

Business and Other Risks

Of the matters related to business and economic conditions outlined in the annual securities report, below are the major risks management recognizes as having the potential to materially affect the financial condition, operating performance and cash flows status of YMFG (the Bank and its consolidated subsidiaries). Recognizing this potential, YMFG strives to prevent such risk from manifesting and to respond appropriately in the event they do occur.

The forward-looking items described below are those of which YMFG is aware as of the end of the fiscal year under review.

1. Credit Risk

(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 the financial condition, reducing 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. Such factors could have a negative effect on operating performance and the financial condition.

(2) Allowance for Doubtful Accounts

In accordance with predetermined standards, primarily, estimated loss amounts for the next one year and next three years are calculated for assets corresponding to normal assets and assets requiring caution. For assets classed as potentially bankrupt assets, loss amounts are stated by subtracting from lending amounts the amount of recoverable collateral or the expected amount recoverable from guarantees. 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. This could have a negative effect on operating performance and the financial condition.

(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 and financial condition.

(4) Response to Borrowers

In some cases, YMFG may not exercise its legal rights even when a borrower defaults on their financial obligations, after taking into account the efficient and effective recovery of loans, among other factors. Furthermore, YMFG may support or cooperate with such borrowers in their efforts to secure additional loans. YMFG's credit costs could rise as the result of a deterioration of the creditworthiness of such borrowers and its support, having a negative impact on YMFG's operating performance and financial condition.

(5) Impact of COVID-19

To prevent the spread of the novel coronavirus disease (COVID-19), companies are being asked to suspend operations, and people are being asked to refrain from going outdoors. This situation is affecting our region to an unprecedented degree. Given these circumstances, YMFG is working to understand the conditions of individual borrowers in a timely and appropriate manner and provide various types of support to help customers with cash flow and other aspects of business continuity, including through the application various types of support measures. However, if the operating environment were to deteriorate, credit costs could rise, having a negative impact on YMFG's operating performance and financial condition.

2. Risks Related to the Capital Adequacy Ratio

(1) 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).

Accordingly, 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. YMFG's capital adequacy ratio currently exceeds these levels. However, changes in amounts of capital stock, retained earnings and valuation differences on available-for-sales securities, as well as fluctuations in risk assets, could affect the capital adequacy ratio.

Uniform international standards call for the setting of a capital conservation buffer (2.5% above individual minimums). Currently, YMFG exceeds these buffer levels. However, if it were to fall below these levels, YMFG might limit dividends and other outflows, having a negative impact on YMFG's operating performance and financial condition.

Among consolidated banking subsidiaries of YMFG, Yamaguchi Bank 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). 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.

(2) 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 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 financial condition and cause the capital adequacy ratio to decrease.

3. Market Risks

(1) 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.

(2) 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.

(3) Exchange transactions

YMFG's operations are affected by exchange rate fluctuations. Ongoing yen appreciation reduces the value of foreign currency transactions when converted to yen. Also, certain assets and liabilities are presented in foreign currencies. If it is not possible to offset assets and liabilities denominated in foreign currencies by the same amount or hedge such differences effectively, YMFG's operating performance and the financial condition may be negatively affected.

(4) Impact of COVID-19

YMFG has in place a system to appropriately manage its holdings of available-for-sale securities. However, if financial markets deteriorate, the value of these holdings of available-for-sale securities could decrease, having a negative impact on YMFG's operating performance and financial condition.

4. Liquidity Risks

(1) Cash Flow 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) Market Liquidity Risk

Market confusion may make it impossible for YMFG to buy and sell available-for-sale securities or it may have no alternative but to conduct such transactions at prices less favorable than usual, thereby generating losses.

(3) Risk Related to Liquidity Regulations

Uniform international standards require the liquidity coverage ratio to be maintained at 100% or higher. YMFG's liquidity coverage ratio currently exceeds this level. However, YMFG's ratio could fall below this level due to changes in the amount of eligible liquid assets or cash outflows, having a negative impact on YMFG's operating performance and financial condition.

5. Operational Risks

(1) Administrative Risk

Although its operations center on banking, YMFG also conducts comprehensive, regionally focused financial services including securities and credit card operations. If executives or employees were to perform operations inaccurately or if accidents or instances of fraud were to occur, in addition to direct losses YMFG could suffer a loss among customers of the trust it has cultivated over many years, consequently having a negative impact on YMFG's operating performance and financial condition.

(2) Risk of Information Leaks

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. In addition, such situations could have a negative effect on operating performance and the financial condition.

(3) System Risk

YMFG has measures in place to address system risk, such as computer systems going down or malfunctioning, as well as against fraudulent use and external cyberattacks. YMFG also has thorough security measures in place and manages information stringently in line with its security policy. However, the manifestation of system risk due to a disaster, the failure of equipment or telecommunication circuits or program failure could result damage or outflows of information. This situation could cause the suspension of payment functions and service operations, as well as a loss in the trust of society, negatively affecting YMFG's operating performance and financial condition.

(4) Legal Risk

YMFG strives to ensure thorough compliance and is reinforcing its systems to prevent legal violations. Nevertheless, YMFG could conduct legal violations within its various business operations, resulting in lawsuits and negatively affecting YMFG's operating performance and financial condition.

(5) Human Risk

YMFG endeavors to recruit and train competent human resources.

However, the failure to recruit or train sufficient human resources could result in a decrease in competitiveness and efficiency, negatively affecting YMFG's operating performance and financial condition.

(6) 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. Business-Related Risk

(1) Risk of Competition

The competitive environment within the financial sector has changed substantially in recent years, due to extensive deregulation of financial systems, the restructuring of regional financial institutions and entry into the financial sector of companies from other industries. YMFG's sales base could lose its competitive advantage against other financial institutions as a result, negatively affecting YMFG's operating performance and financial condition.

(2) Risk of Unsuccessful Business Strategies

Although its operations center on banking, YMFG also conducts comprehensive, regionally focused financial services including securities and credit card operations and enacts business strategies aimed to enhance corporate value. However, greater-than-expected changes in the operating environment could prevent YMFG from generating the level of earnings it anticipates, or costs could be higher than anticipated, negatively affecting YMFG's operating performance and financial condition.

Furthermore, YMFG could fall short of its expected results if it is unsuccessful in enacting management strategies for development outlined in the YMFG Medium-Term Plan 2019, which commenced in the fiscal year ended March 31, 2020.

(3) 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.

(4) Risk of an Expanding Scale of Operations

In line with legislative changes and deregulation, YMFG has expanded its scope of operations to take advantage of new earning opportunities. This greater scale of operations exposes YMFG to new risks. Also, these businesses may not progress as expected. As a result, YMFG's operating performance and financial condition could be negatively affected.

7. Other Risks

(1) 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.

(2) Risk Related to Impairment of Fixed Assets

YMFG applies the "Accounting Standard for Impairment of Fixed Assets" to the fixed assets it owns. Changes in the purpose of use of these fixed assets, or decreases in profitability or asset values could lead to valuation losses, having a negative impact on YMFG's operating performance and financial condition.

(3) Risk of Financial Crimes

In the face of rampant crimes targeting financial institutions, such as the forgery or theft of cash cards and remittance fraud, YMFG is strengthening its security measures to prevent damages due to financial crimes. However, the advent of sophisticated financial crimes could render YMFG unable to stop illegal or inappropriate transactions, leading to unexpected losses and credit losses, having a negative impact on YMFG's operating performance and financial condition.

(4) 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, financial condition and capital adequacy ratio.

(5) 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.

(6) Compliance Risk

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 and financial condition could be negatively affected.

(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.

In addition, to help prevent the recent COVID-19 pandemic from spreading, YMFG has decentralized operations at headquarters and sales branches, introduced teleworking, and adopted a time-shifted working schedule as part of its health maintenance and disease-prevention efforts. However, if the pandemic fails to subside, continues for a protracted period or increases in intensity, or if YMFG employees were to become infected, ensuring business continuity could become problematic. As a result, YMFG's operations and financial condition could be negatively affected.