

# Risk Management Structures

While ongoing liberalization and globalization of Japan's financial markets coupled with advances in financial and information technology and other changes have led to increased business opportunities for financial companies, these developments are also increasing the complexity and diversity of risk.

Responding to this environment, the Bank has designated risk management as a crucial management issue for maintaining the stability and soundness of its operations.

## Comprehensive Risk Management

At the Bank of Kyoto, in order to accurately identify the amount of risk involved in the conduct of operations, and to ensure the stability and soundness of its management base, we have established a set of Comprehensive Risk Management Guidelines, and we maintain a self-managed risk management posture that compares aggregate risk to the Bank's capital. We are working to strengthen and enhance risk management by expanding the integrated management of the Risk Management Division to include the supervisory divisions in our head office that take responsibility for each risk type and provide cross-sectional management.

At the same time, we quantify and allocate capital to principal risks (credit risk, market risk, and operational risk). As regards the amount of risk, the amount of allocated capital is treated as a limit for management purposes in accordance with the semiannual review of risk management policy. The estimated risk amount is reported to the management at the monthly ALM meetings. In addition, we conduct comprehensive stress tests projecting the simultaneous appearance of major risks based on comprehensive risk scenarios.

## Capital Management

In order to ensure that the Bank maintains sufficient capital commensurate with all possible risks inherent in its operating activities, the Bank of Kyoto has formulated internal rules relating to the management of capital. At the same time, the Bank employs a variety of measures in its capital management endeavors including steps to verify that calculated risk levels fall within allocated capital ranges, conducting comprehensive stress tests and applying such benchmarks as capital adequacy ratios.

The Bank's capital allocation policy, which is determined by the Executive Committee after deliberation at the ALM meeting (chaired by an executive of the managing director level or above responsible for oversight of banking operations and who acts as an assistant to the president), is subject to semiannual review. Specifically, core capital (before applying transitional measures), a

primary component of regulatory capital used to calculate a bank's capital ratio, serves as the source of capital for allocation to principal risks. The amount of capital allocated is determined on the basis of forecast risk levels, which take into account past risk levels as well as the overall budget and operational policy.

## Credit Risk Management

Credit risk refers to risk stemming from an inability to recover principal and interest on loans in the event that borrowers experience a deterioration in business conditions, or to the risk of losses due to reduction in the value of securities. In particular, the risk of loss due to fluctuations in foreign exchange rates or political and economic conditions in borrowers' countries is known as country risk.

Having crafted a management posture by compiling a series of Credit Risk Management Guidelines, the Bank is working to strengthen its credit risk management regime by establishing the Credit Risk Management Committee (chaired by an executive of the managing director level or above responsible for the Risk Management Division) in order to develop and maintain a comprehensive stance toward credit risk.

In addition to planning and managing credit risk through means such as internal ratings, a self-assessment system, write-offs of non-performing loans, and provisions for possible loan losses, the Risk Management Division's Credit Risk Management Office is responsible for quantitatively analyzing and assessing credit risk. Additionally, because the concentration of credit in particular business partners or industries can lead to significant losses in the event of environmental changes, the Office analyzes the condition of the Bank's portfolio from a variety of perspectives and manages it to avoid any excessive concentration of credit. Credit risk levels and credit concentration conditions are reported to the monthly Credit Risk Management Committee meeting.

To maintain and improve the soundness of its assets, the Bank subjects them to a self-assessment regime that includes Group companies in order to adequately write off non-performing loans and make provisions for possible loan losses. We also established an Asset Audit Office as a specialized section within the Internal Audit Division to audit the validity of write-offs and allowances based on asset self-assessments.

In managing credit for specific borrowers, we have established a Credit Examination Division independent of marketing sections, and we are pursuing more stringent credit screening guidelines. Credit ratings are determined by a credit assessment officer based on information including the applicant's financial condition, technical capabilities, and future viability. Credit ratings are assessed according to strict standards, after which the loan officer makes a final determination based on the intended usage of the

funds, resources available for loan repayment, and the ability of the borrower to repay the loan.

We are also placing a special emphasis on improving the ability of our personnel to assess credit risk, providing lending services training to employees according to their level of experience.

Moreover, we have established a Management Support Office within the Credit Examination Division and are working to keep the Bank's assets sound by helping customers radically transform slumping businesses via a variety of measures designed to support improvements in management. Other initiatives include strengthening risk management by formulating solution plans based on self-assessment results as policies for dealing with individual borrowers and taking measures in response to changing business conditions through continuous monitoring.

## Market Risk Management

Market risk refers to interest risk, where the profit margin between fundraising and fund management shrinks due to fluctuations in market interest rates, and price fluctuation risk, where declines in market prices cause losses.

While fluctuations in market prices carry with them the risk of the Bank sustaining losses, they also offer profit opportunities. For this reason, it is important to maintain a management posture that not only minimizes risk but also realizes stable earnings.

Our stance on market risk has been set out in the Bank's Market Risk Guidelines, and we are taking steps to strengthen market risk management. The Securities & International Division, which is responsible for overseeing market risk management, sets the limits on acceptable risk levels, as well as position ranges and loss limits, taking into account the Bank's economic capital and net operating profit to achieve a balance between capital and profitability and effectively control market risk for stocks and other securities. For risk amount calculation regarding the Bank's securities position, the Bank regularly monitors the market value of securities and employs the value-at-risk (VaR) method and other methods to assess the amount of risk involved, and then submits a report on risk valuations at the ALM Meeting.

For market risk for stocks and other securities, we use the method of setting and managing acceptable risk amount based on the Bank's capital and appraisal gains on stocks and other securities. Moreover, we are conducting adequate risk management. This includes calculating the daily positions and profits and losses and reporting them to the management, and measuring the amount of risk involved in stocks and other securities and reporting it to the management. A semiannual self-assessment provides an accurate understanding of the stocks and similar securities held by the Bank and Group companies, the results of which are audited by the Internal Audit Division.

In addition, the Bank established the ALM Office within the Risk Management Division to bring uniformity to the management of market risk (including for deposits and loans) with credit and other risks, and to adequately control risk within the scope of the Bank's capital to secure stable earnings. To this end, the ALM Office manages and analyzes risk by utilizing techniques such as VaR and fluctuations in the present value of assets and liabilities (interest risk level based on the outlier standard), and in addition we conduct stress tests supposing a variety of different stress scenarios, and utilize them in risk checks. The Bank also employs tools such as back testing to verify the suitability and effectiveness of its metrics and management methods.

Moreover, the Bank conducts semiannual reviews of risk management policy in areas such as credit interest and liquidity by holding ALM meetings. We also work to strategically address risk management at monthly ALM meetings by reporting on calculated risk levels, examining the appropriate balance of assets and liabilities, and considering measures such as risk hedges as needed.

## Liquidity Risk Management

Liquidity risk refers to the risk of losses caused by a need to resort to fundraising at costs well in excess of normal due to obstructions to financing caused by a mismatch in time between fund management and fundraising or by unexpected fund outflows or other factors, as well as to the risk of losses stemming from an inability to conduct market transactions due to factors such as market confusion or to the need to resort to transactions at prices that are significantly less favorable than usual.

The Bank maintains an appropriate funding position through careful projection and verification of fundraising and fund management balances. Utilizing a system that continuously monitors the amount of funds available in the market, the Bank is always prepared for the occurrence of liquidity risk.

We also regularly conduct liquidity stress tests, and carry out verifications of the impact of unexpected cash outflows on financing.

## Operational Risk Management

Operational risk refers to the risk of losses caused by inappropriate processes in financial institution operations, activities on the part of executives or employees, Bank systems, or external factors. The Bank categorizes operational risk into the following five components for management purposes: (1) clerical risk, (2) information security risk, (3) legal risk, (4) human risk, and (5) tangible asset risk.

The Bank's stance on operational risk management has been

set out in the Operational Risk Guidelines, and the divisions with oversight for each component risk take responsibility for managing those risks from a specialist's perspective. The Risk Management Division is responsible for the overall management of operational risk.

The Bank considers operational risk management to be one of its most important management challenges. The Bank has established an Operational Risk Meeting, which is chaired by an executive of the managing director level or above responsible for oversight of banking operations and who acts as an assistant to the President. The meeting provides a central venue for assessing and analyzing problem areas related to operational risk and discussing policy in an organization-based manner.

## Reputation Risk Management

Reputation risk refers to the risk of losses caused by a deterioration of the Bank's reputation among customers or the market.

The Bank is working to control and minimize reputation risk by establishing a set of Reputation Risk Management Guidelines specifying measures for reducing reputation risk, preventing its manifestation, and responding to the danger of its manifestation.

## Contingency Planning

The Bank has established a series of Emergency Task Force Guidelines for dealing with unforeseeable events including crimes, natural disasters such as fires or earthquakes, system malfunctions, financial crises, information security risks, and market and other risks. In the event of such an emergency, the Bank would set up an Emergency Task Force to provide unified leadership and instruction on a temporary basis. We have developed a Contingency Plan detailing specific procedures, and we are working to strengthen our response capability through regular training and reviews.

We have set out in our Crisis Management Guidelines for Disasters the official procedures regarding rapid disaster recovery and a Business Continuity Plan (BCP) for implementing the minimum processes necessary to run our business in the event of a large-scale natural disaster, disease outbreak, etc. Our basic policy on business continuity, which includes the Bank's intentions to offer support in ensuring the livelihoods of local residents and to help local business enterprises resume business operations, has been set out in the Business Continuity Policy. We have also drafted detailed manuals/guidelines taking into account the possibility of a large-scale earthquake and the outbreak of a new and highly contagious strain of influenza. In this way we are working to strengthen our crisis management system.