

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.

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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 it is necessary to establish a credit risk management system and control the risk using rational yardsticks. 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.

■ Outline of the Corporate Credit Rating System

The Bank implements financial analyses (quantitative evaluations) using statistical rating models based on the financial statements of the customers, and decides the corporate credit rating taking into account qualitative evaluations using the unique screening know-how of the Bank, and the condition of the company. Regarding the

Corporate Credit Rating System, the Bank places importance on the PDCA cycle, conducts in-depth verifications of the state of management and the performance of the Corporate Credit Rating System, and taking into account the results of the verifications works to improve the quality of the credit rating system.

■ Outline of Credit Risk Management

Changes in the financial status of the customers are reflected as changes in the credit risk of the Bank through the credit rating system. In order to more precisely implement credit risk management the Bank does not merely analyze the results of the measurements of the amount of credit risk; it implements credit risk management while being aware at all times of the risks faced by its customers.

Specifically, every quarter we quickly collate financial data based on the financial statements of the customers and analyze the changes and trends in the sales and profits of the customers, then conduct credit risk management while monitoring the composition of the credit portfolios, the volume of credit risk, and other factors.

The Significance and Purpose of the Corporate Credit Rating System

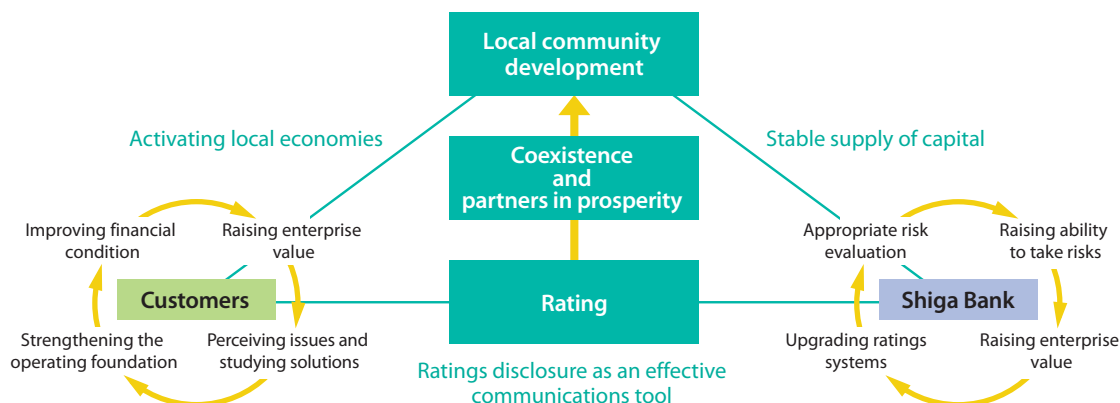
Reasons for adopting Basel II's Foundation Internal Ratings Based-Approach (FIRB)

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



Market Risk Management System

Market risk refers to the risk that the Bank will incur a loss because the value of the assets and liabilities it holds changes due to fluctuations in a variety of risk factors in the market, including interest rates, prices of securities and currency exchange rates.

The Bank aims to ensure stable profits by controlling market risk within a fixed scope based on quantitative methods.

Regarding interest rate risk, one kind of market risk, the Bank comprehensively manages all assets and liabilities including deposits, loans, and securities (ALM management) to carry out asset allocation, and controls the amount of interest rate risk based on the "interest rate risk in the banking book" (outlier standard) in Basel II. Furthermore, in risk measurement the Bank takes into account the type, size, and characteristics of the positions held, and uses VaR and sensitivity (duration, BPV) and other factors for multiple management.

Of the market risks, for the risk arising from fluctuations in the prices of securities and other financial instruments the Bank sets risk tolerance amounts and other limits so as to ensure that the loss due to market fluctuations does not have an effect on the operation of the regulated capital base.

For items for which limits are set using risk amount measurement methods such as VaR, the Bank performs back-testing in order to verify that the risk amounts are being ascertained appropriately, and reports the results of the verifications to the ALM Committee.

As a general rule, the organizational system related to market risk management is divided into the market transaction sector (front office), business management sector (back office), and risk management sector (middle office), each of which checks the operations of the other. Furthermore, The Audit & Inspection Dept., the internal audit department, performs audits of the state of compliance with related laws, related regulations, the operational plan, and other requirements and reports the audit results to the Internal Audit Briefing Sessions comprised of the President and the responsible directors and to the Board of Directors.

Operational Risk Management System

Operational risk refers to the risk that the Bank will incur a loss due to a work-related accident at the bank, a flaw in the systems of the Bank, or external factors such as earthquakes or other disasters.

The Bank has formulated the Operational Risk Management Regulations, divided operational risk into five kinds of risk: (i) processing risk, (ii) information technology risk, (iii) legal risk, (iv) tangible asset risk, and (v) human risk, and is carrying out integrated management of these risks in the Administration Dept.

■ Processing risk management

Processing risk refers to the risk that the Bank will incur a loss, or the credibility of the Bank will be damaged, due to dishonesty or scandals, processing accidents, flaws in the processing management system, executives and employees failing to perform accurate processing, or other problems of this kind.

The Bank is deeply aware that sound processing is the foundation of its credibility, and of the importance of information management, so in order to reduce processing risk and eliminate accidents and dishonesty it is focusing on human resources development, strengthening our organization, development of regulations and manuals, and compliance, while also working on strengthening daily processing instruction and training systems and endeavoring to improve processing quality.

Liquidity Risk Management System

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

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.