Main Points of Monitoring Report on Regional Banks' Securities Investment (1)

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■ For the approx. 20 regional banks that take a large amount of risk in securities investment, we conducted focused monitoring for: A. risk-taking commensurate with their financial strength and risk control capabilities; B. building effective investment and risk management systems commensurate with their risk-taking; C. demonstrating effective risk governance.

< Main discussion points in monitoring>

A. Risk-taking Commensurate with Financial Strength and Risk Control Capabilities

When engaging in securities investments, the risks undertaken should not exceed what can be managed with their current financial strength and risk control capabilities.

(Need to secure financial strength and risk control capabilities in accordance with the positioning of securities investment in business strategies.)

B. Building Effective Investment and Risk Management Systems Commensurate with Risk-taking

1. Clarification of Risk-taking Policy	Clarify risk-taking areas and policies, taking into account the strategic positioning and financial strength (capital and earnings) and risk volume, and establish a management system.
2. Clarification of Risk Tolerance	Clarify the maximum risk amount and loss limits that can be tolerated in light of financial strength (capital and earnings), and establish a risk management system to control risks within those ranges.
3. Risk Management of Fund Investment, etc.	Analyze and manage the risks in investment assets and asset management companies and fund returns to the same extent as possible as in the case where banks directly hold the assets.
4. Utilization of Stress Testing	Utilize scenario-based stress testing that reflects the risks recognized by management and risk-taking policy, and evaluate the impact on future financial strength (capital and earnings).
5. Responding to Change in the Market Environment	Formulate action plans to prepare for market fluctuations, conduct simulations to prepare for future swings in fiscal term earnings, and control risks.

C. Demonstrating Effective Risk Governance

Management-led control

Organization-wide decisions and risk evaluation

Risk evaluation with an eye on the **future**

Substantial involvement of management

*Financial strength refers to the quantitative aspect, such as capital and earnings. Risk control ability refers to the qualitative aspect, such as the quality of the investment and risk management systems.

Main Points of Monitoring Report on Regional Banks' Securities Investment (2)

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- **In general, appropriate efforts have been recognized** at the banks that have been monitored to date.
- On the other hand, with regard to the establishment of effective investment and risk management systems commensurate with risk-taking, some cases of concern and recommended practices were recognized from the perspective of ensuring sustainable soundness and advanced risk management, as shown in the table below.
- We expect that financial institutions use the points at issue discussed and the cases introduced in this report as a reference for their efforts toward the enhancement of investment and risk management systems and effective risk governance in accordance with the risk characteristics of each financial institution.

<Major cases ascertained through monitoring >

Cases of concern	Recommended practices
● The medium to long-term policy for securities investment is unclear. ● In the second line of defense in particular, efforts to secure and develop human resources with a view to skill inheritance are insufficient.	● Clearly positioning securities investment as an important business activity and enhancing both the investment and risk management framework in line with risk-taking.
● In-depth discussion concerning the establishment and management of loss limits is insufficient.	● The loss limits and other parameters are established based on fiscal term earnings at a certain level.
● Risk management level of fund investment, etc. ・Investing small amounts in products based on the same strategies and methods without sufficiently analyzing and selecting the risks. ・Performance evaluations and factor analyses are insufficient.	● Risk management level of fund investment, etc. ・Sensitivity and valuation gains and losses per risk factor are reported to senior management.
	● Utilization of stress testing, considering cross-organizational scenarios that include management.
● No comprehensive risk control considering both capital and fiscal term earnings has been implemented.	● Various response strategies have been formulated in anticipation of capital loss risk. Etc.

*The second line of defense is the risk management department (middle office).