

Financial Inspection

Basic Guidelines

(Provisional Translation)

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Director-General of Local Finance Bureaus
Director-General of Okinawa General Bureau
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Financial Inspectors



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Financial Inspection Basic Guidelines

The Financial Services Agency has set forth the basic approach to implementing and the procedures, etc. for conducting inspections and associated work performed under the Banking Law, Insurance Business Law, etc. (hereinafter referred to as “inspections, etc.”) as follows. Please strive to conduct inspections, etc. in an accurate and effective manner in accordance with the following.

The interpretation and implementation of notices, etc. issued in relation to inspections, etc. shall be governed by this Basic Guidelines.

I. Basic Approach to Conducting Inspections, etc.

1. The mission of the respective inspection departments/bureaus of the Financial Services Agency (FSA) and the Local Finance Bureaus (including the Fukuoka Local Finance Branch Bureau and the Okinawa General Bureau, hereinafter the same) is to verify the compliance functions, various risk management functions, etc. of financial institutions, to point out their problems and checking their awareness, while primarily making use of on-the-spot inspection

techniques for the purpose of ensuring the soundness and appropriateness of financial institutions' operations as required by the Banking Law, etc. The supervisory departments/bureaus shall take administrative action based on such precise fact-finding efforts etc. by the inspection departments/bureaus.

2. In order to fulfill this mission effectively, we need to make the following efforts:
 - (1) We must quickly and accurately identify new realities of the financial sector. Risks that threaten the financial system are uncertainties about the future, which are in a constant state of flux. Inspections, etc. must be conducted in an effort to accurately identify potential risks that are inherent in financial institutions, while envisioning the future of financial institutions and the financial system.
 - (2) We are NOT in the position to make managerial decisions on behalf of financial institutions. Our role is to look into the risks to which financial institutions are exposed, and warn financial institutions, etc. about their problems in an effective manner. This task needs to be performed by going through a process that involves accurately identifying the facts, indicating the problems from an objective standpoint, listening to financial institutions' claims thoroughly, and checking their understanding and awareness (hereinafter referred to as "dialogue").
 - (3) It is NOT our role to minimize the risks to which financial institutions are exposed. The requirement of inspections, etc. is to strictly verify, in a clear-cut manner, whether or not proper risk management functions have been prepared according to the business environment, business status, etc. of each financial institution.
 - (4) On-site verification may impose a heavy burden, etc. on financial institutions. On-the-spot inspection, which by nature is a legitimate exercise of authority set forth in laws and ordinances, needs to concentrate on high-priority matters which require confirmation on the site. Financial authorities must strive to select the most efficient verification method, considering effectively utilizing and coordinating on-site and off-site activities.
3. In order to meet these requirements, inspections, etc. need to be conducted in accordance with the following basic principles.

(1) Principle of Users' Perspective

Inspections, etc., which are conducted by exercising the authority delegated from the nation, shall be conducted to verify the business status of each financial institution, solely for the purpose of protecting depositors and other ordinary users, stabilizing the financial system and promoting the healthy growth of the national economy. They shall NOT be conducted directly in the interests of the top management, shareholders, etc. of financial institutions.

Inspections, etc. shall be conducted to verify the business status of each financial institution, from the standpoint of depositors and other ordinary users and in view of the national economy, with the primary purpose of protecting their interests.

(2) Principle of Complementation

Inspections, etc. shall complement *market discipline*, etc., assuming that internal control is exercised by the financial institution itself based on the principle of self-responsibility, as well as vigorous external audits conducted by the external auditor. The financial institution itself shall be solely accountable as to whether it properly exercises internal control, while the inspection departments/bureaus shall be in the position to verify it.

On the other hand, consideration shall be given when conducting inspections, etc. so that they help enhance internal control functions and audit functions of the financial institution and encourage the financial institution's efforts to make business improvements. From this perspective, inspections, etc. shall attach much importance to the *dialogue* between the inspection department/bureau and the financial institution.

(3) Principle of Efficiency

To effectively utilize the authorities' limited resources, inspections, etc. need to be conducted in an efficient manner, while utilizing the audit functions of the financial institution and cooperating fully with departments that are involved in inspection and supervision.

When conducting inspections, etc., efforts shall be made to accurately assess the effectiveness of audit functions of internal audits, auditors, external auditors, etc. and make use of them to the greatest extent possible.

Further, inspections, etc. shall be conducted in a focused and dynamic manner by varying the frequency, scope, etc. of inspections according to the business status of each financial institution, while organically collaborating with off-site monitoring, etc. conducted by supervisory departments/bureaus.

Moreover, when conducting inspections, etc., efforts need to be made to accurately point out the problems identified in the inspection in a clear-cut manner, considering a materiality viewpoint of how they might affect the overall business of each financial institution, and how big the impact might be.

(4) Principle of Effectiveness

Inspections, etc. need to be conducted to help ensure the soundness and appropriateness of operations of financial institutions.

When conducting inspections, etc., various risks to which financial institutions are exposed shall be accurately identified.

Further, the inspection department/bureau shall work closely with the supervisory department/bureau which takes supervisory measures, so that the problems pointed out in the inspections, etc. will help improve the business of financial institutions in a timely and appropriate manner.

(5) Principle of Process Checking

When conducting inspections, etc., verification shall be performed focusing on process-checking of compliance functions and various risk management functions of each financial institution, as a general rule.

For example, it is impossible to verify a financial institution's self-assessment of all assets and transactions; there is no guarantee that such verification performed at a certain point will ensure the appropriateness of the management of future financial risks which substantially change in a short period of time.

Inspections, etc. shall be conducted with a broad perspective, addressing not only the appropriateness of the way in which individual cases are handled, but also the functions of the

financial institutions that manage them.

If there are serious concerns over the soundness of business, risk management functions, etc. of the financial institution, it is necessary to bear in mind the importance of verifying individual transactions extensively in light of process-checking.

4. It is not an easy task to precisely fulfill such mission of inspections, etc., while dealing with the ever-changing realities in the financial sector, issues, etc.

Therefore, the respective inspection departments/bureaus of the FSA and the Local Finance Bureaus shall work together to: prepare a system to collect information on the latest financial transactions and the financial institution's business; strive to recruit and train inspectors who take on crucial duties and to develop a support system for their recruitment and training; and continue making efforts to conduct "evolutionary inspections" at all times.

On the other hand, each inspector needs to conduct inspections in an appropriate manner, and to comply with "II . Procedures for Conducting Inspections, etc." recognizing the need of strict self-discipline as follows.

Inspectors' Stance (Code of Conduct for Inspectors)

(1) National Mission

Inspectors shall strive to conduct inspections in a fair and impartial manner with pride and a sense of mission, in the interests of the nation, acknowledging that inspections are conducted under the authority delegated from the nation.

(2) Due Process

Inspectors shall acknowledge that an inspection constitutes the exercise of authority to step into private businesses, and shall strive to ensure proper procedures when conducting inspections and conduct verification in an efficient and effective manner. Inspectors shall also constantly review whether inspections are being conducted even in areas that do not necessarily require investigation

in light of the purpose of laws.

(3) Confidence Building

Inspectors shall acknowledge that trust and confidence are the key to inspections, and shall strictly maintain discipline, integrity and confidentiality. Further, inspectors shall strive to engage in dialogue with the other party in a calm manner.

(4) Self Improvement

Inspectors shall have a correct understanding of various regulations, inspection manuals, etc. relating to finance, and shall strive to gain financial knowledge and practical inspection expertise. Inspectors shall also acknowledge that inspections involve handling of the financial sector—which is an economic infrastructure—and shall train themselves to gain a broad socioeconomic perspective.

(5) Spirit of Teamwork

Inspectors shall acknowledge that the quality of inspections is determined by the collaboration between each inspector and the back-office staff, and shall be committed to conducting inspections “for the team”.

II. Procedures, etc. for Conducting Inspections, etc.

Under the Basic Guidelines, the standard procedures, etc. which are fundamental to conducting inspections, etc. are as follows.

On-the-spot inspection, which constitutes the legitimate exercise of authority set forth by laws and ordinances, might impose a heavy burden on financial institutions. On-the-spot inspection can be conducted only with the understanding and cooperation of the financial institution subjected.

The Basic Guidelines gives both the inspector and the financial institution subjected a rough idea of how to determine the extent to which the financial institution is obliged to undergo inspection

and the procedures for conducting inspection, etc., with the aim of deepening the understanding between the two parties, so that inspections, etc. will be conducted in a smooth and effective manner.

The procedures, etc. for conducting inspections, etc. set forth in the Basic Guidelines need to be implemented with the following in mind.

- (1) The purpose of the Basic Guidelines is to help conduct inspections, etc. in an accurate and effective manner, from the standpoint of depositors and other ordinary users, and in view of the national economy. Therefore, consideration needs to be given so as to prevent the procedures for conducting inspections, etc. from being implemented in a mechanical or monotonous manner that undermines the said purpose.
- (2) On the other hand, when handling inspections outside the scope of the following provisions, the chief inspector shall hold discussions, etc. with the division in charge at the Inspection Bureau (or the division in charge of inspections at the Local Finance Bureau, hereinafter the same), and consideration shall be given in providing an explanation to the financial institution.
- (3) The procedures, etc. for conducting inspections, etc. under the Basic Guidelines are set forth assuming the understanding and cooperation of the financial institution. If the assumption does not hold, an alternative approach needs to be taken.

1. Scope of Application

The Basic Guidelines shall be applied to inspections, etc. conducted by FSA and by Local Finance Bureaus under commission from the FSA Commissioner, under the Banking Law, Long-Term Credit Bank Law, Shinkin Bank Law, Law Concerning Financial Services by Cooperative Unions, Labor Credit Association Law, Agricultural Cooperative Association Law, Fishery Cooperative Law, Norinchukin Bank Law, Law Concerning Concurrent Operation of Trust Business by Financial Institutions, Deposit Insurance Law, Insurance Business Law, Securities and Exchange Law, Law Concerning Foreign Securities Firms, Law Concerning Investment Trusts and Investment Corporations and Law Concerning Investment Advisory Business.

(Note) When conducting an inspection simultaneously with other ministries and/or agencies which have the authority to inspect financial institutions under shared jurisdiction, inspection departments/bureaus of prefectural governments, the Deposit Insurance Corporation (DIC), or the Securities and Exchange Surveillance Commission (SESC) (hereinafter referred to as “other ministries, agencies, etc.”), an alternative approach may be taken based on consultation with other ministries, agencies, etc., in accordance with the purpose of the Basic Guidelines.

2. Basic Guidelines and Plans for Financial Inspections

The Inspection Bureau of FSA sets forth the Basic Guidelines and Plans for Financial Inspections at the beginning of each program year.

When formulating and implementing the Basic Plans for Financial Inspections, efforts shall be made to conduct inspections in a clear-cut manner, in compliance with the Basic Guidelines, the Basic Guidelines for Financial Inspections, etc. by utilizing the following types of inspections in an dynamic and effective manner.

For this purpose, the inspection department/bureau shall demand the supervisory department/bureau to provide sufficient information on financial institutions relating to supervision in a timely fashion, and strive to utilize them effectively.

(1) Comprehensive Inspection

This involves verifying the appropriateness of compliance functions, various risk management functions, etc. and the business status of financial institutions in a comprehensive and integrated manner.

(2) Partial Inspection

This involves verifying the appropriateness of compliance functions, various risk management functions, etc. and the business status of financial institutions, focusing on certain fields and areas.

3. Procedures for Conducting Inspections, etc.

As a general rule, inspections, etc. shall be conducted based on the following procedures. However, depending on the circumstances, etc. of the inspection, nothing shall prevent a dynamic approach from being taken subject to consultation between the chief inspector and the division in charge at the Inspection Bureau.

3-1 Before Commencement of On-the-spot Inspection

(1) Advance Notice

As a general rule, the financial institution shall be given notice prior to the commencement of on-the-spot inspection, in order to conduct the inspection in an efficient manner.

However, inspection may be conducted without giving any advance notice if deemed necessary for the purpose of identifying the actual situation in an effective manner.

(Note) In order to ensure user protection and improve user convenience, the name of the financial institution subjected shall be published on the inspection information page of the respective websites of FSA and the Local Finance Bureaus according to necessity, from the day on which advance notice is given (or the day on which on-the-spot inspection commences if no advance notice is given) to the day on which the on-the-spot inspection is completed, and information on the financial institution subjected shall be collected broadly from the general public.

(2) After Advance Notice, Before Commencement of On-the-spot Inspection

In cases where advance notice is to be given, the financial institution shall be notified of the day on which on-the-spot inspection is due to commence, with both the inspection team and the financial institution being prepared.

The above notice shall be given by issuing a written inspection notice (or an inspection memo if the inspection notice does not specify the day on which the commencement of on-the-spot inspection is scheduled). In this case, the name of the inspector who will be conducting the

on-the-spot inspection shall be announced (if the inspector is replaced during an inspection, the name of the new inspector shall be announced every time there is such a replacement.)

The commencement of on-the-spot inspection may be changed or cancelled after giving the said notice, in cases where it is deemed difficult to conduct the inspection in the event of a natural disaster or due to other unavoidable circumstances.

(3) Points to Consider when Requesting Data, etc. in Advance

After giving advance notice, the chief inspector shall provide the financial institution with an explanation of the content, etc. of data, etc. required prior to the commencement of the on-the-spot inspection, and request that the data, etc. be submitted by the specified submission deadline, etc. When requesting the data, etc. in advance, due consideration shall be given to the following. At the same time, the supervisory department/bureau shall strive to utilize the data, etc. collected from the financial institution, and narrow down the data, etc. required in advance to those that are necessary.

- (a) As a general rule, the existing data, etc. of the financial institution subjected shall be utilized.
- (b) The chief inspector shall present the prescribed forms, etc. in advance, either orally or in writing, to give a rough idea of the data, etc. that needs to be submitted. However, any data, etc. submitted by the financial institution accordingly shall be accepted regardless of its form, provided that it contains the necessary information.
- (c) It shall be acceptable to deliver or submit data, etc. in electronic media format and leave data, etc. at the inspection venue, provided that it does not hinder the execution of inspection.
- (d) The submission deadline shall be set in consideration of the capacity and the workload of the financial institution, etc.

(4) Prior Explanation of Important Matters, etc. to the Financial Institution

The chief inspector shall take the following actions before commencing on-the-spot inspection (or promptly after commencing on-the-spot inspection in cases where no advance notice is given). In this case, an explanation, etc. may be provided in the facilities of the financial institution according to necessity by obtaining the said institution's approval.

- (a) Explain the important matters set forth in the Attachment to the financial institution, and obtain approval from the executive with the right of representation by the first day of the on-the-spot inspection (or promptly after commencing on-the-spot inspection in cases where no advance notice is given).
- (b) To facilitate inspections, consult with the financial institution about the essential general affairs, etc.
- (c) Receive an explanation about the outline of the business conditions from the financial institution according to necessity.

3-2 During On-the-spot Inspection

(1) Presentation of Inspection Order, etc.

When commencing on-the-spot inspection without giving any advance notice, the chief inspector shall show the inspection order and his/her identification card which employees of FSA, etc. are required to carry upon inspection to the executive or other responsible persons of the financial institution, and declare that he/she will conduct the inspection. When doing so, the name of the inspector who will be conducting the on-the-spot inspection shall be announced (if the inspector is replaced during an inspection, the name of the new inspector shall be announced every time there is such a replacement.)

In cases where on-the-spot inspection is to be conducted, the inspector shall show his/her identification card which employees of FSA, etc. are required to carry upon inspection, whenever he/she is requested to do so by relevant parties during the on-the-spot inspection.

(2) Relationship with Internal Audits, Audits by Auditors

When conducting an inspection, the effectiveness of internal audits performed by the financial institution shall be thoroughly checked (Note 1) based on the following, in accordance with the principle of complementation. In areas where internal audits are deemed to be functioning effectively, efforts shall be made to improve the efficiency of the inspection in relation to the treatment of the scope of sampling, etc. when, for example, conducting site investigation and verifying self-assessment, depending on the extent to which internal audits are functioning.

- (a) Results of previous inspections
- (b) Follow-up of the results of inspection conducted by the supervisory department/bureau and the nature of off-site monitoring relating to internal audits
- (c) Verification results in the inspection process (including the stage before commencing on-the-spot inspection)

On the other hand, if there are doubts over the effectiveness of internal audits, efforts shall be made to conduct inspection focusing on the overall soundness of the financial institution.

Further, if any problems are found in the effectiveness of internal audits, the problems shall be accurately pointed out to the financial institution, in order to encourage the proper execution of internal control and external auditing based on the principle of self-responsibility (Note 2).

When verifying the effectiveness of internal audits, the results of audits by auditors shall be utilized considering audits by auditors play an important roll in ensuring the soundness and appropriateness of financial institutions management through the audit to business execution in management (including internal audit) in general and it is likely to cooperate with internal audit and utilize internal audit in this process.

(Note 1) For example, the following shall be heeded when checking the effectiveness of internal audits.

- The positioning of internal audits in the financial institution (authority, arrangement,

framework), policies and plans for internal audits, audit results, improvement status based on audit results, etc.

- The result of audits by auditors
- The financial institution's awareness of the effectiveness of internal audits (in cases where the effectiveness of internal audits has been assessed by a third-party organization (including external audits), the financial institution's awareness of such assessment shall be included.)

(Note 2) If serious problems are found in the effectiveness of internal audits, bear in mind that it is necessary to thoroughly verify whether or not there are any problems in the internal control functions, considering that internal audits are processes for examining the appropriateness and effectiveness of internal control functions, etc.

(3) Exchange of Opinions with External Auditor

When conducting an inspection, the results of external audits, etc. shall be utilized according to necessity, in order to identify the actual situation in an efficient and effective manner.

Further, the chief inspector shall request the external auditor to exchange opinions if necessary in inspection.

If the external auditor makes a request to exchange opinions, the request shall be met to the greatest extent possible unless there are special reasons in order to help enhance the audit functions, etc. of the financial institution.

The following shall be heeded when exchanging opinions.

- (a) Obtain consent from the financial institution and the external auditor.
- (b) Before exchanging opinions, confirm that the duty of confidentiality is withdrawn between the external auditor and the financial institution at the venue where opinions are to be exchanged.

(c) When exchanging opinions,

- Confirm the external auditor's awareness, etc. of the external audit status and the business status of the financial institution in the initial stages of on-the-spot inspection.
- Once verification has progressed, inform the external auditor of the problems identified by the inspection team, the reasons for the judgment, etc., directly confirm the external auditor's view on them, and exchange opinions thoroughly between the parties.

(d) Exchange opinions on matters that are commonly addressed by audit and inspection of financial statements of the financial institution.

(4) Points to Consider when Requesting Data, etc.

From time to time, the inspector may request data, etc. in order to accurately identify the business status of the financial institution subjected and to examine its appropriateness.

In regards to the method of submission of data, etc., it shall be acceptable to deliver or submit data, etc. in electronic media format and submit data, etc. by leaving it at the inspection venue, provided that it does not hinder the execution of inspection.

Further, as a general rule, the inspector shall utilize the existing data, etc. of the financial institution when requesting data, etc. Data, etc. other than existing data, etc. shall be requested subject to the chief inspector's approval, in consideration of the following, and in view of conducting inspection in an efficient and effective manner.

- (a) Only request as much data, etc. as needed, after thoroughly examining the necessity and redundancy of the data, etc.
- (b) The format of the data, etc. to be submitted does not matter as long as it contains the necessary information.
- (c) The submission deadline shall be set in consideration of the capacity and the workload of the financial institution, etc.

If the person in charge, etc. at the financial institution is deemed to be causing delays in the

submission of data, etc. without any legitimate reason, the chief inspector shall inform the executives, etc. of the financial institution of the delay and request that improvements be made.

(5) Verification

The inspector shall heed the following when performing verification during on-the-spot inspection.

- (a) The inspector shall fully acknowledge the importance of *dialogue* with the financial institution subjected, and shall carefully listen to the other party's explanation and opinions. Also, any views expressed by the inspector shall be accompanied by an explanation of the reasons, etc.

If the person in charge, etc. at the financial institution subjected clearly repeats giving irrational explanations, etc., the chief inspector shall demand the executives of the financial institution to improve the situation in order to facilitate the inspection.

- (b) If the chief inspector wishes to point out problems to the financial institution subjected, or wishes to confirm the financial institution's awareness of such problems, he/she shall use documentation to clarify the problems and the institution's awareness of such problems. When doing so, he/she shall consider improving efficiency by such means as delivering the documentation in electronic media.
- (c) In cases where the chief inspector is to point out serious problems to the financial institution such as breach of laws and ordinances, he/she shall check with the Inspection Coordination Division of the Inspection Bureau in advance (or the division in charge of inspections at the Local Finance Bureau, hereinafter the same).
- (d) When pointing out problems, caution shall be exercised to avoid interfering with future financing decisions, etc. and demanding certain managerial decisions and actions in the future.

(6) Site Investigation

In order to identify the actual status and the appropriateness of operations of the financial institution subjected in an effective manner, the inspector shall directly visit the facilities where the operations are actually executed by the executives and employees of the financial institution, the data storage site, etc., take samples of and peruse raw data, etc. arbitrarily, and investigate the operations and administration (hereinafter referred to as “site investigation”), according to necessity.

Upon conducting a site investigation, the inspector shall obtain approval from the financial institution when perusing or receiving submissions of the institution’s properties, bearing in mind that the inspection is based on the voluntary cooperation of the financial institution, following the steps below.

If the person in charge, etc. at the financial institution subjected is deemed to be responding in an inappropriate manner to the site investigation, the chief inspector shall inform the responsible person at the financial institution of the inappropriate response and request that improvements be made.

- (a) As a general rule, no advance notice shall be given for site investigation, for the purpose of conducting inspection in an effective manner. However, the financial institution subjected may be informed of the target location, schedule, etc. in advance, in consideration of the necessity of the inspection, workload, the results of previous inspection, etc.
- (b) The chief inspector shall make the inspector thoroughly understand the following when conducting site investigation.
 - 1) Consideration shall be given to ensure that the site investigation causes minimal disruption to the business of the financial institution.
 - 2) No request shall be made for the perusal of personal belongings or other objects concerning the privacy of executives and employees which are unrelated to operations. If it is difficult to judge whether or not an object relates to operations, the judgment shall be made by checking the object to the extent necessary for making the judgment

with the other party's consent.

3) The investigation shall be conducted by more than one inspector. At least one responsible person, etc. from the financial institution shall be present at the investigation.

(c) The chief inspector shall contact the Inspection Coordination Division of the Inspection Bureau as soon as the site investigation is launched.

(d) When conducting site investigation, samples of raw data, etc. required for inspection shall be taken from among all objects relating to operations in the facilities, etc. as necessary, and the perusal of such samples shall be requested.

(e) In the event of removing the raw data, etc. for which perusal was requested under (d) above to outside the facilities, etc. subject to site investigation, such raw data, etc. shall be managed properly by using ledgers, etc.

(7) Procedures for Completing On-the-spot Inspection (Exit Meeting)

To complete on-the-spot inspection, the chief inspector shall do the following together with the executives of the financial institution subjected.

(a) The status of dialogue with the financial institution shall be confirmed, including the exchange of documents under the provision of (5) above.

(b) In particular, it shall be thoroughly confirmed that there are no differences between the parties in regards to the awareness of facts found in the process of on-the-spot inspection.

(c) Based on the above, the chief inspector shall communicate the problems, etc. identified through on-the-spot inspection, interview the financial institution in regards to its awareness of the problems, etc., and confirm the consistency and the difference in awareness between the chief inspector and the financial institution at that time. As a general rule, the said confirmation shall be done in writing for clarification.

(d) The financial institution shall be informed that the final views of the inspection

department/bureau will be presented in the inspection results notice, and that even after the completion of on-the-spot inspection, the inspection itself will continue until the inspection results notice is given. The upcoming procedures shall be explained, and at the same time, off-site inspection monitoring (refer to (10) below) shall be explained once again. Further, if there are any matters of which the chief inspector and the financial institution have a different awareness (hereinafter referred to as “disagreements”), the opinion submission system (refer to 3-3 (1) below) shall be thoroughly explained.

(Note) The inspection shall be deemed to have commenced on the day on which the inspection was conducted (in cases where advance notice was given for the inspection, it shall be the day on which the said notice was given, and in cases where no advance notice was given for the inspection, it shall be the day on which the on-the-spot inspection started) and finished when the inspection results notice is given.

(8) Suspension of On-the-spot Inspection

On-the-spot inspection may be suspended if:

- (a) Suspension of on-the-spot inspection is deemed appropriate for the purpose of conducting inspection in an efficient manner, including cases in which the work to be done by the financial institution will take a long time, and cases in which it would be more efficient to return to the office and then compile and analyze the matters verified at the site; or
- (b) Continuation of the inspection is deemed difficult in the event of a natural disaster, large-scale system failure, acts set forth in (9) below and in other such serious situations.

(9) Other Points to Consider

- (a) During on-the-spot inspection, the chief inspector shall periodically exchange information and opinions with the financial institution with respect to:

- 1) How the inspection is progressing;
- 2) How the financial institution is responding to the inspection; and
- 3) Requests concerning the execution of inspection.

The chief inspector may indicate end expectation of on-the-spot inspection at the stage where the end can be expected, based on the financial institution's request.

- (b) When conducting an inspection, efforts shall be made to take action in a flexible manner, including altering the share of clerical work and seeking cooperation between inspectors, depending on changes in the situation, etc.

Further, when inspecting several financial institutions that belong to the same financial group—such as a financial conglomerate—simultaneously, the inspection teams shall strive to conduct inspection in an efficient and effective manner, including making necessary coordination efforts with each other.

- (c) No third party shall be allowed to be present during on-the-spot inspection based on the financial institution's request, unless the chief inspector considers that there are special reasons to do so.
- (d) As a general rule, queries and requests for data, etc. to executives, employees, etc. of the financial institution shall be made within the working hours of the executives, employees, etc. However, this may not be the case if the chief inspector determines that it is necessary to do so outside the working hours, provided that the other party's consent is obtained.
- (e) The chief inspector shall examine the treatment of the scope of sampling, etc. when conducting site investigation and verifying self-assessment, according to the soundness of business, risk management functions and other circumstances of the financial institution.
- (f) If the chief inspector identifies any conduct that might be construed as a refusal to answer questions, false statement, refusal of inspection, obstruction of inspection or avoidance of inspection, he/she shall promptly inform the head of the Inspection

Coordination Division of the Inspection Bureau (or the head of the inspection coordination division, etc. in the case of Local Finance Bureaus) of such conduct and follow his/her instructions.

The chief inspector shall explain to the financial institution that if there are any doubts over any responses to the inspection that should be heeded, such as the disposal of stored documents during on-the-spot inspection, the chief inspector will be able to check them.

- (g) The inspection department/bureau shall strive to review the data, etc. to be submitted in a timely and appropriate fashion, in order to identify the actual situation through inspection in an accurate and efficient manner and to reduce the workload imposed on the financial institution, etc.

(10) Inspection Monitoring

For the purpose of ensuring that the Basic Guidelines is implemented properly and preventing the inspection manual from being implemented in a mechanical or monotonous manner, the respective senior officers of the Inspection Bureau and the Local Finance Bureaus shall directly listen to the opinions of the financial institution subjected according to necessity (hereinafter referred to as “on-site inspection monitoring”).

Further, to complement on-site inspection monitoring, the senior officers shall listen to the opinions of the financial institution subjected by email or other such means (hereinafter referred to as “off-site inspection monitoring”) (collectively with on-site inspection monitoring, hereinafter referred to as “inspection monitoring”).

In regards to opinions gathered through inspection monitoring, the senior officers shall confirm the facts, and according to necessity, give instructions to the chief inspector and use the opinions to assist in future inspection operations to fulfill the aforementioned purpose.

3-3 After Completion of On-the-spot Inspection

(1) Opinion Submission System

"Opinion submission system" is executed aiming to aim at a qualitative level of a financial inspection and an appropriate, further improvement of the judgment, and to secure the trust of a financial inspection.

In regards to disagreements, if the financial institution submits its opinion to the Director-General of the Inspection Bureau, the Opinion Submission Review Board of the Inspection Bureau shall review the disagreements.

The Opinion Submission Review Board shall consist of the senior officials and outside specialist other than the inspector who conducted the on-the-spot inspection, and shall review the disagreements from a technical and impartial standpoint.

The chief inspector shall explain the nature of the system to the financial institution before commencing the on-the-spot inspection (or promptly after commencing on-the-spot inspection in cases where no advance notice is given), and after checking the existence of any disagreements with the financial institution upon the completion of the on-the-spot inspection, explain the details of the system according to necessity.

(2) Issue, etc. of Inspection Results Notice

The chief inspector shall prepare an inspection report (draft inspection results notice) which summarizes the matters, problems, etc. identified through inspection, promptly after the completion of on-the-spot inspection.

The Director-General of the Inspection Bureau (or in the case of Local Finance Bureaus, the respective Director-Generals of Local Finance Bureaus, Fukuoka Local Finance Branch Bureau and Okinawa General Bureau) shall examine the report and other matters verified in the inspection, and prepare the inspection results notice by sufficiently taking into account the conclusions, etc. drawn from the outcome of the review of the aforementioned opinions submitted, if any, and issue the inspection results notice to the financial institution. (The inspection result notice (copy) shall be issued to the financial holding company that makes the financial institution subsidiary company as necessary.)

When doing so, the financial institution subjected shall be given an explanation that inquiries may be made to the inspection department/bureau with respect to the content of the inspection results notice.

As a general rule, the inspection results notice shall be issued roughly within three months after the completion of the on-the-spot inspection.

(3) Collaboration with Supervisory Departments/Bureaus for Inspection Results Notice

The inspection department/bureau shall give consideration to providing the supervisory department/bureau with a thorough explanation of the content, etc. of the inspection results notice.

Further, in the event of performing follow-up activities as part of supervision based on the inspection results notice pursuant to the Banking Law, Insurance Business Law, etc., the examiner (inspector, etc. according to necessity) shall be present when an interview is conducted with the financial institution subjected to confirm the content of the inspection results notice based on the supervisory department/bureau's request.

4. Information Management

(1) Reasons for Nondisclosure of Information on Individual Inspections, etc.

Information on inspections, etc. of individual financial institutions shall not be disclosed due to the risk of:

- (a) Undermining the financial institution subjected and its client's rights, competitive positioning and other honest profits;
- (b) Undermining the effectiveness of future inspections in general, including causing difficulties in accurately identifying the facts; and
- (c) Materially affecting the financial institution subjected, and even having an unforeseeable

impact on the financial climate in general and destabilizing the financial system overall.

(2) Points to Consider in Inspections, etc. regarding Information Management

Inspectors and other employees shall properly manage information relating to inspections, etc. pursuant to the Law on Protection of Computer Processed Personal Data held by Administrative Organs and other laws and ordinances, as well as regulations, etc. on the management of general government documents. In particular, the following shall be heeded when doing so.

- (a) No secrets learned in the course of conducting inspections, etc. shall be divulged.
- (b) Information relating to inspections, etc. shall not be used other than for inspection and supervision purposes (excluding use which corresponds to a legitimate act under laws and ordinances).
- (c) In particular, secrets of financial institutions and information concerning clients' privacy, etc. shall be handled with the greatest care.

(3) Identification of Actual Status, etc. by the Chief Document Manager, etc.

The chief document manager, etc. and the chief inspector shall determine whether or not the employees of the inspection department/bureau are properly managing the information, and shall take proper measures as necessary.

(Note) The chief document manager, etc. shall refer to the chief document manager and document manager set forth in FSA's regulations on the management of government documents (at Local Finance Bureaus, the document managers set forth in the Local Finance Bureaus' regulations on the management of government documents, etc.).

(4) Treatment of Inspection-related Information and Content of Inspection Results Notice

Inspection-related information (Note 1) and the content of the inspection results notice, which

includes “judgments made by the inspection department/bureau”, etc., need to be responsibly managed by the inspection department/bureau as information subject to the duty of confidentiality in order to ensure the effectiveness of inspections, etc. Therefore, the chief inspector shall explain to the financial institution before on-the-spot inspection (or promptly after commencing on-the-spot inspection in cases where no advance notice is given) that the disclosure of inspection-related information and the content of the inspection results notice to any third party (Note 2) is prohibited —excluding disclosure to the inspection and supervisory departments/bureaus and the financial institution—without the prior approval of the chief inspector before the completion of the on-the-spot inspection or the head of the Evaluation Division of the Inspection Bureau (or the head of the division in charge of evaluation at the Local Finance Bureau) after the completion of the on-the-spot inspection, and shall obtain approval by the first day of the on-the-spot inspection (or promptly after commencing on-the-spot inspection in cases where no advance notice is given).

(Note 1) “Inspection-related information” in this context refers to questions asked, matters pointed out, requests made, etc. by the inspector and other exchanges between the inspector and the executives, employees, etc. of the financial institution during inspection.

(Note 2) “Third party” in this context do not generally include the holding company that has submitted the approval form in prescribed style to the FSA. Also, it is necessary that it is the holding company that controls the management whole of the financial institution subjected (banking holding company pursuant to the provisions of Article.2 of the Banking Law, insurance holding company pursuant to the provisions of Article.2 of the Insurance Business Law) or the overseas headquarter (of the foreign financial institution subject to the inspection).

5. Other

(1) Collaboration with the Securities and Exchange Surveillance Commission (SESC)

If a financial institution engages in different types of businesses—including those of a securities company, investment trust management company and securities investment advisory service—and comprises a financial conglomerate, etc., necessary collaboration with the Securities and Exchange Surveillance Commission (SESC) shall be performed, including conducting

simultaneous inspections, in order to verify (Note) the consolidated risk management status of the group as a whole in an accurate and efficient manner.

(Note) For verification, refer to the Guideline for Financial Conglomerate Supervision, etc.

(2) Collaboration with the Bank of Japan

When conducting inspections, etc., due consideration shall be given to ensure proper collaboration with the assessment conducted by the Bank of Japan.

(3) Application of Inspections, etc. to Government-affiliated Financial Institutions and Japan Post

Inspections, etc. of government-affiliated financial institutions and Japan Post shall be conducted in accordance with the Basic Guidelines, taking into account the purpose of the inspections, the characteristics of the types of businesses, etc.

6. Enforcement Date, etc.

The Basic Guidelines shall come into effect on July 1, 2005, and shall apply to inspections for which advance notice is given on or after the said date (in cases where no advance notice is given, it shall apply to those in which on-the-spot inspection commenced on or after the said date).

The notice dated March 31, 1998, titled “Fundamentals of New Financial Inspections” (Ministry of Finance Inspection Notice No. 140) shall be abolished on July 1, 2005. Inspections for which advance notice was given before June 30, 2005 (in cases where no advance notice was given, those in which on-the-spot inspection commenced before the said date) shall be governed by precedents.

(Attachment)

Explanation and Other Information

Important matters set forth in 3-1 (4) (a) of the Financial Inspection Basic Guidelines (hereinafter referred to as “the Basic Guidelines”) shall refer to the following.

1. Basic Explanation

- (1) Reasons for on-the-spot inspection (legal basis, inspection order, etc.)
- (2) Date of commencement of on-the-spot inspection, list of inspectors’ names, type of inspection, primary scope of verification (including the Date of Inspection in cases where self-assessment is subject to verification).

2. Matters to be Coordinated before Commencement of On-the-spot Inspection (or promptly after the commencement of on-the-spot inspection if no advance notice is given)

- (1) Content of data, etc. to be submitted in advance, submission deadline, submission method, points to consider when preparing the data, etc.
- (2) Matters to be prepared by the financial institution in order to facilitate on-the-spot inspection
- (3) Response in the event of natural disaster, etc. after giving notification of inspection
- (4) Requests from the target financial institution
- (5) Means of communication with the target financial institution during on-the-spot inspection (Refer to 3-2 (4), (5), (6) and (9) (a), (d) and (g) of the Basic Guidelines, etc.)

3. Points to Consider in On-the-spot Inspection (Matters to be thoroughly understood by executives and employees)

- (1) Description of the Basic Guidelines
- (2) Cautions for handling inspection-related information, content of inspection results notice, etc. (Refer to 4 of the Basic Guidelines)

- (3) Accurate reporting of the inspection status to the management team
- (4) Other points to consider as deemed appropriate by the chief inspector

4. Explanation of Various Systems

- (1) Nature of inspection monitoring system
- (2) Nature of opinion submission system
- (3) Exchange of opinions with external auditors (including request concerning release agreement of outside auditor's confidentiality of information for the target financial institution)
- (4) Nature of the Financial Inspection Rating System "FIRST"