Risk Management

ITOCHU is exposed to various risks such as market risks, credit risks and investment risks, due to the nature of its business. These risks include unpredictable events that may have adverse effects on its future business and financial performance. ITOCHU has enhanced its risk management system and risk management methods to monitor and manage these risks.

Since the introduction of a "Division Company System" in 1997, ITOCHU has reinforced the concept of self-management in which each Division Company manages the risks associated with individual projects, while the Headquarters has continued to develop sophisticated risk management methods. ITOCHU has also established the ALM (Asset Liability Management) Committee as an advisory body to the HMC (Headquarters Management Committee), the highest decision-making body in ITOCHU. The ALM Committee plays a central role in managing the balance sheets of the whole ITOCHU Group and proposing improvements, and in analyzing the risk management across ITOCHU and proposing various risk management methods and improvements. Specifically, it manages risk exposure for each individual product and service by setting internal covenants for major balance sheet items and segmenting products and services in detail to set exposure limits, criteria to undertake, and standards for return.

Furthermore, ITOCHU has introduced RCM (Risk Capital Management), a risk management method based on RAROC (Risk-adjusted Return on Capital) to thoroughly manage its business portfolio through the utilization of two management benchmark: Risk Assets and Risk Return Index.

Market Risks

ITOCHU is exposed to market risks such as foreign exchange rate risk, interest rate risk, commodity price risk and stock price risk. ITOCHU aims to minimize risks relating to market fluctuations such as changes in foreign exchange rates and interest rates by establishing a risk management system using balance limit and other such measures and by utilizing a variety of derivative instruments for hedging purposes. Please refer to ITOCHU's accounting policy for derivative instruments in notes to consolidated financial statements "2. Summary of Significant Accounting Policies" and "19. Financial Instruments."

Foreign Exchange Rate Risk

ITOCHU is exposed to foreign exchange rate risk regarding transactions denominated in foreign currencies due to its significant involvement in import/export trading. ITOCHU uses forward exchange contracts and currency swap contracts to minimize risks for these transactions. Also, to manage foreign currency balance, ITOCHU sets limits on foreign exchange rate risks (limit of balance and that of loss), whereby it manages its balance of foreign currency by contract amount, the amount of its own/others' risk, and short-term/long-term. Since ITOCHU engages in businesses involving foreign currencies with a number of overseas trading subsidiaries and other overseas group subsidiaries, the figures denominated in Japanese yen on its consolidated balance sheet are also exposed to so-called foreign currency translation risk. ITOCHU does not hedge the translation risk, which does not have an impact on its financial and business performance denominated in foreign currencies.

Interest Rate Risk

ITOCHU is exposed to interest rate risk in fund raising or using by its lending, investing, and operating activities. Interest rate risk refers to the risk of income fluctuation caused by changes to interest rates, when mismatches in interest rates and durations occur. Interest rate risk is, on the whole, expressed by the equation of "balance x magnitude of interest rate change x duration."

To control interest rate risk in a concrete and objective manner, ITOCHU has grappled with quantification of interest rate risk by measuring interest rate risk with a new methodology, "Earning at Risk (EaR)." Based on the results of EaR, ITOCHU sets a certain limit (Loss Cut Limit) as the highest acceptable interest payment, and executes hedging transactions to maintain the loss cut limit. ITOCHU mainly utilizes interest rate swaps to minimize interest rate risk. EaR is monitored every month and a review of the loss cut limit situation is carried out regularly.

Commodity Price Risk

ITOCHU is exposed to commodity price risk on commodity products that it trades such as crude oil and grain. In ITOCHU, each Division Company sets its own risk management policy and manages purchase contracts, inventories and sales contracts including off-balance sheet items. In addition, particularly for products that have high price volatilities and may have a large impact on ITOCHU's management, ITOCHU designates them as "specified important products" and each Division Company sets and manages a balance limit and loss cut limit for each individual product. The loss cut limits for products with a large amount of trading are examined by the ALM Committee and approved by the HMC. The trading volumes of specified important products are regularly reviewed and reported to the ALM Committee along with their product management standards and methods. ITOCHU is reducing commodity price risk by minimizing the balance of products and by utilizing futures or forward contracts. For price fluctuation risk of ship charter fares regarding shipping balance ITOCHU owns for its own use, like specified important products, it sets and manages balance limit and loss cut limit.

Stock Price Risk

ITOCHU holds available-for-sale marketable securities which are vulnerable to price fluctuation. As for stock price risk, ITOCHU aims to optimize the amount of investments by applying exit rules for inefficient and less meaningful investments, because hedging by derivative instruments is not effective for available-for-sale marketable securities held for long-term. Fair value of the available-for-sale marketable securities held by ITOCHU was ¥167.4 billion as of March 31, 2003 and ¥256.1 billion as of March 31, 2002. In cases where the aggregate prices of these investments had fluctuated by 10%, fair value would also have fluctuated by ¥16.7 billion as of March 31, 2003 and by ¥25.6 billion as of March 31, 2002.