply with all laws, regulations and social norms, use disclosure to fulfill its obligation of accountability, and maintain a high degree of transparency.

## 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. The Bank has also prepared and distributed to all employees a compliance handbook as a practical guide to the laws and ordinances that must be observed in the pursuit of business activities, and to dealing with problems that may arise. Further efforts to ensure compliance include group training programs and branch-level training programs.

## Compliance Structure

### (1) Operation Monitoring Committee

The Bank has established the Operation Monitoring Committee under the chairmanship of the Deputy President to serve as an organ for discussing compliance-related matters. Each organizational unit presents a report on the status of its compliance activities to the Committee, which then considers approaches to improving the compliance system.

### (2) Compliance Coordination Division

The General Coordinating Division has been designated as the organizational structure responsible for planning and managing basic aspects of compliance, and is working closely with other divisions to develop a compliance structure for the Bank.

### (3) Compliance Managers and Compliance Officers

Head office divisional managers and branch managers have been deployed as compliance managers and head office personnel have been deployed as compliance officers to ensure maximum levels of compliance. In addition to checking whether employees contravene laws and regulations as they go about their daily work, they provide guidance and training for employees where necessary. In cases where head office divisional compliance officers draw up or amend internal regulations, they are examined to ensure that their contents comply with laws, ordinances and rules and pose no problems from the viewpoint of social norms. Where necessary, external experts are consulted.

### (4) Compliance Inspections

Head office divisions and branches are required to conduct their own self-assessments to ensure thoroughgoing compliance.

The Internal Audit Division, which is independent of other head office divisions, also conducts thorough compliance inspections of head office divisions and branches. Reports on the results of audits are submitted to the Operation Monitoring Committee.

## Compliance Structure

