Business and Other Risks

Risks that could have a material impact on investor decisions are outlined below. Forward-looking items described below are those of which YMFG is aware as of the end of the fiscal year under review.

1. Non-Performing Loans

(1) Non-Performing Loans

YMFG maintains sufficient allowances against non-performing loans to maintain the soundness of its assets. However, YMFG's non-performing loans and credit expenses could increase as the result of economic movements in Japan and the local community, fluctuations in real estate values and share prices, and the management status of recipients of YMFG's financing. Such factors could have a negative effect on operating performance and reduce equity capital.

To date, YMFG has worked diligently to move non-performing loans off the balance sheet, to write off non-performing loans appropriately, and to post sufficient allowances for doubtful accounts. However, the Group could face larger-than-expected losses when disposing of non-performing loans or incur higher-than-expected amortization.

(2) Allowance for Doubtful Accounts

In accordance with predetermined standards, YMFG posts an allowance for doubtful accounts using expected losses based on past loan loss ratios. However, actual losses may differ from the amounts expected when the allowance for doubtful accounts is posted. As a result, actual losses could significantly exceed expected losses, resulting in an insufficient allowance for doubtful accounts.

Furthermore, worsening overall economic conditions, declines in collateral values and other unexpected factors may require the Group to revise its set standards and expected losses, resulting in the need to increase the allowance for doubtful accounts.

(3) Loans by Business Category, Geographic Region and Other Factors

From a risk management perspective, YMFG conducts credit management of its portfolio by rating level, business category, scale, region and other factors.

However, large amounts of non-performing loans could be generated in a specific business category and, if poor business conditions in that business sector are prolonged, new corporate bankruptcies could arise. In such circumstances, YMFG's credit expenses could increase, having a negative impact on YMFG's operating performance and financial condition.

Furthermore, as YMFG's main bases of operation are in Yamaguchi Prefecture, Hiroshima Prefecture and the city of Kitakyushu, the Group's operations tend to be particularly affected by regional economies. Conditions in those regional economies could therefore have a negative impact on YMFG's operating performance.

2. Capital Adequacy Ratio

As YMFG has overseas bases, it calculates a consolidated capital adequacy ratio according to uniform international standards as provided by "standards for determining whether a bank holding company's equity capital is sufficient, after taking into account assets held by the bank holding company and its subsidiary companies, based on the provisions of Article 52-25 of the Banking Act" (Financial Services Agency Notification No. 20 of 2016).

Yamaguchi Bank, a YMFG subsidiary, calculates its non-consolidated capital adequacy ratio according to uniform international standards based on "standards for determining whether a bank's equity capital is sufficient, after taking into account assets held by the bank, based on the provisions of Article 14-2 of the Banking Act" (Financial Services Agency Notification No. 19 of 2016).

Under uniform international standards (Basel 3), the consolidated capital adequacy ratio must be maintained at 8% or higher, the Tier 1 ratio at 6% or higher and the Tier 1 ratio on common shares at 4.5% or higher (as of the end of the consolidated fiscal year under review).

Momiji Bank and Kitakyushu Bank calculate their non-consolidated capital adequacy ratios according to domestic standards, based on Financial Services Agency Notification No. 19 of 2016.

Domestic standards require a bank to maintain a capital adequacy ratio of 4% or higher (as of the end of the consolidated fiscal year under review).

If the capital adequacy ratio falls below the above-stated standards, the regulatory authorities may order a bank to discontinue all or part of its operations.

(1) Deferred Tax Assets

As of the end of the consolidated fiscal year under review, Japanese accounting standards allow companies to record deferred tax assets as expected tax benefits to be realized in the future.

Uniform international standards (Basel 3) allow deferred tax assets related to temporary differences to be included in equity capital, up to a certain limited amount, and YMFG includes in equity capital an amount calculated in accordance with Financial Services Agency Notification No. 28 of 2012.

As the balance sheet amount of deferred tax assets is based on various forecasts and assumptions, including those related to future taxable income, YMFG may reduce deferred tax assets if it decides that all or part of these deferred tax assets cannot be recovered. Such a reduction would have a negative impact on YMFG's operating performance and cause the capital adequacy ratio to decrease.

(2) Total Accumulated Other Comprehensive Income

Under uniform international standards (Basel 3), the entire amount of total accumulated other comprehensive income is included in common stock and other Tier 1 capital. Momiji Bank and Kitakyushu Bank, which apply domestic standards (Basel 3), include amounts equivalent to 45% of land revaluation differences in 50% of equity capital under transitional measures provided by Financial Services Agency Notification No. 6 of 2013.

Accordingly, decreases in valuation differences on other available-for-sale securities due to fluctuations in share prices and interest rates, as well as declines in land revaluation differences in line with impairment or sale, can cause the capital adequacy ratio to decrease.

3. Interest Rate Risk

YMFG, which engages mainly in banking operations, is affected by fluctuations in market interest rates through interest on loans—an asset investment method, yields on bond and other investments, and interest rates on deposits—a funding method. Mismatches between the amount and timing of asset investments and funding, as well as unforeseen interest rate fluctuations, may have a negative effect on YMFG's operating performance and financial condition.

4. Risk of Price Fluctuations on Holdings of Available-for-Sale Securities

YMFG has substantial holdings of marketable, available-for-sale securities for investment purposes. Broad-based and large-scale price declines may engender impairments or valuation losses on holdings of available-for-sale securities, which could have a negative effect on YMFG's operating performance and financial condition and lower the capital adequacy ratio.

5. Risk Related to Pension Obligations

Decreases in the market value or investment yield of YMFG's pension assets or changes in the base rate used for calculating retirement benefit obligations can result in losses. Also, changes in pension plans can incur amortization expenses on past service obligations. In addition, changes in the interest rate environment and other factors can have a negative impact on the unfunded portion of retirement benefit obligations.

6. Risk of Credit Rating Being Lowered

If rating agencies were to lower their ratings, YMFG could be required to engage in transactions under unfavorable conditions or become unable to engage in certain transactions. This situation could have a negative impact on YMFG's operating performance and financial condition.

7. Compliance

To encourage all executives and employees to reinforce the compliance system, each year YMFG formulates compliance program practice items and undertakes a variety of initiatives. However, if a compliance-related problem were to arise, it could cause direct losses as well as resulting in the loss of trust among customers cultivated over many years. As a result, YMFG's operating performance could be negatively affected.

8. Holding Company Risk

Being a bank holding company, the majority of YMFG's earnings come from the dividends paid by its wholly owned subsidiaries, Yamaguchi Bank, Momiji Bank and Kitakyushu Bank. Under certain conditions, the Banking Act or the Companies Act may restrict the amounts that Yamaguchi Bank, Momiji Bank and Kitakyushu Bank can pay as dividends to YMFG. In addition, Yamaguchi Bank, Momiji Bank and Kitakyushu Bank may become unable to pay dividends to YMFG due to the insufficient posting of earnings. Their inability to pay dividends to YMFG could render YMFG unable to pay dividends.

9. Other Risks

(1) Liquidity Risk

YMFG raises the majority of its funds through deposits and is therefore able to manage funds provided through a stable source of funding. However, inconsistencies between investment and funding or unexpected outflows of funds could hinder funding, rendering YMFG unable to fulfill its payment obligations on their settlement dates. Alternatively, YMFG may be compelled to raise funds at substantially higher interest rates than usual, thereby generating losses.

(2) Operational Risks

YMFG faces operational risks in the course of its operations. These risks include internal fraud, external fraud, workplace improprieties (such as acts that conflict with laws and regulations), the improper handling of customer transactions (including violations of obligations and problems with product designs), natural disasters, accidents, system failures, customer relations, the inappropriate handling of transactions and unsatisfactory process management. Such issues with business operations could result in losses and have a negative impact on YMFG's operating performance and financial condition.

(3) Risk Related to Significant Legislation

YMFG strives to ensure thorough compliance and is reinforcing its system for preventing violations of laws and regulations. Nevertheless, YMFG could become subject to lawsuits due to violations of laws and regulations in its various operations. Such situations could negatively affect YMFG's operating performance and financial condition.

(4) Risk Related to Outflows of Customer Information

YMFG retains significant information about customer deposits and loans that should not be leaked outside. The Group has in place measures to prevent outside incursions of its online and other systems. However, unexpected circumstances could result in outflows of such information. The Group stringently manages information printed on paper or stored in electronic media in accordance with information asset management regulations, but such information could be leaked outside the Group by people with malicious intent or as the result of the mishandling of information. Such situations could call into question the Group's social responsibility and result in claims of compensation for damages.

(5) Reputational Risk

Negative news reports and rumors about YMFG and the financial industry, whether true or not, could negatively affect YMFG's operating performance, financial condition and share price.

(6) Risk of Regulatory Change

As a bank holding company, YMFG is subject to restrictions and supervision under the Banking Act and is bound to operate within the restrictions in place as of the end of the consolidated fiscal year under review (including laws, regulations, policies and conventional practices). Consequently, future regulatory changes could negatively affect YMFG's execution of operations, operating performance and capital adequacy ratio.

(7) Risks Related to External Factors

External factors such as natural disasters (including earthquakes, storm and flood damage, and contagious diseases), man-made disasters (including terrorism and cybercrime) and technological disasters (including electrical outages and computer trouble), could result in damage to YMFG's head office, branches and other locations, threatening YMFG's ability to continue all or part of its operations and significantly affecting YMFG's operations. As a result, YMFG's operations and financial conditions could be negatively affected.