

The Foundation of Reliability

The Bank's commitment to strengthening management standards and boosting return on equity (ROE) makes risk management a priority issue.

CREDIT RISK

The responsibility for credit evaluation lies with the Credit Department, which performs thorough credit inspections of loan applications based on standards clearly defined in the Bank's Credit Policy and credit criteria. The General Planning Department's Risk Management Office is in charge of credit portfolio management, and the Credit Portfolio Committee—a group of directors that meet quarterly to review the Bank's credit exposure—examines important credit issues and establishes the Bank's basic policy in respect of credit exposure. The Credit Portfolio Committee was established in August 1996. As part of efforts to improve portfolio management, in March 1997 the Bank introduced an internal, industry-specific credit risk management system to avoid excessive exposure to particular industries. Also in 1997, the Bank completed a total revision of its credit rating system for corporate customers for the purpose of raising efficiencies in credit examination and creating a risk qualification framework for credit portfolio management.

In May 1999, a group of 58 regional banks, including the Bank of Yokohama, completed the development of a credit risk quantification system. The system comprises the following three main components:

- 1) A common database: The database provides information on loan defaults from almost every regional bank in Japan. Because of the comprehensive coverage of this database, it is expected to be a particularly valuable tool for credit risk management.
- 2) A standard credit scoring system: The system has three functions. First, it provides a common measure of credit to be attached to loan data transferred to the common database center so that the data can be processed in a uniform format. Second, it calculates an independent credit rating. Third, in the future, it will serve as a convenient reference for participating banks when purchasing or selling each other's loan assets.
- 3) A credit risk quantification system: Calculations are performed using customized software developed jointly by the Industrial Bank of Japan, Limited, and NTT Data Corporation. The main work has been the addition of a simulation function. This system takes into account the effects of changes in regional demographic and structural economic conditions as well as the effects of changes in the composition of loan portfolios.

MARKE T RISK

Primary responsibility for managing market risk lies with the Risk Management Office and the Treasury and Capital Markets Department.

The risk position limit—the maximum permissible potential loss for the Bank’s combined market transactions—is established by the Executive Committee, the Bank’s highest decision-making body under the Board of Directors. Risk positions as well as loss-cutting rules 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 its risk limits.

The Risk Management Office, a unit that is independent of the Bank’s market operations, measures risk exposure for individual business sections on a daily basis and reports this information to the directors in charge of the 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 forecastable loss that may occur due to adverse market movements over a specified period of time, estimated through probability analyses of historical market data. In making VAR calculations, the Bank assumes a holding period of one day and a confidence level of 99.0% (2.33 σ).

L LIQUIDITY RISK

The Risk Management Office and the Treasury and Capital Markets Department perform liquidity risk management.

A ADMINISTRATIVE AND ELECTRONIC DATA PROCESSING (EDP) RISK

Administrative and EDP risk management functions are performed by the Operations Planning and Administration Department.

A SSET AND LIABILITY MANAGEMENT (ALM)

The ALM Committee is at the core of the Bank’s asset and liability risk management operations. Consisting of directors, the committee is one of the Bank’s highest decision-making bodies.

I NTEGRATED RISK MANAGEMENT

To improve ROE while maintaining a sound asset base, it has become necessary for banks to effectively integrate credit risk and market risk management functions. The Bank aims to achieve an allocation of management resources that will maximize returns based on a thorough understanding of its overall risk.

In October 1995, the Bank established the Risk Management Office within its General Planning Department to help it achieve this goal.

The Risk Management Office measures risk volume for each risk factor, including credit, market, and liquidity risk, as well as calculates a Bankwide profit target based on these volumes. The office also establishes whether the Bank has the financial strength to accommodate its 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 to management decisions regarding portfolio structures and risk volume limits.