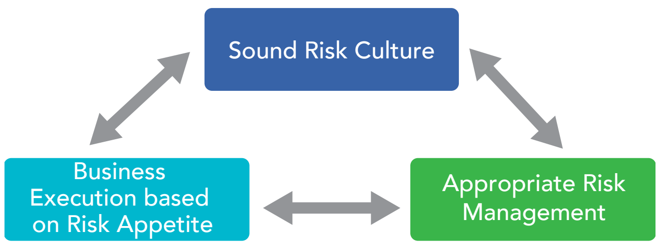
Risk Governance

Basic Concept

Risk governance is an important area of the corporate governance framework, and the SBI Shinsei Bank Group has positioned itself as a self-disciplined entity to control risk in a sustainable manner by properly defining and enforcing the supervision and execution functions of the Board of Directors and executives.

Conceptual Diagram of Risk Governance



The SBI Shinsei Bank Group has formulated a Group Risk Governance Policy, which outlines the concept of governance based on a sound risk culture, business execution based on risk appetite and appropriate risk management. In order for financial institutions to secure stable profits and achieve sustainable growth, it is necessary to take on risks while clarifying their risk appetite, and to manage risks appropriately to support them. These are the aggregation of the judgments and actions of individual executives and employees and are strongly affected not only by rules and regulations, but also by the values and cultures of the organization. We believe that risk governance initiatives require a bird's-eye view of all elements.

We have worked diligently to upgrade our risk management and continue to make ongoing efforts to develop a system commensurate with the risks we face. At the same time, we have focused on building a system for appropriate business execution based on our risk appetite, and have developed an integrated management framework based on our risk appetite and consistency of financial plans. Furthermore, as a member of the SBI Group, we are continually working to foster a sound risk culture based on our management philosophy. We believe that risk governance is an important premise as appropriate risk-taking generates returns as expected and, in turn, aims to improve financial indicators under the sound risk culture.

Risk Culture

Creating a sound risk culture is essential to establishing strong risk governance. The SBI Shinsei Bank Group has established the SBI Shinsei Bank Group Code of Conduct under the SBI Group's common management philosophies and code of conduct. Based on this charter, the SBI Shinsei Bank Group has established a risk culture based on a set of values that serve as behavioral principles for dealing with risk.

To improve corporate value, it is important not only to avoid risks, but also to take appropriate risk-taking measures. Accordingly, we have clarified the basic stance of the Board of Directors and the executives team and have implemented measures to foster a sound risk culture, including conduct of risk awareness surveys of employees.

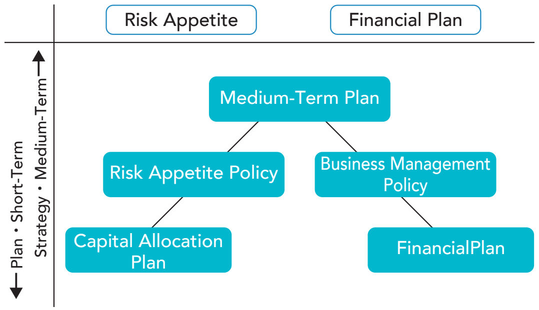
Business Execution based on Risk Appetite

The Risk Appetite Framework is a management framework of the company's overall risk-taking policy, generally considered as the company's "risk appetite." The SBI Shinsei Bank Group focuses on the consistency of risk appetite and financial planning as a key premise. By operating the existing functions related to both in an integrated manner, we have established a system that aligns the intentions of the Board of Directors with the execution by the executives on risk appetite.

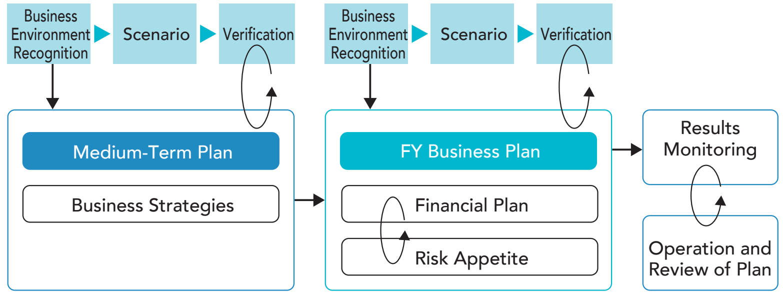
The risk appetite and financial plans are detailed and embodied based on business-line-specific strategies and tactics based on the medium-term management plan. Based on the approval of the Board of Directors, the SBI Shinsei Bank Group has formulated the Risk Preference Policy, which documents risk appetite appropriately in a detailed manner. The Group has clarified the risk appetite of the Group's financial plan and is strengthened monitoring during the term by using quantitative indicators set for the entire SBI Shinsei Bank Group and for each risk category. Risk appetite is quantified on a uniform basis. Risk capital is allocated to each business line, and its use is monitored regularly to ensure soundness.

In order to ensure consistency between risk appetite and financial planning, the SBI Shinsei Bank Group conducts scenario analysis (stress test) to examine the adequacy of capital, funding liquidity, and profitability. If a scenario analysis (stress test) determines that there is excessive risk taking or if there is any doubt about the feasibility of a financial plan, a system is in place to review risk appetite and financial plans. We have also established the Group Risk Policy Committee as a consultative body on management's risk appetite. At the working level, however, we emphasize close communication between sections involved in promoting and controlling risk-taking, and it is an important concept in the integrated management framework.

Conceptual diagram of the relationship between risk appetite and financial planning



Conceptual diagram of joint operations



SBI Shinsei Bank Group Risk Appetite Policy (Summary)

With the repayment of public funds in mind, we will strive to further improve assets and capital efficiency and maximize profits.

- We will strive to earn a steady profit toward repayment of public funds and receive confidence in the sustainability and growth of the SBI Shinsei Bank Group.
- In order to maintain a certain level of capital adequacy ratio, we will not rely solely on the expansion of operating assets, but will raise assets and capital efficiency more than ever before.
- In order to maximize profitability under capital constraints, we will enhance the risk-taking capacity of the Bank Group by improving asset-capital efficiency (i.e., the return on equity ratio) while maintaining and improving the quality of our portfolio.

Regarding the risk-taking capacity of the SBI Shinsei Bank Group, we will pay attention to the following two points.

- We will keep the credit concentration in mind and maintain the soundness of assets.
  ~In order to control fluctuations in profits due to potential bad debt losses, credit concentration (concentration of individual companies and industries) shall be carefully examined and monitored.
- We will maintain stable funding structure.
  ~In order to build a stable financing structure, we will implement measures to acquire sticky deposits.

(NOTE) Based on the basic policies shown in the table above, risk appetite and risk tolerance are set for each of the following four categories: capital adequacy, funding liquidity and financing, business, and operational risk.

Risk Management

The SBI Shinsei Bank Group has established an internal control system that consists of three functions: an autonomous control function (first-line function) in the business execution line on the job site, a control function (second-line function) that is independent of the business execution line on the job site, and an internal audit function (third-line function) that is independent of both of these functions. Of these, the second-line control function verifies the status of risk-taking, determines the will and ability to “take on challenges” (objection) that can be deliberated without hesitation in case there are disagreements among functions while respecting everyone’s actions. In particular, the officer of Group Risk is in principle a jury to the Board of Directors, ensuring opportunities to challenge management policies.

The basic policy for risk management is based on the Group Risk Management Policy, which is based on a management framework for each type of risk and an appropriate allocation of resources to business lines. With regard to capital allocation, which is the primary target area for resource allocation, we have developed an integrated risk management system centered on the risk capital system to comprehensively grasp the risks held by the Group as a whole and compare and contrast them with our management strength.

For more information on risk management, please refer to the Risk Management on page 7 of our Integrated Report 2023 Data Appendix.

With changes in the business environment and the pursuit of value creation both inside and outside the Group, including SBI Group companies, risks that are difficult to identify under the existing framework are increasing. The SBI Shinsei Bank Group identifies "material risk" (top risk) as a risk that is likely to have a material impact on its management. The Group Risk Policy Committee and other committees consider the selection of such risks, including nonfinancial risks that are difficult to quantify. At present, the Group identifies risks such as increases in credit-related costs triggered by rising long-term interest rates and decrease in the value of securities held due to the emergence of geopolitical risks, as well as human resource and IT risks. To address these important risks, we are focusing on improving the management of predictive control and strengthening our ability to respond to them.

Important Risks of the SBI Shinsei Bank Group

Risk scenario	Risk Scenario Details / Impact
1. Increase in credit costs	● Increase in credit costs due to a global economic downturn triggered by rising long-term interest rates, the emergence of geopolitical risks, and the occurrence of large-scale natural disasters and pandemics, as well as a decline in real estate prices. ● Increase in credit costs due to deterioration in the creditworthiness of large-scale investment and loan recipients and credit concentration industries.
2. Risk of rate increases	● A decline in the value of securities holdings and an increase in funding costs due to a rise in interest rates triggered by a change in central banks’ monetary policy and a further rise in policy interest rates.
3. Foreign currency liquidity risk	● Decrease in foreign currency liquidity and increase in foreign currency funding costs due to the financial market turmoil triggered by geopolitical risks, large-scale natural disasters, and pandemic.
4. Emergence of human resource risk (increasing difficulty in hiring new workers and increase in retirees)	● Decline in competitiveness in strategic and core fields due to difficulties in recruiting new graduates and mid-career workers due to intensifying competition to acquire human resources. ● The emergence of internal management problems and the intensification of operational constraints due to the increase in the number of retirees of middle-tier and veteran employees due to the acceleration of human resource mobility.
5. IT risks (cyber attacks and system failures)	● Direct losses and deterioration of reputation caused by the outflow of customer information and the suspension of settlement functions, etc. due to cyber attacks, or the occurrence of unauthorized use or transfer of funds due to cyber-financial crimes. ● Direct losses and deterioration of reputation due to leakage of customer information and stoppage of settlement function due to system failure.
6. Violations of laws and regulations or inappropriate actions by officers and employees	● Direct losses and deterioration of reputation caused by inappropriate acts or omissions by officers and employees that deviate from the law or social norms. ● Administrative penalties, direct losses and deterioration of reputation due to inadequacies in money laundering, terrorist financing measures, etc.
7. Risks related to the promotion of overseas business strategies	● Competitiveness deteriorated due to shortage of specialist human resources required for overseas business planning, promotion, and management. ● Due to differences in the legal system and business practices overseas and limitations in the preliminary survey, the incurrence of response costs and surcharges for unexpected events, and the increase in credit costs.
8. Risks associated with dealing with environmental and social issues	● Strengthening of laws and regulations concerning responses to environmental (including climate-related) and social issues. ● Competitiveness and reputational deterioration resulting from the perceived inadequacy of the SBI Shinsei Bank Group’s response to environmental and social issues. ● Increase in credit-related expenses due to deterioration in business conditions of investment and loan companies that have not sufficiently addressed environmental and social issues.