Risk Management

Message

Message from the Chief Risk Officer (CRO)

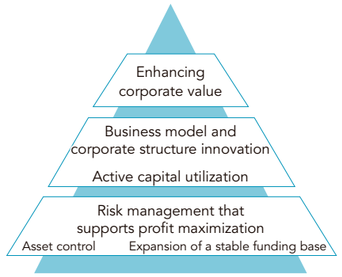
Takahiro Yoshida
Managing Executive Officer, CRO
SuMi TRUST Group

Risk management is an important management foundation that supports the realization of the Group's Purpose and Mission, and the enhancement of corporate value. The external environment is becoming increasingly uncertain due to heightened geopolitical tensions, the rise of new technologies, and natural disasters. In light of such changes, we will strengthen our capability to detect risks at an early stage, and work on the upgrading of our management system and response capabilities in preparation for the risk propagation. While upholding the confidence expected of us as a fiduciary institution grounded in the trust business, we will engage in appropriate risk-taking amid change through productivity improvements and efficient capital utilization, thereby achieving sustainable growth and strengthening resilience. Under the new Medium-Term Management Plan, we will continue to steadily enhance our risk management while accurately identifying both risks and opportunities, and continue to be a company that is trusted by stakeholders.

Topics

Risk Management That Supports Profit Maximization

The Group is promoting innovation in its business model and corporate structure and active capital utilization towards enhancing corporate value. Taking a holistic view of the entire balance sheet, we are working on a transition to optimal allocations that balance profitability and risk tolerance. Through the expansion of a stable funding base and asset control, we will appropriately manage Group-wide risks based on disciplined balance sheet management to support profit maximization in a sound and disciplined manner.



01 Basic Policy

The Group follows a basic policy of accurately assessing risk conditions and implementing necessary measures through a series of risk management activities, including risk identification, evaluation, response, and monitoring, based on the Group's management policy and basic policy on the internal control system. The Group's risk management framework is based on the Risk Appetite Framework, with each activity interlinked and functioning organically within the Group.

02 Risk Management System

For the Group-wide risk governance system, the Group has developed a Three Lines of Defense system consisting of risk management by individual Group businesses (first line of defense), risk management by the Risk Management Department and individual risk management-related departments (second line of defense), and validation by the Internal Audit Department (third line of defense). The Board of Directors determines the Group's management policy and, based on that policy, the risk management policy, risk management framework, and other related matters. It also supervises the development and operation of an appropriate risk governance system. The Executive Committee (composed of representative executive officers and other executive officers designated by the President, including the CRO) makes decisions on matters concerning risk management and undertakes preliminary discussions regarding matters to be resolved by and reported to the Board of Directors. Moreover, the Board of Directors has voluntarily established the Risk Committee and the Conflict of Interest Committee as advisory bodies based on the business strategies and risk characteristics of the Group.

(i) First line of defense

Each Group business identifies and gains an understanding of the risk characteristics involved in its own business, based on knowledge of the services and products in that business. Each Group business takes risks within the scope of its risk appetite in accordance with its risk-taking policy, evaluates risks, and swiftly implements risk control at the on-site level if risks that are outside of its risk appetite materialize. In addition, the status of risk management is reported to the second line of defense in a timely manner.

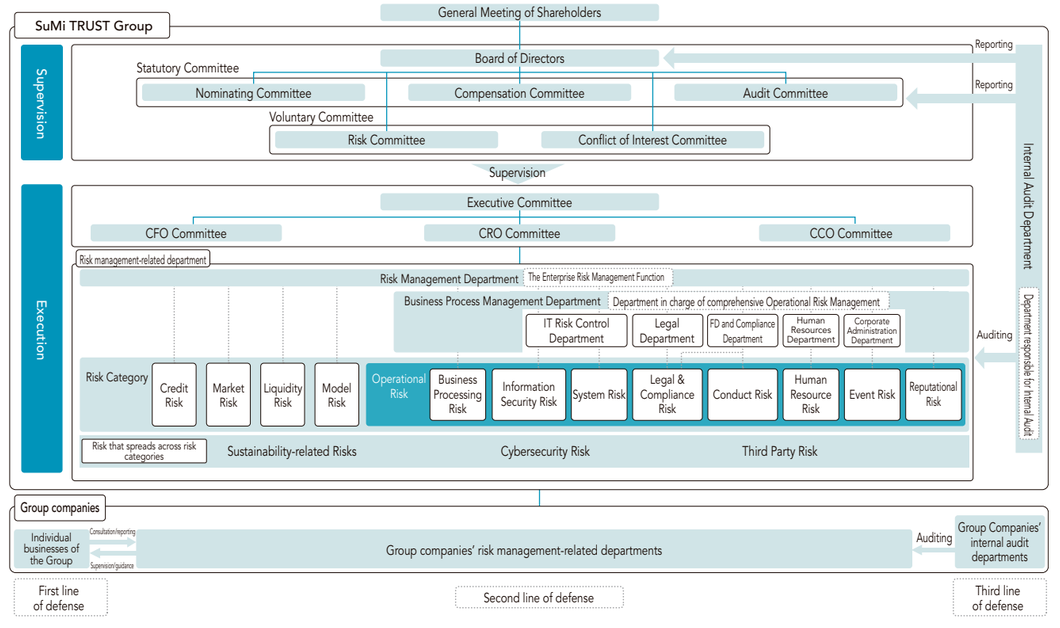
(ii) Second line of defense

In accordance with the Group-wide Risk Management Policy approved by the Board of Directors, as control departments responsible for the management of each risk category, the Risk Management Department and risk management-related departments perform a check and balance function for the risk-taking of the first line of defense, and supervise and provide guidance regarding the risk governance system from a standpoint independent from the first line of defense. The Risk Management Department, as the Enterprise Risk Management Function, develops a risk management process for the entire Group and sets risk limits. In addition, it formulates Group-wide recovery strategies, in advance, to prepare for cases when risks materialize. Furthermore, it shares information with risk management-related departments appropriately, monitors the overall status of risks and risk management in an integrated manner, and the CRO reports the status to the Executive Committee and the Board of Directors.

(iii) Third line of defense

The Internal Audit Department audits the effectiveness and appropriateness of the Group-wide risk governance system and processes from a standpoint independent of the first and second lines of defense.

● Risk Governance System



03 Proactive Management of Top Risks, etc., in the Risk Management Process

Based on the features and risk characteristics of the Group's business model, we select the top risks (risks that could have a material impact within one year and that require management attention) and emerging risks (risks that could have a material impact in the medium to long term beyond one year) and review them regularly. Top risks are monitored regularly and reported to the Board of Directors.

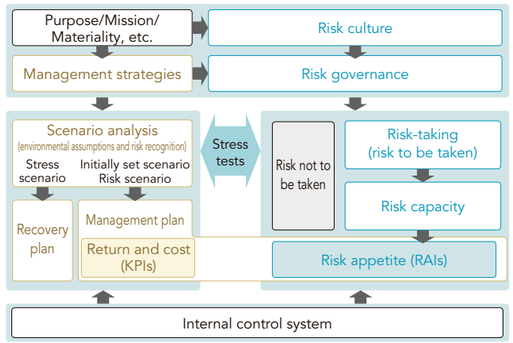
Main top risks
Geopolitical risks
Risks related to climate change
Credit concentration risk to major obligors
Risks related to ALM (asset liability management)
Risks related to cyberattacks
Legal & compliance risks
Risks related to the ability to detect and prevent financial crime

04 Risk Appetite

(i) Outline of the Risk Appetite Framework

The Risk Appetite Framework is a Group-wide corporate management framework consisting of the process for determining risk appetite (the level of risk accepted by management) within the Group's risk capacity (the maximum tolerable risk), together with an internal control system that monitors the process and its appropriateness and sufficiency, in order to achieve management strategies formulated based on the Group's Purpose, Mission, materiality, and others. With the primary objective of balancing the strengthening of profit earning capacity with enhancement of risk management, our Group's Risk Appetite Framework has established communication processes through the determination and monitoring of risk appetite and promotes the improvement of transparency in the decision-making process for risk-taking overall, the optimization of the allocation of management resources, and the strengthening of the monitoring system. Through the above, the Group is promoting the enhancement of risk governance, which forms a part of corporate governance, with the aim to achieve sound and sustainable development through the value creation process by implementing and enhancing the Risk Appetite Framework.

● Outline of the Risk Appetite Framework



(ii) Determining risk appetite target

The Group classifies risks into "risks to be taken" and "risks not to be taken." Risks to be taken are classified further into risks that are willingly accepted as part of a management decision for the development of new fields and future growth, and risks that cannot be eliminated completely and are therefore to be managed or controlled. "Risks not to be taken" means risks that are not accepted under any circumstances, including violations of social norms and ethics, not just violations of laws and regulations.

At the Group, the Board of Directors determines the risk-taking policy, performance indicators (KPIs), and risk appetite indicators (RAIs) based on the Purpose, etc., and the Executive Committee determines the detailed strategies. We have established a risk appetite statement as a document that clarifies the overall picture and our thinking on these issues, and review our risk-taking policy and KPIs/RAIs at least once a year or as necessary, in alignment with our management plan.

(iii) Risk appetite monitoring

Through KPIs that show the progress of the management plan and RAIs that visualize the amount of risk associated with them and which monitor the balance between risk and cost, we monitor whether appropriate risk-taking is being carried out regularly.

If these indicators deviate from the set levels, we analyze the causes and implement countermeasures or review strategy as necessary.

05 Enterprise Risk Management

(i) Enterprise risk management structure

The Group identifies and assesses the various risks it faces comprehensively, and responds actively and strategically to risks that should be managed, in order to ensure appropriate resource allocation and earnings (enterprise risk management).

Among the risks we manage in enterprise risk management, we aggregate risks that can be quantitatively measured using a common metric, such as VaR,* and compare the aggregated risk volume against our corporate strength, i.e., capital adequacy, thereby managing risks (integrated risk management).

The Group conducts enterprise risk management through efficient capital allocation operations, stress testing to prepare for future uncertainty, risk appetite management, etc.

*VaR: Value at Risk

(ii) Capital allocation operations

The Group allocates capital to each Group business by risk category (credit risk, market risk, and operational risk) in consideration of the external environment, risk-return performance, scenario analysis, and the results of assessment of capital adequacy level.

The capital allocation plan is subject to the approval of the Board of Directors. Capital allocation levels are determined based on the Group's risk appetite. Each Group business is operated within both the allocated amount of capital and the risk appetite. The Risk Management Department measures risk amounts on a monthly basis, and reports regularly on the risk status compared to the allocated capital and risk appetite to the Board of Directors and others.

(iii) Capital adequacy assessment

The Risk Management Department performs three types of stress tests (hypothetical scenario stress testing, historical scenario stress testing, and examination of the probability of occurrence) each time a capital allocation plan is formulated or reviewed, with the aim of ensuring capital adequacy from the standpoint of depositor protection. Based on the results of these stress tests, it assesses the level of capital adequacy, and reports to the Board of Directors and others.

06 Fostering and Instilling a Risk Culture

At the Group, we define risk culture as "the mindset and behavioral norms within our corporate culture (the mindset and behavioral practices that form the foundation of the organization and shared within the company) that underlie risk-taking and risk management in particular."

The Group will aim to contribute to enhancing corporate value and stakeholder value by building a sustainable business model, and positions the fostering and instilling of a sound risk culture as an important management issue. All directors, executive officers, and employees actively identify the inherent risks in their own work, are aware of sound risk-taking and appropriate risk control, and encourage each other to foster a sound risk culture throughout the Group. To that end, we are building an open and transparent organization and promoting understanding of our risk culture and embedding it through positive messaging by management and the ongoing implementation of e-learning-based and rank-specific training.