

# Risk Management

## Integrated Risk Management System

The principal forms of risk to which banking operations are subject include credit risk, market risk, and operational risk. In order to improve profitability and ensure sound business operations, the Chiba Bank considers it necessary to not only individually manage each of these forms of risk, but also to centrally monitor those risks to control within acceptable overall limits.

Accordingly, in addition to assigning divisions to manage overall risk in the Group for each form of risk, the Chiba Bank has an integrated risk management system in which the Risk Management Division centrally monitors these risks. The division engages in detailed management and discussions of risks at meetings of the ALM Committee, Credit Risk Management Committee, and Operational Risk Management Committee and reports to the Board of Directors on risk-related matters. In addition, the division is developing an integrated risk management system for considering and implementing risk countermeasures.

To ensure an effective risk management system, the Audit and Inspection Division periodically conducts audits to determine whether risk management is appropriately implemented and reports the audit results to the Board of Directors.

## Integrated Risk Management

The basis of risk management at the Chiba Bank is the integrated management of various risks using uniform measures to the extent possible. The term “integrated risk” refers to the sum of credit risk, market risk, and operational risk measurement, forms of risk that can be managed by means of risk quantification.

The Risk Management Department in the Risk Management Division, the section responsible for integrated risk management, conducts a comparison of quantified integrated risk and capital, verifies the adequacy of capital with respect to risk, and reports the results quarterly to the Board of Directors. The division also conducts stress tests, a means of verification of capital adequacy in times of stress that involves the assumption of certain stress scenarios, such as deterioration of the corporate environment in a period of recession, or a decrease in land prices, and forecasting the increase in the amount of risk based on the scenarios.

The Chiba Bank has introduced a risk appetite framework, which it uses to control the occurrence of losses. The framework monitors the current status of risk capital use and risk-return performance in each business sector. It also performs scenario analysis predicated on future environmental changes.

## Credit Risk Management

Credit risk is the risk of incurring a loss because of a decline in, or total loss of, the value of owned assets as a result of deterioration in the financial soundness of debtors. Credit risk accounts for a major portion of risk in banking operations.

The Chiba Bank has developed a rigorous credit risk management system centered on an internal credit rating system

and engages in individual credit management and credit portfolio management. In the self-assessment of assets, the Chiba Bank implements appropriate write-offs and provisions and has introduced a rating and self-assessment system linked to internal credit ratings to upgrade credit risk management.

Also the Chiba Bank has long ensured the independence of the sections involved in credit risk. Specifically, the credit screening and administrative sections manage credit risk for individual business transactions in the credit executing section (banking offices and sales promotion divisions). The Credit Risk Management Department in the Risk Management Division, whose organization and operation are independent from the credit screening and administrative sections and the credit executing sections, is a credit risk management section that engages in unified management of overall credit risk. The Risk Management Department in the Risk Management Division is a unified risk management section that engages in the integrated management of all forms of risk, including credit risk. The Audit and Inspection Division audits operations in the business units involved in credit risk management.

The Credit Risk Management Committee meets regularly and considers credit risk management policy, monitors the operation of the internal credit rating system and the credit portfolio, and works to ensure the quality of loan assets.

## Internal Credit Rating System

The Chiba Bank uses an internal credit rating system to place borrowers into 15 credit rating categories on the basis of financial data such as financial condition and cash flow. We strive to enhance the identification and examination of the financial circumstances at companies, the starting point of credit risk management, by means of periodic annual reviews and reviews at other times in accordance with the status of individual debtors. The internal credit rating system is the core of credit risk management and is extensively used in actual management, such as credit pricing standards and approval authorization.

## Individual Asset Credit Management

The banking branches or offices and the Credit and Supervisory Department in the Credit Division take the lead with regard to examining individual applications for credit, engaging in rigorous investigations in accordance with screening criteria on the basis of the basic principles of credit (safety, profitability, liquidity, growth potential and public good). The Business Support Department in the Business Support Division provides support for the financial soundness of borrowers who need to improve their operations, and the Credit Administration Department in the Business Support Division engages in resolution and collection activities with regard to Bankrupt Debtors and other borrowers. The Chiba Bank strives to accumulate high-quality loan assets and minimize future losses through this practice of advanced screening and supervision after credit has been extended.

## Credit Portfolio Management

Credit portfolio management is the management of the risk of incurring a major loss due to the concentration of individual loans in specific countries or specific industries. The Credit Risk Management Department in the Risk Management Division monitors the state of credit risk from various perspectives, such as by country, by industry, and by customer credit rating.

In credit portfolio management, the Chiba Bank engages in the quantification of credit risk. The quantification of credit risk is the forecasting by statistical methods of the amount of future losses (the amount of risk) forecasted to occur due to circumstances such as borrower bankruptcy or worsening business performance. We measure value at risk (VaR: the assumed maximum loss) as the amount of risk and strive to increase the soundness of the credit portfolio by accumulating and organizing default data and loan recovery data from defaulted borrowers.

By importing the quantitative results into various systems, we utilize them in loan pricing that reflects credit risk and other processes. In this way, we aim to ensure more appropriate interest rate levels than were previously possible and refine risk management.

## Self-Assessment of Assets

Self-assessment of assets is the practice whereby financial institutions review and analyze their own assets individually and classify them on the basis of asset value impairment and the risk of default. Self-assessment of assets is obligatory for financial institutions under the system of prompt corrective action under the

Banking Law. The system of prompt corrective action is a system by which administrative measures are triggered in accordance with the state of the capital ratio of financial institutions. A prerequisite to the accurate calculation of capital is implementation of appropriate write-offs and provisions and the preparation of financial statements that, to the extent possible, objectively reflect the actual state of asset quality.

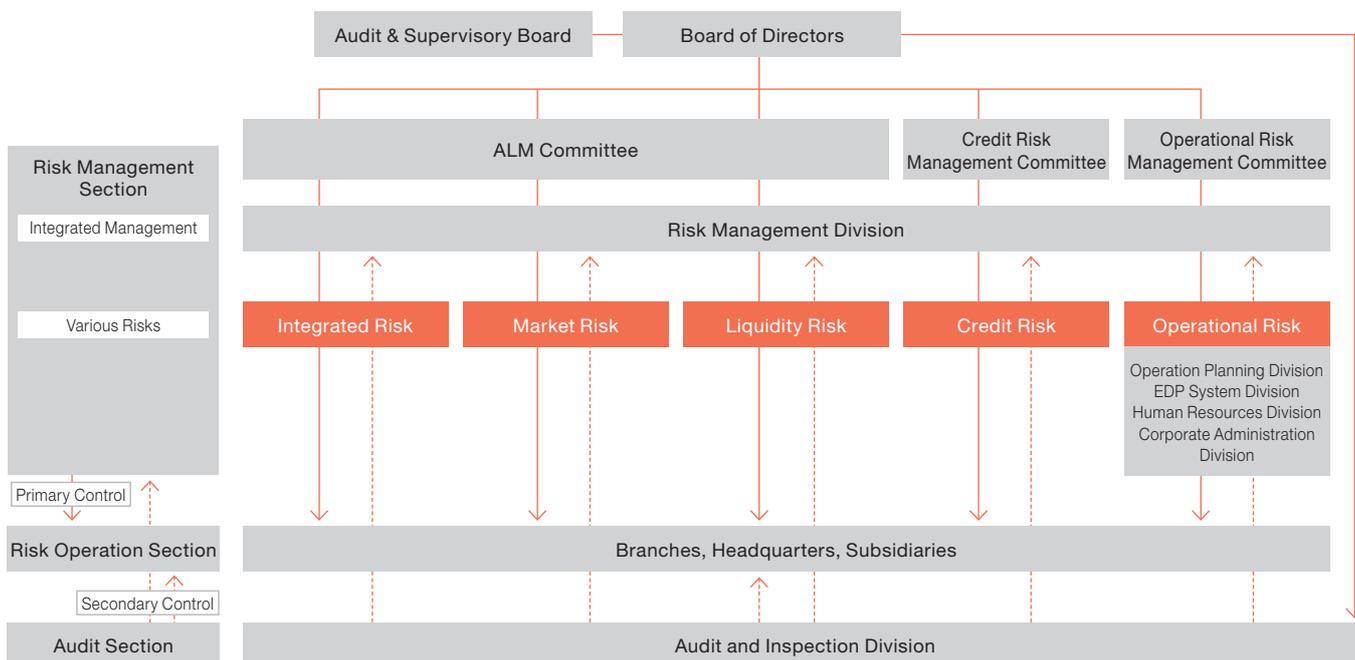
At the Chiba Bank, branches and offices conduct self-assessments of assets on the basis of Asset Self-Assessment Regulations, and the credit screening and administrative sections check details of self-assessments. Next, the Audit and Credit Assessment Department in the Audit and Inspection Division conducts an audit to verify the accuracy of the self-assessment results and process. According to the results of these assessments, the Credit Risk Management Department in the Risk Management Division calculates the amounts of provisions, and the Credit Administration Department in the Business Support Division implements write-offs. Finally, the Audit and Credit Assessment Department in the Audit and Inspection Division conducts an audit. Through this process, the Chiba Bank rigorously maintains the soundness of its assets.

## Market Risk Management

Market risk is the risk of incurring a loss due to a change in the value of owned assets as a result of fluctuations in interest rates, prices of securities or other financial instruments, or exchange rates.

The Chiba Bank has introduced an ALM management system with respect to market risk. The ALM Committee meets periodically

## Risk Management System



to discuss and decide detailed measures to counter interest rate risk, foreign exchange risk and price fluctuation risk, and manage overall market risk.

Specifically, as part of the Risk Capital Allocation System, within the scope of the risk capital allocated to the business sectors, the Chiba Bank sets and manages risk limits for the amount of market risk (value at risk or VaR: the assumed maximum loss) for each product, such as securities investments and other market transactions or loans and deposits. In this way, we strive to ensure management soundness. In addition to VaR management of market transactions, the Chiba Bank sets upper limits for market investments according to the balance and alarm point of valuation differences and implements risk-control by reviewing investment policy each quarter.

With regard to market risk for market transactions for trading purposes (trading with the aim of earning profit by means of short term fluctuations in interest rates or prices), VaR is calculated on a daily basis, periodic stress tests (the estimation and testing of losses in worst-case scenarios that assume sudden market fluctuations) are conducted, and risk is limited and the occurrence of major losses avoided through the setting of maximum trading limits and the rigorous application of stop loss rules.

The allotment of market operations among the front office (the Treasury Division and overseas branches), back office (the Treasury Operation Division), and middle office (the Market Risk Management Department in the Risk Management Division) results in the mutual control of each section.

### Liquidity Risk Management

Liquidity risk consists of cash flow risk and market liquidity risk. Cash flow risk is the risk of incurring a loss due to failure to maintain cash flow as a result of the inability to secure necessary funds or the necessity of procuring funds at significantly higher interest rates than usual due to the worsening of the financial institution's financial position or other circumstances. Market liquidity risk is the risk of incurring a loss due to the inability to trade on markets or the necessity of trading at prices significantly less favorable than usual due to market turmoil or other circumstances.

At the Chiba Bank, the Treasury Division is the section that manages cash flow. The division ascertains the market environment and analyzes the state of investment and procurement of funds. With respect to cash flow risk, the division engages in appropriate day-to-day cash flow management through such means as the establishment of upper limits to ensure that the amount of funds procured on the market is not excessive and the maintenance of a certain minimum level of assets as a liquidity reserve that can be converted to cash in a short time. The Chiba Bank manages market liquidity risk by setting limits on daily positions taken in market trading.

As the section that manages risk, the Market Risk Management Department in the Risk Management Division strives to avoid increases in liquidity risk by identifying and assessing various factors that affect liquidity risk and monitoring the observance of

limits. The ALM Committee meets to discuss and decide matters related to liquidity risk, as it does with market risk. The Chiba Bank also maintains a crisis management plan that provides for a rapid, network-wide response in the event of unforeseen circumstances that could affect the Chiba Bank's cash flow.

### Operational Risk Management

Operational risk is the risk of incurring losses due to the inappropriateness of business processes, employee activities, or systems or external events. The Chiba Bank classifies operational risk into clerical risk (described below), system risk (described below), human risk, tangible asset risk, and reputational risk. Human risk is the risk of a loss occurring due to workplace safety, discrimination, or the like. Tangible asset risk is the risk of a loss occurring due to damage to buildings or facilities or the like. Reputational risk is the risk of a loss occurring due to loss of public confidence resulting from deterioration of the Chiba Bank's reputation.

In its risk management structure, the Chiba Bank decides the corporate divisions having jurisdiction over the various forms of operational risk (the Operation Planning Division for clerical risk, the EDP System Division for system risk, the Human Resources Division for human risk, and the Corporate Administration Division for tangible asset risk), and the divisions collaborate in risk management under the overall management of the Risk Management Department in the Risk Management Division, which is responsible for central oversight of risk. The Risk Management Department in the Risk Management Division directly manages reputational risk and, the Compliance Division jointly manages legal risk and compliance-related risk included in the various risk categories with the corporate divisions that have jurisdiction.

The Chiba Bank has an Operational Risk Management Committee. On the basis of direct involvement in management, the committee receives reports concerning the state of operational risk losses and develops a management structure for improving and correcting problem areas by means of a PDCA cycle involving the preparation of a risk management plan, development of management regulations, and evaluation and improvement. To ensure the effectiveness of management by means of this PDCA cycle, the Chiba Bank has introduced Control Self-Assessment (CSA), by which it formulates and implements measures to identify, assess, monitor, and manage the details of risk, as well as to reduce risk. Management by means of CSA entails responding to operational risk loss events that have occurred at the Chiba Bank as well as preventing problems from occurring by evaluating the adequacy of the Chiba Bank's management system. This is based on scenarios prepared using loss events that have occurred at other banks or in other industries and devising countermeasures as necessary.

### Clerical Risk Management

Clerical risk is the risk of incurring a loss due to the failure to perform accurate clerical work, clerical accidents or fraud, or the failure to

perform official obligations or provide explanations to customers.

The Chiba Bank considers accurate clerical work to be essential to obtain the trust of customers, and the Operation Planning Division plays a central role in the performance of exact clerical work in accordance with basic procedures and in the effort to prevent clerical accidents.

Specifically, the division prepares clerical standards that indicate detailed clerical procedures for each operation; ensures the correct handling of cash, promissory notes, passbooks, and other important items; provides guidance on clerical management systems at branches, offices, and headquarters; and conducts training to raise the standard of clerical work.

The branches and offices periodically conduct self-assessments and strive to ensure clerical accuracy and raise the level of clerical work through monitoring and verification by the Operation Planning Division.

With regard to the auditing system, the Audit and Inspection Division visits all branches, offices, and headquarters at least once a year and conducts rigorous audits of all clerical work in accordance with auditing standards. The division promptly notifies the branches, offices, and headquarters of the audit results, periodically reports to the Board of Directors, and implements a framework for reflecting audit results in clerical improvements.

## System Risk Management

System risk is the risk of incurring a loss resulting from a leak or falsification of information owned by the Chiba Bank or the unauthorized use, failure, or incorrect operation of computer systems.

The Chiba Bank possesses customer transaction data and various other types of information and has developed systems to process that information. To ensure the provision of various services to customers, the role of computer systems in banking operations is increasing year by year, and a system risk event would result in great inconvenience to customers. For this reason, we regard system risk management as increasingly important.

The EDP System Division plays a central role in devising measures to ensure the stable operation of computer systems. Specifically, the Chiba Bank duplicates hardware and circuits for account systems, information systems, and other backbone systems and maintains a framework for rapidly switching to the backup system so that business can continue in the event of a failure. In addition, for all computer systems, including those used individually at departments, the Chiba Bank has implemented a rigorous data management system, measures to prevent unauthorized access or the introduction of viruses, and the preparation of a contingency plan to provide for unforeseen circumstances such as large-scale disasters.

Moreover, in terms of cyber-security, the Bank continues to take measures to ensure customer safety and security.

As part of audit procedures, the Audit and Inspection Division conducts audits of computer systems throughout the organization.

## Business Continuity System

In addition to the risk management system described above, the Chiba Bank maintains a business continuity system to allow essential operations to continue for the preservation of the financial system during an unexpected disaster such as an earthquake or pandemic influenza. Centered in the Risk Management Department in the Risk Management Division, this system focuses on the rapid restoration of operations that the Chiba Bank would be forced to suspend during an emergency.

Since the Great East Japan Earthquake, the Chiba Bank has installed emergency in-house power generators at more branches, upgraded countermeasures against tsunami risk, expanded measures for persons unable to return home due to a disaster, and taken other steps to continue business operations following a disaster.

## Basel III Compliance

The Basel III capital adequacy regulation was first applied in the fiscal year ended March 31, 2013. Changes to the new regulation compared with the earlier Basel II regulation include tighter rules for items included in capital and an increase in the number of items excluded with the aim of improving the quality of capital. Other changes include additional provision for risks relating to transactions with large financial institutions and derivative transactions. Banks will also be required to meet minimum capital adequacy standards based on four capital ratios: total capital ratio, Tier 1 capital ratio, common equity Tier 1 capital ratio, and capital buffer ratio (applicable from the fiscal year ended March 31, 2016). Basel III consists of three pillars. Pillar 1 is a minimum capital ratio, which is the level of capital required to cover a bank's risk. Pillar 2 is the development of capital strategies by banks and verification by regulatory authorities. Pillar 3 is the assurance of market discipline through the increased disclosure of information. Under the regulation, each bank selects a method of calculating minimum required capital according to its risk profile and risk management method.

The basic policy of the Chiba Bank is to expand its business by upgrading internal management, and it is proactively complying with the regulation as part of its policy of building an integrated risk management system. With regard to the calculation of minimum required capital, we have adopted the foundation internal ratings-based (FIRB) approach for credit risk and standardized approach for operational risk (both approaches require the approval of regulatory authorities) and more thoroughly reflect risk in capital ratios.

Furthermore, for Pillar 3, disclosure of the leverage ratio was started as an indicator to complement the capital ratios.

Going forward, a number of new requirements will be introduced, including the net stable funding ratio. The Chiba Bank is currently developing and strengthening management systems to comply with these regulations.