Risk Management

Basic Perspective

The risks that banks in Japan face are becoming increasingly diversified and complicated as financial liberalization and internationalization progress and financial and information technology advances. Under such circumstances, in order to improve the corporate value while ensuring soundness and stability of management, it is necessary that we appropriately manage and control risks according to the characteristics of operations and risks.

The Bank understands adequate risk management as one of the most important managerial tasks. The Board of Directors has established the Basic Policy on Risk Management and strengthens and improves the risk management system, including the risk management following this basic policy.

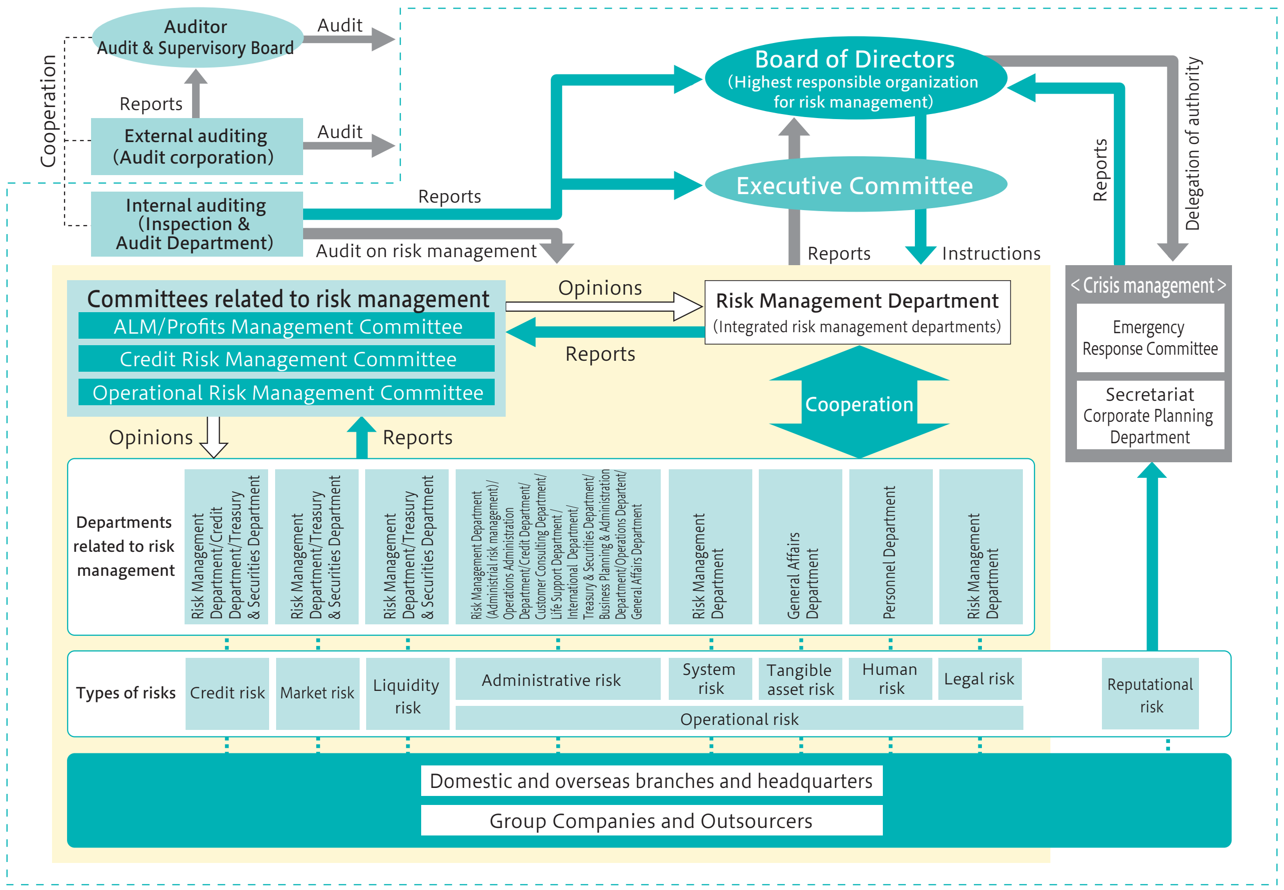
Overview of Risk Management System

The Board of Directors fully recognizes the importance of risk management, determines the risk management policy based on the Bank's management policy, etc., and strives to foster a corporate culture that places emphasis on risk management.

In addition, the Risk Management Department has been established as an integrated risk management organization for the entire bank, which comprehensively grasps and manages the status of various risks including risk measurement results from a cross-sectional perspective.

The Risk Management Department and various risk management-related departments work together concerning risk situations and challenges and report the results to the Executive Committee and the Board of Directors based on discussions and reviews by the ALM/Profits Management Committee, the Credit Risk Management Committee, and the Operational Risk Management Committee.

Organizational framework of risk management



Integrated Risk Management

(1) Basic perspective

In addition to managing individual risks such as credit, market, and liquidity risks, it is necessary to comprehensively manage risks such as overall risk of the Bank as a whole, and to compare and contrast these risks with management vitality. For this reason, the Risk Management Department is taking the lead in developing a system for integrated risk management, strengthening the management of various risks, and promoting the advancement of integrated risk management.

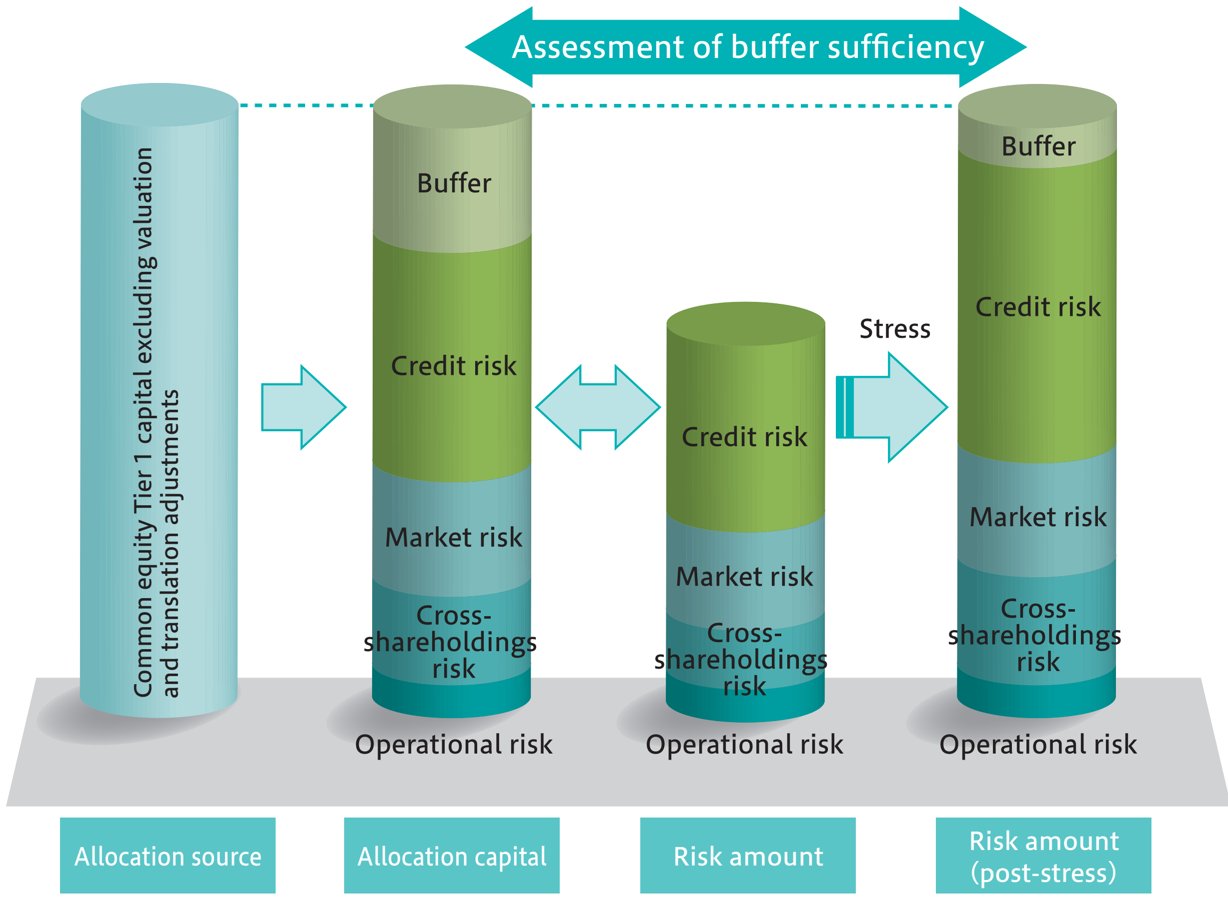
(2) Integrated risk management framework

As one of the methods for integrated risk management, we implemented a system of integrated risk management to measure the amount of risk by each category such as credit risk and market risk using a unified framework (value at risk (VaR), etc.) and integrate them to be compared with management vitality (equity capital).

In specific terms, the Board of Directors determines allocation of risk capital by risk category every six months, with the amount obtained by subtracting valuation and translation adjustments, etc. from common equity Tier 1 capital as the allocation source.

The department for risk management regularly monitors the risk amount to determine whether it is within the allocated risk capital. The Management Committee is reported the results every month through the Asset Liability Management (ALM) / Profits Management Committee as well as the Executive Committee.

[Integrated risk management framework]



Risk Management [Management by Risk Category]

Credit Risks

The nature of the risk, the degree of likelihood that the risk will materialize and timing of materialization, and the impact on business performance if the risk does materialize

- Credit risk refers to the possible loss that a bank may suffer because a bank's business partner or securities issuer cannot repay/redeem interest and/or principal as promised due to worsening business conditions, etc.
- The occurrence of unexpected nonperforming loans due to various factors such as the local economic situation in the local area (*1), business conditions of borrowers (*2), fluctuations in real estate prices and stock prices may increase the cost of disposing of nonperforming loans, which could have an adverse effect on the Bank's business performance.

*1. Local economic situation
The three prefectures of Gunma Prefecture, Saitama Prefecture, and Tochigi Prefecture are the Bank's core areas. Core areas account for more than 70% of the Bank's total loans and more than 90% of total deposits on a non-consolidated basis. A downturn in the economy in our core areas could have an adverse effect on the Bank's business performance.

*2. Loans to SMEs
The Bank has been working to increase its lending to SMEs and individuals. Although the Bank seeks to diversify risk by reducing the size of its loans to SMEs and individuals, trends such as the business performance of SMEs, falling prices of secured real estate, and the household budgets of individuals could have an adverse effect on the Bank's business performance.

Measures in response to risks

- At the Bank, asset-based lending accounts for the majority of credit risk, and ensuring the soundness of asset-based lending is an important task in managing credit risk in the future.
- In order to perform strict credit risk management, mutual checks on credit risks between related departments are necessary. At the Bank, the Risk Management Department is independent from the sales promotion departments and the examination departments, and plans and verifies the management system that forms the basis of credit risk management, such as a credit rating system, asset self-assessment, and amortization and depreciation system, which all work as a regular check function.

Market Risk

The nature of the risk, the degree of likelihood that the risk will materialize and timing of materialization, and the impact on business performance if the risk does materialize

- Market risk refers to the possible loss that a bank may suffer due to fluctuations in market factors such as interest rates, exchange rates, and share prices.
- Although the Bank manages securities appropriately while keeping a close eye on market trends, it may incur valuation losses on bonds including Japanese government bonds due to rising interest rates, foreign exchange losses due to fluctuations in foreign exchange rates, and stock write-downs due to declines in stock prices. As a result, it could have an adverse effect on the Bank's business performance.

Measures in response to risks

- For the departments in charge of market transactions, the department in charge of trading (front office) is separated from the department in charge of risk management and the department in charge of routine paperwork (middle and back offices) to provide a check and balance system.
- Our basic policy is to recognize the importance of impact of fluctuations in market factors for management and to take appropriate actions. In particular, bonds and shares are subject to price fluctuations, and therefore, we deal with them within the range of proper transaction size by determining suitable and sufficient risk assessment.

Liquidity Risk

The nature of the risk, the degree of likelihood that the risk will materialize and timing of materialization, and the impact on business performance if the risk does materialize

- Liquidity risk consists of cash flow risk and market liquidity risk.
- Cash flow risk means the possible loss that a bank may suffer if the Bank is unable to secure the necessary funds due to mismatches between operating and funding periods or unexpected capital outflows or is forced to raise funds at significantly higher rates than usual.
- Market liquidity risk refers to the possible loss that a bank may suffer due to an inability to trade because of market turmoil, etc. or a trade where the Bank is forced to accept significantly unfavorable price.
- The Bank could incur losses if it is not be able to obtain the necessary funds or is forced to raise funds at significantly higher interest rates than usual due to changes in internal or external economic conditions or market conditions, or due to a decline in the creditworthiness of the Bank. For example, if liquidity risk materializes due to factors such as a credit rating downgrade, it could have an adverse effect on the Bank's business performance.

Measures in response to risks

- Our basic policy is to recognize the importance of impact of liquidity risk for the Bank. When liquidity risk becomes apparent, there arises a possibility of directly leading to management failure. We constantly assess the status of liquidity risk precisely.

Operational Risk

The nature of the risk, the degree of likelihood that the risk will materialize and timing of materialization, and the impact on business performance if the risk does materialize

- Operational risk is the possible loss that the Bank may suffer due to inadequate operational processes, activities of workers such as executives, employees, and temporary employees, and functions of systems, or exogenous events. The Bank divides operational risk into five categories in accordance with the organizational structure and content of operations.

(1) Administrative risks
Failure to properly handle the administrative work associated with each type of transaction may result in accidents, which may result in the loss of financial assets or costs associated with restoring the property to its original condition, or a loss of public trust. This could have an adverse effect on the Bank's business performance.

(2) Systems risk
In the event of a computer system outage or malfunction due to computer equipment or communication line failure, program malfunction or the destruction or leakage of information due to unauthorized use of a computer or external attack, settlement functions or service operations may be suspended, or public confidence may be damaged. This could have an adverse effect on the Bank's business performance.

(3) Tangible asset risk
The occurrence of a natural disaster such as an earthquakes, social infrastructure damage such as a power outages or damage caused by crimes, terrorism, etc. to facilities owned by the Bank, such as branches, head office buildings, or computer centers, may interfere with the Bank's business operations. This could have an adverse effect on the Bank's business performance.

(4) Human risk
Factors such as various problems in personnel management (such as remuneration, benefits, or termination) or discriminatory behavior (such as sexual harassment) could have an adverse effect on the Bank's business performance.

(5) Legal risk
If the Bank fails to comply with laws, regulations, and contracts due to differences in interpretation of laws and regulations, deficiencies in legal procedures, violations of laws and regulations by the Bank or its executives and employees, etc., the Bank may be subject to penalties or compensation for damages. This could have an adverse effect on the Bank's business performance.

Measures in response to risks

- The Board of Directors has established a Basic Policy on Risk Management and Basic Regulations on Operational Risk, which stipulate basic matters concerning operational risk management. The Director in charge of the Risk Management Department is designated as the person in charge of supervising overall operational risks and the Risk Management Department is designated as the integrated operational risk management division. The Risk Management Department plans and supervises the overall management of operational risk under the direction and supervision of the director in charge, and each risk management-related department manages each risk from a specialized standpoint.

Disaster Risk, Infectious Disease Risk, and Reputational Risk

The nature of the risk, the degree of likelihood that the risk will materialize and timing of materialization, and the impact on business performance if the risk does materialize

- The occurrence of a large-scale natural disaster, such as an earthquake with an epicenter in the Tokyo metropolitan area or an outbreak of an infectious disease such as the novel coronavirus could result in sluggish economic activity in the region or interfere with the Bank's business activities, and this could have an adverse effect on the Bank's business performance.
- Negative press and malicious rumors about the Bank and the banking industry, which may or may not be true, could lead to liquidity risk, and this could have an adverse effect on the Bank's business performance.

Measures in response to risks

- Based on our social responsibility and public mission as a regional financial institution, the Bank has developed a system that can respond to emergencies quickly and appropriately in the event of a major natural disaster, system failure, novel coronavirus pandemic, etc. and convey relevant information to everyone within the organization.
- Specifically, in order to ensure the safety of our customers, executives and employees, and to perform operations smoothly, we have a crisis management plan (business contingency plan (BCP)). We conduct regular training to ensure its effectiveness and periodically review its contents. We have also established a system to convene an emergency response committee chaired by the President in the event of a crisis. In particular, for major earthquake disasters, we have developed measures such as backup offices and backup systems based on the expected impact.

Risk of Cyber Attacks

The nature of the risk, the degree of likelihood that the risk will materialize and timing of materialization, and the impact on business performance if the risk does materialize

・Unauthorized access to computer systems and networks via means such as the Internet could result in the theft, falsification, or destruction of information, as well as malfunctions or shutdowns of computer systems, etc., and this could have an adverse effect on the Bank's business performance.

Measures in response to risks

・In order to cope with cyber-attacks, we have established a list of Regulations for Cyber Security Management and implement multi-layered measures to prevent unauthorized entry into the system and to detect viruses. We are continuously reviewing these regulations to ensure their effectiveness.
・The Gungin CSIRT* installed in the Risk Management Department plays a central role in dealing with cyber-attacks. In addition to taking necessary measures, we collect relevant information and conduct classes and training in cyber security and cyber-attacks. We are continuously strengthening our security management system.

*CSIRT: Abbreviation for "Computer Security Incident Response Team"

Risk Related to Outsource Operations and Introduction of New Products and New Businesses

The nature of the risk, the degree of likelihood that the risk will materialize and timing of materialization, and the impact on business performance if the risk does materialize

・If an incident, such as an administrative accident, system failure, or information leakage, occurs at any of our outsourcers, the resulting damage to public confidence could have an adverse effect on the Bank's business performance.
・If a violation of laws and regulations, loss of customers, or leakage of information, etc. occurs due to an inappropriate new product or new business structure or administrative processing system, the resulting damage to public confidence could have an adverse effect on the Bank's business performance.

Measures in response to risks

・When outsourcing operations, the Bank has established the Outsourcing Management Regulations that outline the procedures for starting outsourcing, during outsourcing, and at the end of outsourcing to maintain a level of operation equivalent to work done in house, and we strive to ensure that functions for customer risk management and operational risk management work well in outsourced operations.
・In addition, when introducing new products and new operations, we identify, evaluate, and manage in advance the presence/absence of inherent risks and the types of risks. Further, we have established and operated a management framework that allows multiple departments to verify risks from various angles so that they can prepare materials and measures for coping with risks and explain them to our customers.

Risk Related to Financial Crime

The nature of the risk, the degree of likelihood that the risk will materialize and timing of materialization, and the impact on business performance if the risk does materialize

・In the event of a financial crime of a greater magnitude than anticipated, the Bank may violate the laws and regulations of domestic and foreign authorities, incur significant compensation to victims, incur significant costs for security measures, or be imposed with fines. The resulting increase in expenses or loss of credibility could have an adverse effect on the Bank's business performance.

Measures in response to risks

・In view of the increasing diversification and sophistication of financial crimes such as forgery and theft of cash cards and remittance fraud, the Bank is taking measures to strengthen security to prevent damage from occurring. The Bank is aware of the risk of our products and services being used for money laundering and financing of terrorism due to the borderless nature of financial crimes, and it has positioned the prevention of money laundering and financing of terrorism as an important management issue and is working to strengthen its preventive measures.

Initiatives of the Financial Crime Countermeasures Office

The Bank has established the Financial Crime Countermeasures Office in the Risk Management Department and it is enhancing system to centrally manage and cope with money laundering. Based on the Required Actions for a Financial Institution indicated by the Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism issued by the Financial Services Agency, the Bank has taken a risk-based approach to identify and assess risks and enhance risk mitigation measures. Specifically, we analyze each suspicious transaction report by category such as reason of notification, area of occurrence, and type of entity, and prepare our own money laundering risk assessment report . This money laundering risk assessment report not only analyzes the details of the suspicious transactions reported, but also describes the risk factors for each product/service, customer attributes, and the counterparty country. The report describes a series of anti-money laundering measures, including the implementation of risk reduction measures according to the level of risk and regularly updating customer information according to the level of risk.

Financial crime prevention service

If you are affected by bank-transfer fraud, please contact the following service.

Gunma Bank "Financial Crime Prevention Service"
Toll free number: 0120-788511
Hours: 09:00-17:00 (excluding bank holidays)

Establishment of a Risk Appetite Framework (RAF)

The Bank performs integrated management of profits, risk, and capital, and makes the best use of limited capital and management resources, and accordingly, builds and utilizes a risk appetite framework (RAF), a framework for business management that optimizes risk and return.

[Integrated management of profit, risk. and capital]