Credit Risk Management System Checklist and Manual

"Credit risk" is the risk that an insurance company will incur losses because the financial standing of the credit granted company has deteriorated to the point that the value of an asset (including off-balance-sheet assets) is reduced or extinguished. Among credit risks, the risk that insurance company will incur losses because of political or economic conditions and/.or circumstances of foreign currency in the belonging country of credit granted company is referred to as "country risk."

Inspectors will verify and inspect the credit risk management systems of insurance companies using the Risk Management Systems Checklists (Common Items), the Asset Investment Risk Management System Checklist, and the Credit Risk Management System Checklist. They will also inspect the self-assessments on asset quality, write-off and allowances by using the Credit Risk Inspection Manual.

This checklist and manual apply to all insurance companies, including the foreign offices of Japanese insurance companies (foreign branch , foreign subsidiaries, and offices of the overseas workers, etc., though whether to include these offices in the inspection by this checklist and manual will be determined in light of applicable laws and ordinances, including applicable foreign-country laws and ordinances) and the Japan offices of foreign insurance companies.

Inspections on solvency margin ratio, etc. will be performed by using the "(Attachment) On Inspections concerning Solvency Margin Ratio, etc." of the "Real Estate Investment Risk Management System Checklist" on the basis of the checklists and manuals for "Insurance Underwriting Risk", "Asset Investment Risk", "Market Risk, Real Estate Investment Risk" as well as this checklist and manual.

[Notes on the use of this manual in inspections]

This manual is essentially a handbook to be used by inspectors in the inspection of insurance companies. It is expected that, as part of their efforts to ensure sound and proper operations and in accordance with the principle of self-responsibility, individual insurance companies will fully exercise their creativity and innovation to voluntarily create their own detailed manuals. These insurance company manuals should make note of the content of this manual and be adapted to the size and nature of the insurance company.

The check points in this manual represent standard to be used by inspectors in evaluating the risk management systems of insurance companies. They do not constitute direct statutory obligations to be achieved by insurance companies. Care must be taken that the manual is not adopted by rote and uniformly. If there may be cases in which the checklist description has not been fulfilled literally, by insurance company , in the light of ensuring the soundness and appropriateness of its operation only the time that the measures by insurance company are equivalent in their effects to the descriptions for the check point or are sufficient given the size and nature of the insurance company, these measures would not be deemed inappropriate.

Inspectors will therefore need to fully dialogue relevant points with insurance companies during on-site inspections.

Note: Explanation of check points

① Unless explicitly stated otherwise, items expressed in the question form such as "does the insurance company" or "is the insurance company" are minimum standards that are expected of all insurance companies. Inspectors, as they go through their checklists, need to fully verify the effectiveness of these items.

② Unless explicitly stated otherwise, items worded in the form of “it would be desirable that” constitute “best practice(sound practice)” for all insurance companies. Inspectors need only confirm these items.

Note: Distinction between “board of directors” and “board of directors, etc.”

① Items that are defined as roles of the “board of directors” are items for which the board of directors itself needs to determine all essential matters. This does not, however, preclude the board of directors from delegating consideration of draft documents to the management committee or similar bodies.

② The phrase “board of directors, etc.” includes the board of directors, the management committee, the management meeting, and similar bodies. Items that are defined as roles of the “board of directors, etc.” would ideally be determined by the board of directors itself, but may be delegated to the management committee, etc. provided that there has been a clear delegation of this authority from the board of directors, the management committee, etc. has kept minutes of its proceedings and other materials that would allow after-the-fact confirmation, and there are adequate internal checking by the measure the results are reported to the board of directors, or auditors are allowed to participate in the management committee, etc.

Note: Explanation of “business base”, “business bases”, “insurance sales”

① The phrase “business base” refers to organizations other than the head office that constitute business bases, such as branch offices, business headquarters, foreign branch offices, and foreign subsidiaries. The phrase “business bases” refers to organizations other than the head office that do not engage in sales activities, such as operating bases, service centers, and foreign liaison offices.

②The phrase “insurance sales” refers to insurance agency or insurance agent and does not include insurance broker.

Credit Risk Management System Checklist

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
I. Recognition of risk management, etc.	(1) Articulation of strategic goals conforming to management policies, etc.	(1) Does the insurance company clearly set strategic goals for the financing divisions, etc. conforming to management policies, etc. for the insurance company as a whole? Are the strategic goals for the financing divisions, etc. appropriate in light of credit risk management that results? For example, do they eliminate a concentration of credit risks from efforts to achieve short-term profits by lending to specific industries or groups?	
1. Recognition of directors and role of board of directors	(2) Directors' understanding and recognition, etc. of risk management	(2) Do directors understand the need, in light of credit risk management, of integrated management of not only loan but all assets and off-balance-sheet items for which there are credit risks (including the credit risks associated with market transactions) at the insurance company and, to the extent permitted under applicable laws and ordinances, its consolidated subsidiaries and equity method investees? Do directors understand credit risk management techniques (including the content of credit ratings and portfolio management) and monitoring techniques? Does they recognize the need, in light of credit risk management, for credit ratings, portfolio management, and self-assessments on asset quality? Do directors in charge of these and related areas have deep understandings and recognition of these issues? Does the board of directors verify that write-off and allowances are at levels commensurate to credit risks? If the board of directors uses quantification's of credit risk in the management of the insurance company, does it understand quantification techniques, data availability issues, the relationship between credit risk exposure, capital position, claims-paying capacity, and other issues in the use of this information?	
	(3) Establishment of credit risk management policies	(3) Does the board of directors articulate credit risk management policies in light of strategic goals? Does the insurance company have a set credit policy that contributes to credit risk management? This would include the scope of financing, credit rating standards, portfolio management policies (for example, prevention from concentrations of credit granting by setting credit limits for specific industries and groups), and decision-making authority?	
	(4) Establishment of organizations for risk management	(4) Has the board of directors provided for appropriate management of credit risk by, for example, erecting an appropriate screening management structure that separates the financing divisions from the screening management division so that the screening management division is not influenced by the financing divisions, or by erecting an appropriate credit management structure with the establishment of a credit audit division and risk management division? Note: ① "Loan divisions" refers to divisions engaged in loan operations at the head office. ② "Screening management division" refers to a division that screens proposed financing and manages credit granting. ③ "Credit audit division" refers to a division that is independent of the financing divisions and the screening management division,(for example, credit screening office, inspection division, screening management division and which carries out audits of self-assessments, etc. and of credit management and credit management status. ④ "Risk management division" refers to a division that manages overall credit risks, including off-balance-sheet assets.	

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	(5) Reporting on risk status to the board of directors, etc. and use of risk information in decision-making for the organization as a whole.	(5) Does the board of directors, etc. receive regular reports on credit risks (including the status of concentrated credit granting to specific industries or groups)? Does it verify adherence to credit risk management policies based on measured risk information? Does the board of directors receive reports on credit risks at other times as necessary in addition to regular reports? Does the board of directors make necessary decisions according to predetermined policies, issues instructions to reduce credit risk volume by diversifying risks, or otherwise make use of risk information in risk management?	
2. Recognition and roles of manager	(1) Establishment of rules for risk management	(1) Does manager establish rules for credit risk management in accordance with asset investment risk management and credit risk management policies and with the approval of the board of directors, etc? Does it review these rules as necessary? Do rules for credit risk management include the scope of financing, credit rating, portfolio management, decision-making authority, screening policies, credit audit methods and other relevant matters?	Note: "Manager" refers to persons in senior managerial positions (including directors).
	(2) Appropriate risk management practice	(2) Does manager practice effective credit risk management in individual divisions in accordance with risk management policies and risk management rules, and does it bear the responsibility for risk management? It is desirable that internal models, etc. based on credit ratings be used to measure credit risks for credit risk management purposes, and that the insurance company set credit risk limits commensurate to appropriate profitability, allocations of managerial resources, capital adequacy, business strength such as claims-paying ability. It is also desirable that such systems have adequate computer system support.	
	(3) Reporting on risk status to the asset investment risk management division	(3) Does manager report credit risk status to the asset investment risk management division in accordance with set reporting rules?	
II. Establishment of appropriate risk management systems	(1) Establishment of integrated risk management structure	(1) Does the insurance company practice integrated credit risk management that includes, to the extent permitted under applicable laws and ordinances, its consolidated subsidiaries and equity method investees? Does the insurance company practice integrated management that covers not only loan but all assets and off-balance-sheet items for which there are credit risks (including the credit risks associated with market transactions)?	
	(2) Evaluation of new products and activities	(2) When introducing new products and activities, does the risk management division evaluate the locus, etc. of credit risk, seek opinions from the legal affairs division and internal audit division, etc. when necessary, report to the board of directors, etc. on its risk evaluation findings, and seek the approval of the board of directors, etc. for the introduction of new products and activities?	
2. Screening management	(1) Establishment of screening management structure	(1) Is the screening management division insulated from the influence of the financing divisions, for example, by being independent of the financing divisions and not having directors concurrently overseeing both the screening management division and the financing divisions? If the screening management division is not independent of the financing divisions or if a director concurrently oversees both the screening management division and the financing divisions, has the insurance company provided for checking functions to ensure that screening management is appropriate?	

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	(2) Role of screening management division	(2) Does the screening management division provide appropriate screening management of loans, for example, by accurately measuring the financial position of credit granted company, the use to which the funds will be put, and the resources from which the loan will be repaid, and utilizing this information to verify the accuracy of credit ratings? Does the screening management division, etc. check that financing divisions are appropriately following its instructions, that they have sound financing stances (providing a smooth flow of funding to credit granted company engaged in sound businesses, banning financing to win insurance contracts, banning speculative real estate financing and financing for excessively speculative financial schemes, and refusing to supply funds to antisocial organizations), and that they are not engaged in inappropriate recovery of funds? Does the screening management division communicate to financing divisions that "Insurance Company Inspection Manuals" created by the authorities are not to be used as an excuse for refusing to supply fund to loan customer engaged in sound businesses, for collection of funds from such borrowers, or for other inappropriate handling? Does it verify to ensure that the financing divisions are not engaged in inappropriate handling?	
3. Credit management	(1) Establishment of credit management division	(1) Do the financing divisions and screening management division have systems in place for integrated management of credits (for example, the status of business conditions in the borrower's industry) that covers, to the extend permitted under applicable laws and ordinances, the insurance company, its consolidated subsidiaries, and its equity method investees? Is a specific division assigned to verify the levels of write-off and allowances? Does this division verify that the levels of write-off and allowances are commensurate to credit risks, and does it report the amount of write-off and allowances accurately to the board of directors? Is a specific division assigned to manage portfolio status (including the concentration of credit granted in specific industries and groups)? Does this division engage in appropriate portfolio management and does it report regularly on the status of the portfolio to the board of directors, etc.?	
	(2) Roles of credit audit division	(2) Does the insurance company have a credit audit division that audits the accuracy of credit ratings, the status of borrower credit management, and other relevant information? Does this division audit the appropriateness of credit management and report its findings to the board of directors, etc? If a financing division or a screening management division manages the portfolio, does the credit audit division audit the appropriateness of portfolio management? Does the insurance company have specialized structure for its credit auditing (including structure in which the risk management division performs credit audits)?	
	(3) Roles of risk management division	(3) Does the insurance company have a risk management division that provides integrated management of assets with credit risk and off-balance-sheet items? Does it practice integrated credit risk management? Does the insurance company have specialized structure for its risk management division (including structure in which the risk management division performs credit audits)?	
4. Management of problem credits	(1) Establishment of management structure for problem credits	(1) Is there a specific division assigned to manage and collect problem credits? Does it appropriately manage problem credits? Does the insurance company specify the range of credits that particularly require management as problem credits? It would also be desirable for insurance companies to have specialized structure for managing and collecting problem credits.	

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	(2) Role of problem credit management division	(2) Does the division responsible for managing and collecting problem credits articulate clear policies for working with problem borrowers and manage the business conditions, etc. at problem borrowers accordingly? Are problem borrowers given appropriate guidance in rebuilding, or are they liquidated or collected, based on the policies for working with problem borrowers?	
5. Self-assessment on asset quality	See “Credit Risk Inspection Manual.”		
6. Write-off and allowances	See “Credit Risk Inspection Manual.”		