



Message from the President

On behalf of the Shoko Chukin Bank, I would like to take this opportunity to thank all of our stakeholders for their continued support and understanding.

We sincerely apologize for causing a great deal of inconvenience and concern to our customers and the people, concerning fraud in confirming requirements for crisis response measures.

Following the occurrence of this case, we established a third-party committee on December 12, 2016, and received the results of investigations, suggestions, etc. on April 25, 2017. Furthermore, we received an administrative punishment as of May 9, 2017 from the competent ministries, pursuant to Article 59 of the Shoko Chukin Bank Limited Act and Article 24 of the Japan Finance Corporation Act. Based on the order, we submitted plans to improve operational processes and operations on June 9, 2017.

<Summary and the Bank's realization>

In implementing crisis response measures, the Bank confirms that customers fulfill requirements for loans appropriate for crisis response measures, such as “a temporary decrease in sales and/or other aggravation of the business situation due to the impact of crisis,” based on trial balances and other documents submitted by the customers. However, some employees falsified such trial balances and other documents by replacing or changing figures and/or dates.

With regard to the causes of the occurrence of this case, we realize that the following are particularly important:

- 1) Inadequate awareness of the risk of fraud led to insufficient management structures, as illustrated by the shortcomings in the procedures designed to prevent fraud.
- 2) The allocation of the budget for crisis response measures, set aside in preparation for emergency, was incorporated into the performance assessment of branches meant that the administration could not be carried out strictly in accordance with the aim of

the government's measure, resulting in excessive pressure from the headquarters to the field, while the awareness of the importance of compliance was insufficient.

- 3) Failure in taking sufficient recurrence prevention measures despite having the chance to identify fraud in the past at Ikebukuro Branch.

<Administrative punishment>

The details of the administrative punishment we received on May 9 are as follows:

- 1) Investigations will continue of all crisis-response loans that have yet to be investigated, along with checks conducted by outside experts to ensure proper objectivity, and the results of these investigations and of those conducted by the third-party committees will be utilized to identify problems and their root causes.
- 2) For the present, the following approaches should be implemented immediately to ensure the appropriate administration of the crisis-response loans: clarify administrative arrangements and establish/improve business management systems to address the promotion of the suitable performance of operations and compliance; foster the awareness of the importance of compliance throughout the entire organization; and establish operational processes that take into account the risk of fraud in order to ensure the appropriateness of operations.
- 3) For matters not corresponding to the requirements for crisis-response loans, procedures should be properly and promptly carried out to avoid detrimental effects on business partners through transfers to other loans, etc., and suitable measures such as cancelling guaranty insurance agreements with Japan Finance Corporation should be implemented, and the interest rate compensation already paid should be promptly refunded to Japan Finance Corporation.

The order states that operational processes pertaining to 1) and 3) above as well as plans for the operation improvement pertaining to 2) that should promptly

implemented for the time being are to be submitted and then promptly implemented.

It is also mentioned in the order that new administrative actions may also be considered to establish/improve structures of compliance, business management, and internal control in view of the problems and root causes, etc., identified under the order.

<Plans for improvement of operational processes and operations under the order>

The details of the plans for improvement of operational processes and operations, submitted on June 9, are as follows:

- 1) With regard to operational processes of continuing investigations, we will continue investigations of all accounts that have yet to be investigated, after ensuring proper objectivity, and these investigations are expected to be completed at the end of September 2017. In parallel with these investigations, we will also work on identification of problems and their root causes.
- 2) The details of the plans for the operation improvement that should be promptly implemented for the time being are as follows:
 - i) To clarify administrative arrangements and establish/improve business management systems, the Bank established a Reform Headquarters under the direct control of the President and Representative Director. Also, we upgraded Compliance Meetings and Internal Auditing Meetings to Management Meetings, which are chaired by the President, and invited external directors and external Audit and Supervisory Board Members to enhance the governance structure. Furthermore, we will exclude crisis response measures from the framework of performance assessment and work on efforts such as a review of performance assessment in a bid to establish a structure to appropriately conduct business from a customer-first standpoint.

- ii) To foster awareness of the importance of compliance throughout the entire organization, the Bank will improve compliance training for all employees both in quality and quantity and carry out training continuously.
 - iii) To ensure appropriateness of operations based on risk of fraud, the Bank changed administrative procedures to make management-level employees confirm authenticity of evidences, including trial balances, in confirming requirements for crisis response measures. In addition, we established a Crisis Response Measures Management Department at the Headquarters and enhanced control by shifting to a structure under which prior consultation and post audit are conducted for all individual cases.
- 3) With regard to operational processes of matters not corresponding to the requirements, we will properly and promptly carry out procedures to avoid detrimental effects on customers. Also, we will properly and promptly refund the interest rate compensation already paid, to Japan Finance Corporation (The portion identified by the third-party committee has already been refunded.)
- Under the Reform Headquarters, which is under the direct control of the President, we will first disclose the whole picture by identifying problems and their root causes based on the results, etc. of the said investigations, and then quickly work on taking necessary measures with all our might, including formulation of drastic recurrence prevention measures and clarification of responsibility among the executives and employees. We will do our utmost to win back the trust of our stakeholders by going back to the starting point and quickly and steadily carrying out the operation improvement plans. We would appreciate your understanding.

Financial and Economic Environment

The Japanese economy in Fiscal 2016 saw a sense of stagnation in movement toward recovery in the first half of the fiscal year due to the slowdown in overseas

economies and volatility in financial markets. In the second half, there was a trend toward improvement reflecting recovery of overseas economies and improvement in consumer sentiment.

According to the Shoko Chukin Bank's Monthly Survey of SME Business Sentiment, SME's business confidence was up and down. There are causes for concern, including an increase in the burden of personnel costs due to the tightening of labor supply-and-demand conditions, exemplified by the fact that the ratio of companies which answered that they are suffering from labor shortages hit an all-time high since the commencement of the survey.

Overview of Fiscal 2016

Amid this environment, as a designated financial institution that is responsible for conducting crisis response measures, the Shoko Chukin Bank continued to devote its utmost efforts to fulfilling the safety net function, considering the impact of unexpected natural disasters, including the 2016 Kumamoto Earthquake, and external factors such as the slowdown in the world economy on business performance and cash flows of SMEs. Through this support for SMEs in terms of cash flows and stabilization of management, we endeavored to contribute to maintaining employment and stabilizing the economy of local communities.

Income before income taxes and other of ¥49.1 billion and net income of ¥31.3 billion were recorded despite a decrease in interest income due to factors such as declining returns amid a low-interest environment. We are grateful for the support of our shareholders and clients in enabling us to achieve these results.

Operating Performance and Management in Fiscal 2017

Although capital investment is up and down, the economy is showing trends toward improvement, reflecting recovery of overseas economies and improvement in the employment environment. SME's business confidence generally remains unchanged, but concern is mounting over future cost increases mainly

due to rises in crude oil prices and the impact of labor shortages.

Moreover, looking at the future, the era of fully-fledged population decline is expected to arrive, along with further progress of globalization, and we anticipate that management needs of SMEs will become more sophisticated and diversified. It is precisely the mission of the Bank to support SMEs and the local economy by making the most of its network and solution functions, in addition to its role in fulfilling the safety net function, in response to such management needs of SMEs.

While the business environment surrounding financial institutions is undergoing changes due to monetary easing by the Bank of Japan, we will continue to work with all our power to enhance the corporate value of SMEs and SME cooperatives and to contribute to revitalization of the local community as a financial institution trusted and chosen by all, by thoroughly ensuring and implementing business operations based on our customer-first policy.

First and foremost, the Shoko Chukin Bank makes it a principle to handle, with consideration and courtesy, loan consultations from SMEs whose business performance and cash flows are impacted by adverse factors and to show due consideration for the circumstances of each individual applicant. Furthermore, as a designated financial institution that is responsible for conducting crisis response measures, the Shoko Chukin Bank will swiftly and properly implement such measures, while continuing to put in the utmost effort to fulfill the safety net function.

With regard to supporting growth, in collaboration with regional financial institutions we will provide risk money to SMEs engaged in strategic overseas development, key local companies that have a great influence on the economy of the local community and SMEs and SME cooperatives working together with other business operators to use local resources. In anticipation of the growing needs for capital investment aimed at improvement of productivity, business restructuring including consolidation, responses to labor shortage, etc., the Bank intends to strengthen initiatives such as

supply of growth funds in a timely and appropriate manner, support for overseas expansion, support for M&As and business succession, and business matching.

Furthermore, with regard to support for revitalization, we will further strengthen our collaboration with various support institutions, and work on efforts such as performing our consulting capabilities through initiatives such as support for formulating management improvement plans and follow-up activities, support for drastic revitalization, and support for normalization of financial transactions.

In addition, we will construct a sound management base through efforts to expand a stable funding platform and to further streamline management, in order to fulfill the Bank's mission of contributing to the sustainable growth of SMEs and SME cooperatives.

| In Closing

The Bank seriously takes this issue head-on and sincerely reflects on it, and at the same time it will strongly realize once again its mission and social responsibilities as a financial institution run by SMEs for SMEs and do its utmost to win back the trust of its stakeholders, with each and every member of the Shoko Chukin Bank Group working together.

We would like to express our gratitude for your patronage thus far, and ask for your continued strong support.

July 2017

Kenyu Adachi

President

The Shoko Chukin Bank, Ltd.