

The Foundation of Reliability



CREDIT RISK

The Bank thoroughly screens loan applications based on standards clearly defined in the Bank's Credit Policy and credit criteria. The scope of the Bank's credit evaluation activities is not limited to traditional personal and business loans; it includes checking the overall credit situation of each client, covering its on- and off-balance-sheet transactions as well as foreign and domestic loans. These activities include assessing the creditworthiness of counterparties to derivatives and other market transactions as well as analyzing country-specific credit risks for overseas loans. In fiscal 1997, the Bank progressed with work to create a credit risk quantification framework as part of a total revision of its credit rating system for corporate customers. More statistical data will be collected to improve the reliability and accuracy of the Bank's customer credit risk ratings.

To improve credit portfolio management, in August 1996 the Bank established a Credit Portfolio Committee, a group of directors that meets quarterly to review the Bank's credit exposure. The committee reviews the structure of the Bank's overall loan portfolio in terms of exposure by customer size, credit rating, industry, and country. Two basic credit risk analysis methods are adopted: statistical analysis, which involves quantitative credit portfolio analysis, and credit monitoring, which is a subjective analysis based on the observations of committee members.

In March 1997, the Bank introduced an industry-specific credit risk management system to avoid excessive exposure to particular industries. Furthermore, in April 1997 the Bank established the Credit Examination Office, thus improving its credit management systems by adding another perspective to its regular credit analysis activities.

MARKET RISK

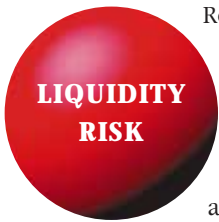
Asset/liability management (ALM) involves integrating the control of interest rate, exchange rate, price fluctuation, and liquidity risks, which is an integral part of the Bank's activities to strengthen its profit earning potential.

Decisions regarding market risk management issues are made by the Executive Committee, a group of managing directors that is the Bank's highest decision-making body under the board of directors. The Executive Committee meets twice a year to formulate half-year budgets, in which a risk position limit—the maximum permissible potential loss for the Bank's combined market transactions—is established. Risk positions for each trading section and business department are then set based on this value. Each department, in turn, observes loss-cutting rules and devises operating strategies to achieve targeted profits based on their risk limits.

The General Planning Department's Risk Management Office, a unit that is independent of the Bank's market operations, measures risk exposure and profitability for individual business segments on a daily basis and reports this information to the directors in charge of respective departments.

The front (Treasury and Capital Markets Department), middle (Risk Management Office), and back (Market Operations Department) office functions related to market operations are completely separated to minimize the potential for unauthorized dealings and facilitate cross-checking.

The Bank has adopted the value-at-risk (VAR) method to manage the risk involved with trading account transactions. VAR is the maximum possible loss that may occur due to adverse market movements over a specified period. VAR is estimated based on a statistical analysis of historical market data. In making VAR calculations, the Bank assumes a holding period of one day and a confidence level of 99.0%.



Regarding yen-denominated assets and liabilities, the Bank aims to manage maturity schedules for interbank funds efficiently and thus limit the risk associated with excessive funding from short-term money markets. With respect to foreign currency banking operations, the Bank strives to raise long-term funds and avoid the excessive concentration of fund placement with any one party. In addition to the ALM Committee, an internal specialist market risk management committee has been established to participate in monitoring the Bank's total funds position. This committee meets every week to forecast interest rate and exchange movements, paying particular attention to the potential impact that any market changes may have on the Bank's liquidity positions.



The Bank ensures that thorough and clearly defined administrative management procedures are followed to maintain and strengthen the trust that customers place in the soundness of its operations. Regular inspections are performed by an internal Inspection Department to confirm that administrative procedures are being followed and that the systems in place adequately protect against the possibility of unauthorized dealings.

In April 1997, the Bank's independent company, the Hamagin Business Operations Center Co., Ltd., established to centralize the Bank's domestic administration activities and reduce the margin for administrative error, began operations.

The Bank follows recognized safety standards for financial institution computer systems to ensure the stable operation of its on-line systems. To minimize the potential disruption to operations caused by natural disasters, in May 1996 the Bank established the Chiba Computer Center, which will act as a backup to its main computer center, the Yokohama Computer Center.



To secure a desired level of profitability while maintaining a sound asset base in an operating environment characterized by diverse and complex operating risks, it has become necessary for banks to do more than manage credit, market, liquidity, and other risks in isolation. To realize these goals, it is necessary to perform an integrated analysis of the Bank's quantifiable risk to achieve the efficient allocation of management resources.

The Bank has adopted this approach in strengthening its risk management systems. In October 1995, the Bank established a Risk Management Office within its General Planning Department. The activities of this office are outlined on page 11.

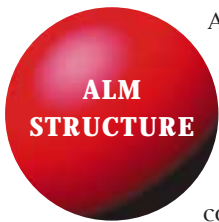
- The Risk Management Office measures risk volume for each risk factor, including credit, market, and liquidity risks, as well as estimates Bankwide profit. The office also evaluates whether the Bank has the financial strength to accommodate this total volume of risk.

- As a satellite office of the ALM Committee and the Credit Portfolio Committee, the Risk Management Office studies risk/return information and offers support for management decisions regarding portfolio structures and risk volume limits.

- A team from the Risk Management Office, as a middle office, analyzes the risk/return issues associated with market transactions as well as inspects and audits front and back office activities.

The Risk Management Office is working with various sections to analyze historical default and recovery rates to formulate statistical tools that will enable the Bank to gauge an accurate quantitative measure of the risk volume of its overall credit portfolio.

In autumn 1997, the Bank of Yokohama and other major regional banks joined to commence work on the development of a default database—comprising information on loan default rates—and a credit risk quantification system. The banks aim to have both these systems up and running from April 1999.



At the core of the Bank’s ALM operations is the ALM Committee. Consisting of directors, the committee is one of the Bank’s highest decision-making bodies.

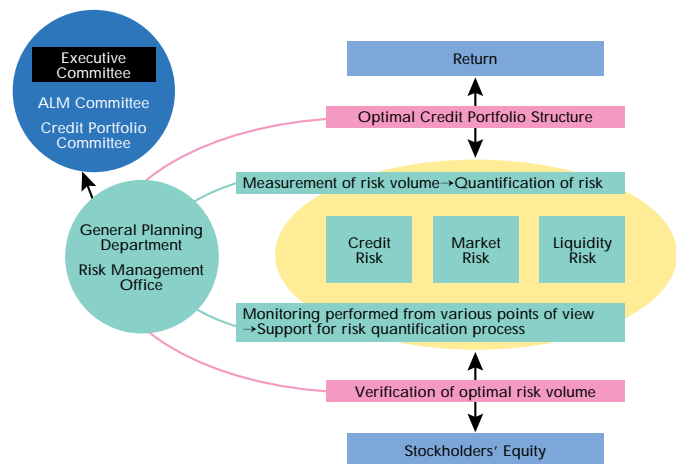
The ALM Committee meets regularly to deliberate and decide on important risk-related issues. Specifically, in conducting a thorough analysis of the Bank’s overall risk position, the committee employs such tools as interest rate forecasts, interest rate gap analysis, simulation techniques, and basis-points-value and VAR measures. Based on this analysis, the committee sets risk volumes for market risks that can be adequately accommodated by the Bank’s financial strength and, within such risk limits, strives to achieve a desired level of return in each of the Bank’s business sectors.

The Bank has given greater consideration to manage interest rate risk in constructing an asset/liability portfolio that is capable of securing stable profits. Through the use of such hedging instruments as interest rate futures, swaps, and options, the Bank has improved its ability to control interest rate risk.



In market-related transactions, as the Bank deals with highly fluid off-balance-sheet transactions, including swaps, options, and other financial derivatives instruments, particular attention is given to the management of liquidity risk.

The Bank has given the management of market, credit, and other risks associated with off-balance-sheet transactions an equal priority to the risk



management of more traditional deposit and lending operations. Management activities include measuring the current exposure risk of derivatives transactions and establishing risk position limits and loss-cutting rules, which are strictly enforced and regularly reviewed. The Bank also estimates the potential exposure risk of these transactions and manages them together with conventional credit transactions.

Derivative Financial Instrument and Foreign Exchange Forward Contracts

	Billions of yen			
	Contract Value or Notional Principal Amount		Credit Equivalent Amount	
	1998	1997	1998	1997
Foreign-exchange-related transactions:				
Currency swaps	¥ 223.6	¥ 226.0	¥ 24.2	¥ 26.5
Forward exchange agreements (FXAs)	0	37.0	0	0.3
Foreign exchange forward contracts	1,545.6	1,688.6	61.4	66.4
Currency options (buy)	7.4	3.1	0.4	0.4
Subtotal	1,776.8	1,954.9	86.1	93.7
Interest-rate-related transactions:				
Interest rate swaps	2,709.2	2,902.5	52.9	51.4
Forward rate agreements (FRAs)	521.9	331.3	0.1	0
Interest rate options (buy)	15.8	13.9	0	0.1
Other derivatives instruments	2.4	21.6	0	0
Subtotal	3,249.4	3,269.5	53.1	51.7
Total	¥5,026.2	¥5,224.5	¥139.3	¥145.5

- Notes: 1. Figures given above were calculated according to capital adequacy guidelines set by the BIS, on a consolidated basis. The current-exposure method was used in calculating the credit equivalent amounts.
 2. The figures for credit equivalents are not netted amounts, i.e., the market value of amounts owed to counterparties to off-balance-sheet transactions has not been offset.
 3. The amounts of transactions excluded from the capital adequacy guidelines are transactions on public exchanges and foreign-exchange-related transactions for which the original contract has a duration of 14 days or less. The amounts of such transactions are shown below.

	Billions of yen	
	Contract Value or Notional Principal Amount	
	1998	1997
Foreign exchange forward contracts and others (within 14 days)	¥ 558.7	¥ 664.0
Interest rate futures	448.7	374.3
Interest rate options (sell)	36.5	7.6
Interest rate options (buy)	7.9	—
Other derivatives instruments	15.4	38.8
Total	¥1,067.2	¥1,084.7

Credit-Related Transactions

	Billions of yen	
	Contract Value	
	1998	1997
Commitments	¥2,353.8	¥2,348.4
Guarantees	388.6	426.8
Other credit-related transactions	132.1	14.5
Total	¥2,874.6	¥2,789.7

YEAR 2000 COMPLIANCE ACTIVITIES

Since 1996, the Bank of Yokohama has been working to solve difficulties related to the so-called Year 2000 problem. In April 1998, the Bank inaugurated its Year 2000 Problem Committee and reinforced a Groupwide structure to deal with related issues. The Bank is moving

forward with a range of computer system tests and expects it will have completed the work necessary to adjust its basic operating systems by December 1998. As regards the Bank's on-line account systems, all Year 2000 problems were rectified when the Bank switched to its third on-line system in 1989.