Risk Management

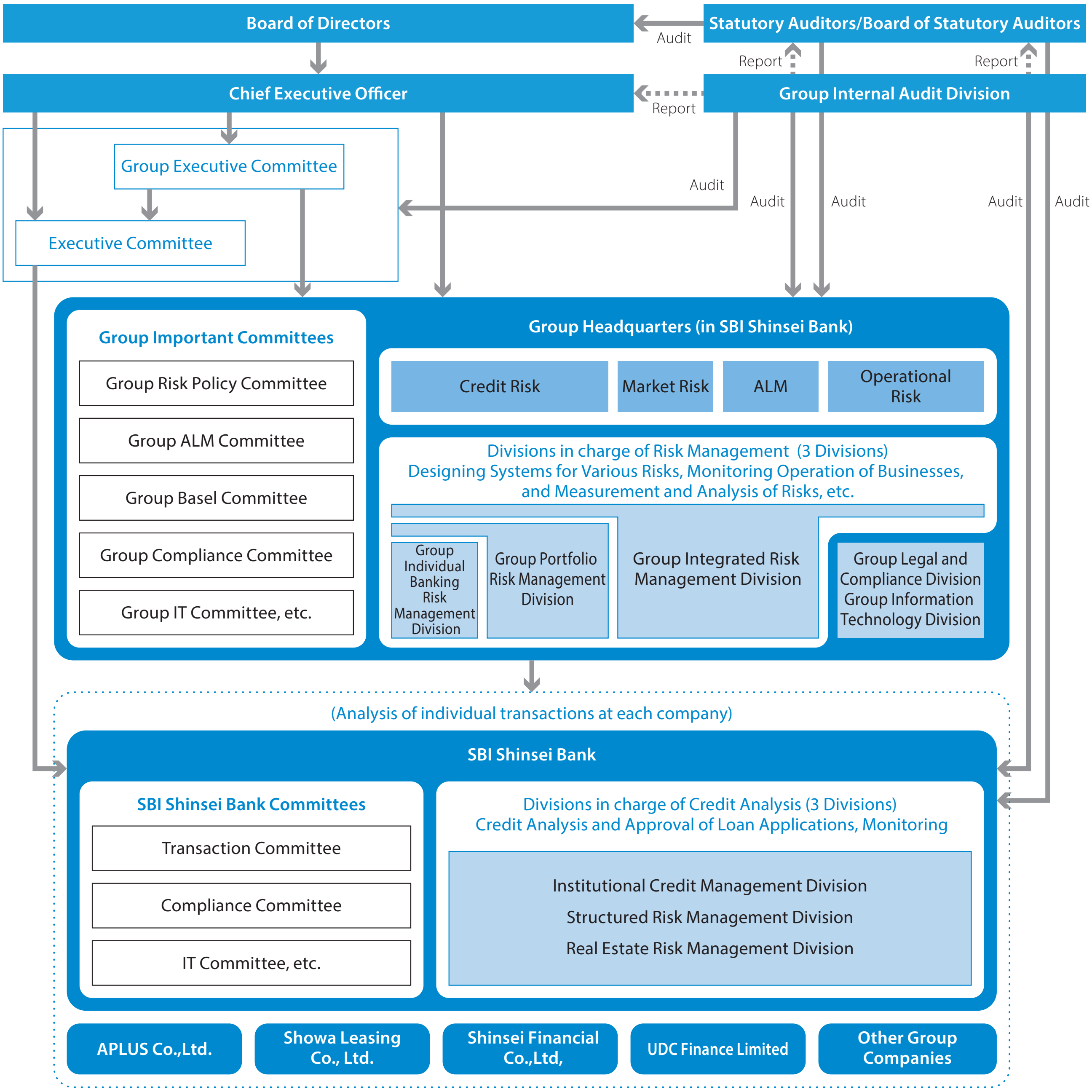
Overview of the Group's Risk Management Systems

To ensure that our risk management is effective, the Bank has established various committees, such as the Group Risk Policy Committee, Transaction Committee, Group Asset and Liability Management (ALM) Committee and Market Business Management Committee.

All these committees are able to function effectively as bodies responsible for making important risk judgments by constantly improving their composition and functions in response to changes in the operating environment. The Group Risk Policy Committee, whose members include senior management, such as the CEO, officers of the Group corporate planning and financing facilitation and Group risk management, and the Group head of risk management, performs the crucial role of setting and coordinating the appropriate and optimal level of risk taking by concurrently reviewing the Bank's risk management policies and business strategy.

SBI Shinsei Bank has established the Group Risk Management Policy as the fundamental policy on risk management and basic recognition of risk categories based upon the understanding of the totality of risks faced by the entire SBI Shinsei Bank Group and the need to actively manage them.

■ Risk Management System Chart (As of June 27, 2023)



Risk Management

Basic Concept Regarding Risk Management

Financial institutions are exposed to various risks, including credit risk, market risk, interest rate risk, liquidity risk, and operational risk. To maintain highly profitable and stable operations, a financial institution must make the control of these risks a management priority. For that purpose, the Bank must be able to ascertain that risks are taken in line with the Bank-wide policies as well as individual operational policies, and that they remain within appropriate limits. To strengthen the required monitoring functions and further develop the risk management framework, the Bank established two risk management groups: 1) credit analysis divisions responsible for credit analysis, loan application approvals and monitoring and 2) divisions responsible for overall risk management, measuring and analyzing credit, market, and other risks, and integrating functions for examining and verifying fair value.

■ Definitions of Risk Categories

Risk Categories	Definition
Credit Risk	Credit risk is the risk of incurring losses due to deterioration in the financial condition of a borrower resulting in an erosion or total loss of asset value (including off-balance assets).
Market Risk	Market risk is the risk of incurring losses due to changes in the value of assets or liabilities through fluctuations of various risk factors, such as interest rates, foreign exchange rates, and stock prices, etc.
Liquidity Risk	Liquidity risk (fund-raising risk) is the risk of incurring losses due to difficulties in securing necessary funds or the need to raise funds at an interest rate that is substantially higher than normal stemming from mismatches in the maturities of assets and liabilities or an unexpected outflow of funds.
Operational Risk	Operational risk refers to the risk of incurring losses resulting from inadequate or failed internal processes, personnel, and systems, or from external events.

Credit Risk

Credit Risk Management: Group Governance

SBI Shinsei Bank has established a cross-Group credit risk management system under the Group Credit Management Policy.

The SBI Shinsei Bank Group Headquarters comprehensively supervises the credit portfolio status and risk management policies of each group company, and also makes timely and appropriate involvement in establishing internal rules, and reviews the management systems of each company. In addition, several councils have been set up between the Group head office and each Group company to share policies based on strategic goals and resolve issues related to risk management operations.

Institutional Business: Credit Risk Management

Under the Group Credit Policy, the SBI Shinsei Bank Group has identified risks which we cannot accept or should not accept as a corporate group, and has established general policies concerning the criteria for selection of the companies to be credited, and has clearly set out various procedures as well as the basic policies for credit business and specific guidelines for credit risk management.

Credit risk management processes for institutional businesses are broadly grouped into credit risk management for individual transactions and portfolio-based credit risk management.

Credit Risk Management for Individual Transactions

(1) Organization & Structure

Regarding credit assessments for institutional business, an effective system of checks and balances on sales promotion divisions is established through the veto rights of risk management divisions.

(2) Obligor Rating Systems

Using credit estimation models including a model benchmarking the credit ratings of external credit rating agencies, we calculate model ratings and apply adjustments to these based on qualitative factors, and use this method to determine credit rankings.

Portfolio-Based Credit Risk Management

(1) Monitoring Analysis System

At SBI Shinsei Bank, we perform analysis that derives from unique entry points based on the risk Profiles of each product and monitor risk diversification status by segments such as industry, ratings, products, and regions, to report to the appropriate management layer.

(2) Quantifying Credit Risk

By factoring measured expected losses and unexpected losses into loan spreads, we can harness this data to ensure an appropriate risk-return for every transaction.

(3) Credit Concentration Guideline

Our credit concentration management framework consists of guidelines for country credit limits as well as industry, obligor group, and product concentrations. When the credit concentration exceeds the guideline, we conduct reviews and adopt countermeasures.

Individual Business: Credit Risk Management

Risk management for our consumer finance businesses encompasses all operations from loan application assessment (entry-point credit) to managing risks after a contract is signed (credit monitoring) and, if needed, loan collection operations. The Group Individual Banking Risk Management Division is in charge of risk management for products for individual customers, including our consumer finance businesses. The division holds a monthly risk performance review meeting with other risk-related divisions including the officer for risk management at the Bank as well as risk officers from subsidiaries in order to share information and promote a shared awareness of risks. The division also provides operational support and advice to relevant units of the Bank and its subsidiaries relating to overall risk management concerning credit administration policies and credit strategies. Risk-related divisions at the Group subsidiaries carry out appropriate risk control through a process that incorporates scoring models into credit administration processes, while using credit-related databases of customer attributes stemming from the nature of their businesses, credit information, and transaction history.

The scoring models, essentially the initial credit score, assess at credit monitoring stages, collection strategy scores, etc. were developed using statistical methodologies, and to maintain the accuracy of the scoring models in line with the level achieved when it was first developed. The model performance is constantly monitored and the model is subject to fine-tuning as needed.

The Group Individual Banking Risk Management Division is working to elevate its scoring model development and enhance the entire Group's credit provision capabilities in ways that help maximize earnings of the entire Group in the medium and long term.

Credit costs are crucial to the management of profitability in the consumer finance business. We, therefore, conduct monitoring while tracking multiple leading indicators and verification metrics at the portfolio level to enable us to quickly grasp any deterioration in the portfolio's overall asset quality and take timely action to improve profitability.

Credit Risks on Market-Related Transactions

Counterparty credit risk associated with market transactions such as derivative transactions are managed based on estimations of the fair value and future value fluctuations of transactions.

Self-Assessment

Asset self-assessments are a part of credit risk management. Financial institutions examine and analyze their asset holdings so they can grasp the actual state of their assets as steps in preparing for appropriate asset write-downs and write-offs as well as reserve provisioning. At SBI Shinsei Bank, sales promotion divisions and credit analysis divisions conduct asset appraisals, and risk management divisions that are in dependent of sales promotion and credit analysis verify appraisal results.

Market Risk

Market Risk Management Policy

In accordance with the Trading Business Risk Management Policy, market risks in the trading business are managed through a series of processes with the Group Risk Policy Committee determining overall market risk and loss limits. The Group Integrated Risk Management Division monitors on a daily basis the status of compliance with these limits, and the Market Business Management Committee reviews every month trends at individual businesses, the status of profits and losses, market risk conditions, and overall business risks of products being handled.

Trading Book

Market risk in the trading book is managed through techniques such as VaR. VaR is the maximum loss amount expected due to future price fluctuations within a given probability range, assuming a specific position is held over a specific time horizon. In addition, we measure multifaceted risks using sensitivity analysis for various factors. In calculating the amounts equivalent to market risk, the Bank's VaR model is based on a historical simulation method and uses a 99% confidence level, a 10-day holding period and an observation period of 250 days (see the following table). The effectiveness of the VaR model is verified through back testing, which examines how frequently actual daily loss exceeds daily VaR for a one-day holding period.

■ VaR Data for Fiscal Year End, Maximum, Minimum, and Average

(Millions of yen)

	FY2021	FY2022
FY End VaR	313	726
FY VaR		
Maximum	611	931
Average	356	560
Minimum	235	296

■ Stressed VaR Data for Fiscal Year End, Maximum, Minimum, and Average

(Millions of yen)

	FY2021	FY2022
FY End VaR	1,190	800
FY VaR		
Maximum	2,304	2,246
Average	1,611	1,118
Minimum	1,046	598

The results of backtesting are described in Capital Adequacy Requirement (Basel Accord) Pillar III (Market Discipline).

Interest Rate Risk in Banking Book

Interest rate risk is the risk of eroding profits or incurring losses due to market interest rate fluctuations amid mismatches in the interest rate or maturities of assets and liabilities. To measure interest rate risk exposure, we calculate the change in economic value of the banking book (△EVE) by using the three scenarios of IRRBB Standards: parallel shock up, parallel shock down and steepener shock, and use maximum △EVE across three scenarios above for internal controls. △EVE is significantly impacted by the recognition of asset and liability maturities and loan prepayments. We are endeavoring to appropriately capture interest rate risk controls.

Risk Related to Marketable Credit Instruments

Investments in structured bonds, funds, securitized instruments, etc., are generally held until maturity, although some instruments can be traded on the market. Such instruments have a complex risk profile that includes market risk and liquidity risk in addition to credit risk related to their underlying assets and counterparties. The Bank has established a system to ensure appropriate management of these risks, regularly reviews its investment policies based on the investment environment. The Transaction Committee, the Market Business Management Committee and the Group Risk Policy Committee strive to promote appropriate management of risks through regular reviews of risk exposure.

Liquidity Risk

Liquidity Risk Management Policy

For funding liquidity risk, based on the Liquidity Risk Management Policy, the Group Treasury Division, a fund-raising management unit, and the Group Integrated Risk Management Division, a funding liquidity risk management unit, have been put in place, and the Group ALM Committee receives reports on the following designated liquidity risk management indicators: funding gap limit, minimum liquidity reserves, liquidity stress tests, and liquidity coverage ratio. The levels of funding liquidity risk consist of three Risk Administration Modes: normal, need for concern, and crisis with the Group ALM Committee determining the current mode. The response framework for each specific mode is set forth in the Funding Liquidity Contingency Plan, and regular training is provided.

Operational Risk

Operational Risk Management Frameworks

To ensure comprehensive management of operational risks, the Bank has established an operational risk management policy that defines risks and sets forth its basic policy and organizational structures for risk management as well as procedures for identifying, evaluating, monitoring, reporting and controlling/mitigating risk. The Group Integrated Risk Management Division, a unit responsible for Group-wide operational risk management, evaluates, analyzes, and reports on operational risk to management. Moreover, for each domain of operational risk, such as administrative risk and systems risk, specialized risk management divisions that are independent from business divisions manage operational risks according to the attributes of each category.

Risk Management Frameworks for Administrative Risks

Administrative risks refer to the risk of incurring losses from inaccuracies in clerical tasks due to the carelessness of executives or employees, or errors or misconduct in their performance of work duties. For administrative risks, we recognize that their effective management of these risks is extremely important for our ability to offer services that our customers trust. We strive to improve the level of our administrative work performance by clarifying the content of procedures through efforts to revise terminology, hold training seminars, provide guidance on administrative work, and improve administrative workflows. Also, we have established a system of branch self-audits where autonomous checks are performed at the work-task level and by creating a database documenting past errors have enabled the analysis of the causal factors behind errors that will help prepare and put in action specific administrative risks control measures for preventing reoccurrences.

Risk Management Frameworks for Systems Risks

Systems risks include the risk of companies or individuals incurring losses from the disappearance of valuable data of customers as a result of information systems shutting off and software or hardware failures. Through consecutive reviews of systems risks, we are identifying and evaluating the risks, and working to improve quality in systems development and prevent systems failures, and to ensure rapid recoveries when problems occur by improving our systems operating capabilities. We continue to manage risks for safe operations of new systems. We have endeavored to improve the level of systems risk management and information security for the entire Group, including subsidiaries. We have positioned cybersecurity risks that threaten the security of the financial system as one of the key risks of management, and the SBI Shinsei Bank Group C-SIRT is working on Group-wide management.

We will strive to ensure the safety of our customer's information and assets by conducting tests using practical attack methods.

Due Diligence System for New Business and Products

The Group New Business/Product Committee was established in the Group headquarters to conduct due diligence for new businesses and products of our Group companies.

In strategic investments with capital tie-ups, due diligence has to be conducted by this committee before the Group Executive Committee makes decisions.

Furthermore, a post launch monitoring system for new business has been established and we take appropriate actions if a problem in the business arises.

Due diligence system for new business and products

Chairman and committee members

- (Co-chairman) Officers of the Group Corporate Planning & Financing Facilitation and the Group Risk
- Officer and GM of internal management sections in the group headquarters (Corporate Planning, Financial and Regulatory Accounting, Legal and Compliance, IT, Risk and etc.)
- Heads of risk management divisions in the group companies and executive officer in credit management of the Bank.
- Group Internal Audit Division, Audit & Supervisory Board Member of the Bank

Main verification items

- Conformance with the legal and compliances measures, action on anti-money laundering
- Adequacy of the financial and regulatory accounting process
- Implementation of technologies that conform to the Group's security standards
- Management process of risks inherent to business and service.

→ Credit risks, market risks, liquidity risks and etc.

Authority etc.

- Verification of the framework of internal management, in response to legal and compliances measures requires the approval from all of the Committee members.
- For strategic investments, important new business and products, the Committee reports the results of verification to the Group Executive Committee, in which decision-making authority resides.

Process after a business is launched

Monitoring system

- The effectiveness of the approved matters is confirmed by the Committee.
- Managements and business sections regularly evaluate performance of the business.