

# Toward a Stronger Risk Management System

Based on the Bank's policy that "Shiga Bank must be sound in order for the local community to be healthy," we are building a Comprehensive Risk Management System and Internal Rating System in order to accurately assess and control risk using rational criteria without undue reliance on personal intuition or experience.

## Risk Management System



## Outline of Risk Management System

The Shiga Bank's Board of Directors have established risk management rules, specified the types of risk that should be managed, and defined the roles and responsibilities of the sections responsible for those risks. At the same time, Risk Management Rules prescribe risk management methods.

Furthermore, in light of the Bank's strategic goals and risk status, "risk management policies" are instituted semiannually at the board of directors' meeting.

Risk management status is properly managed by having it reported to management through the ALM Committee, the Meeting of Managing Directors, and the Board of Directors.

## Comprehensive Risk Management System

Comprehensive risk management means to appropriately manage risks by looking at various types of risk as a whole, and comparing them to capital adequacy which represents the strength of the financial institution.

The Bank's Assets & Liabilities Managing Department is responsible for unified monitoring of all risks, including quantitative monitoring and management of loan concentration risk, which is outside

the scope of capital adequacy requirements, and interest rate risk in the Bank's own accounts.

## Integrative Risk Management System

In our integrative risk management, we measure and manage risk quantitatively using such integrated yardsticks as the (maximum) Value at Risk (VaR) formula applied to each risk category.

The Bank conducts its business based on the capital allocation system, controlling risk by keeping it within the specified ratio to both 1) regulatory capital and 2) economic capital.

We are creating a structure that complements the capital allocation system for 1) regulatory capital and 2) economic capital, by additionally controlling price change risk in investments in securities by keeping it within a specified range.

### VaR (Value at risk)

VaR uses a statistical technique to measure the losses that could potentially be incurred in a fixed period of time (for example one year). The Bank uses risk amounts measured with a confidence interval of 99% and a holding period of one year in its internal management.

### Credit Risk Management System

Credit risk is the risk that the Bank will suffer losses due to the worsening financial conditions of clients, etc.

Recognizing credit risk as the most important risk to business management from the standpoint of its size and scope, the Bank believes that controlling risk through the use of a rational benchmark based on the principle of self-responsibility — “protecting one’s own castle oneself” — is essential in the pursuit of mutual prosperity with regional communities.

For this reason, in December 1998 the Bank introduced its own corporate credit ratings system, and then it adopted Basel II’s “Foundation Internal Ratings Based-Approach” beginning from the fiscal year ended March 31, 2008.

Based on this ratings system, we have established the Shigagin Ratings Communication Service, a rational communication tool connecting the Bank and its customers which is used to disclose credit

ratings to the customers. We are working hard to learn about the challenges and risks faced by our customers so that we can make proposals and assist in the development of management improvement plans aimed at strengthening the customers’ management infrastructures.

From the perspective of risk management, we have developed the management system in accordance with risk characteristics such the rating and loan concentration, and we carry out simulations of the degree of impact on our customers under multiple macroeconomic scenarios. Afterwards the result of the assessment is used for credit risk management and capital adequacy ratio management across the entire Bank.

Furthermore, through these initiatives we are establishing a system for rationally assessing risk, and we are actively working on pricing (setting of the interest rate on loans) commensurate to credit risk, in order to ensure an appropriate risk return.

### The Significance and Purpose of the Corporate Credit Rating System

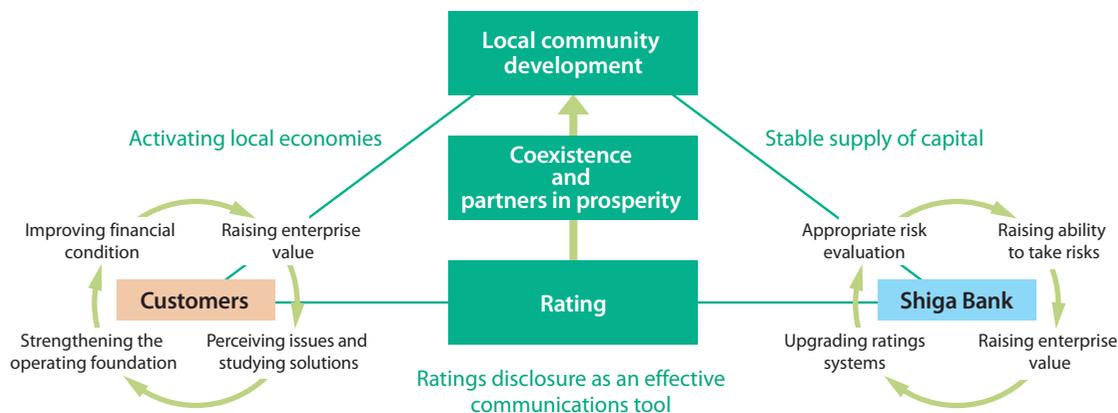
#### Reasons for adopting Basel II’s Foundation Internal Ratings Based-Approach (FIRB)

Based on its conviction to adhere to our “responsible management” system, and with the aim of sophisticating credit risk management, the Bank introduced its own corporate credit ratings system in December 1998 as a rational communication tool for the Bank and its customers to use together to raise enterprise value.

Based on its belief that Basel II is ultimately a tool for pursuing mutual prosperity with regional communities, the Bank recognizes that the building of a solid internal ratings system is essential for consistent implementation of the responsible management model. Therefore, it will do its utmost to further improve its risk management system.

From this viewpoint, the Bank, in adopting Basel II, has selected the Internal Ratings-Based Approach founded on the principle of accountability, has proactively committed itself to a credit-based business and its own credit ratings system, and wants to contribute on a broad basis to the further development of regional communities.

#### Significance and purpose of the ratings system



## Operational Risk Management System

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Operational risk should be avoided as much as possible during the course of daily operations. We are taking measures to forestall such risk where its emergence is expected, and to minimize its impact when it materializes. Risk appraisal is based on the regular implementation of the Risk-Control-Self-Assessment (RCSA) standard as part of our efforts to establish a risk management system in conformity with Basel II.

To refine our risk management, we gather and analyze data relating to operational risk, and implement measures aimed at forestalling such risk. Furthermore, we are controlling, transferring and avoiding risk to increase the effectiveness of risk management, and we are adopting the Plan-Do-Check-Act (PDCA) cycle.

## Market Risk Management System

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To ensure stability of earnings, we draft an ALM plan each half-year, which incorporates plans for investments in securities and other instruments, taking into account the risk-return scenario of the entire Bank. The status of market risk is quantified and monitored, with findings reported to top management. Organizationally, front office, back office, and middle office (risk management) operations are conducted by separate departments, each of which checks the operations of the others.

## Liquidity Risk Management System

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In managing the flows of funds, the Financial Markets Department monitors the financial environment, balance of liquid assets, expected cash outflows, and other fund-raising factors, and acts as appropriate. At the same time, the Assets & Liabilities Managing Department keeps track of day-to-day risk management, to ensure that obstacles to our fund-raising do not appear.

## Reputational Risk Management System

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The Bank has formulated a general outline for dealing with rumors that could affect its business, and has put in place measures and internal systems to deal with exceptional situations or expected exceptional situations related to reputational risk.

## Information Asset Management System

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At Shiga Bank, to enable the efficient and safe use of information assets, we handle information assets in accordance with their importance and an assessment of the risks involved. For this purpose, an Information Management Office has been set up within the Administration Department to maintain and enhance a Bank-wide information security system, as well as to draw up appropriate information management measures and supervise information management activities. We have also established the Information Security Committee, which acts to enhance information asset security by examining and promulgating measures to prevent information leaks, and by taking steps to ensure that the information asset management system is sufficiently secure across the entire Bank.

## Measures to prevent leakage of information

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To help prevent information leaks, when data contained in a personal computer is printed out, the paper is encoded with "watermark characters" that identify the person who printed the document.

In addition, we take the following steps to prevent the leakage of customer information.

1. Data contained in a personal computer cannot be downloaded from that PC without the approval of an Information Management Officer.
2. In principle, no customer information may be taken outside the Bank. In cases where this is unavoidable, prior permission must be received from the branch manager or an officer of equivalent rank, and established safety procedures must be strictly followed.
3. Documents from all the Bank's branches that contain customer information are collected for disposal by shredding facilities at the Bank's head office, after which the paper is recycled.

## Personal data protection

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The Bank has laid down a strict seven-point personal data protection policy to guide employees in the handling of customers' personal data. We also use the Bank's website as well as leaflets to explain to our customers the nature and purposes of the Bank's utilization and management of their personal data.