

Inspections of Write-off and allowances

I. Purpose of inspections of write-off and allowances

Write-off and allowances are a means of estimating in a timely and appropriate manner the losses on credits expected to be incurred by the insurance company in the future based on self-assessment. There is a strong need for insurance companies to maintain the soundness of their assets in order to fulfill their public and social responsibilities, and provisions of write-off and allowances according to the degree of credit risk are vital in accomplishing this. It is therefore necessary for insurance companies to provide appropriate levels of write-off and allowances for the credit risks they hold.

Insurance companies are also required to provide for write-off and allowances under the Commercial Code and the corporate accounting principles, and external auditors are required to appraise the effectiveness of internal controls on write-off and allowances when they audit financial statements.

Therefore, when inspecting write-off and allowances, inspectors should assume that financial statements have been audited by external auditors and verify the status of systems and processes for write-off and allowances, the appropriateness of write-off and allowances levels and rationality of write-off and allowances calculations, and whether the total value of write-off and allowances is commensurate to the degree of credit risk to which the insurance company under inspection is exposed.

Note: Appraisals of credits using discount present value method may be introduced taking into account deliberations in business accounting council and the status of adopting at insurance companies.

II. Method of inspecting write-off and allowances

Inspectors shall begin by performing "process examination." That is, they will first verify the status of the systems that the institution has put in place for write-off and allowances and the appropriateness of the insurance company's write-off and allowances levels. Having done this, they will then verify whether write-off and allowances have been provided for in an appropriate manner.

Should there be problems identified during inspections, the inspectors shall endeavor to exchange opinions with the insurance company. For example, inspectors shall provide the insurance company under inspection with the viewpoints of the authorities, shall fully recognize the thinking of the insurance company in this regard, and shall directly confirm the viewpoint of the accounting auditors in the presence of the insurance company.

III. Verification of status of the insurance companies' write-off and allowances systems

Inspectors shall verify the status of the systems that the insurance company has put in place for write-off and allowances by checking the items listed below.

1. Formulation of write-off and allowances standards

Do write-off and allowances standards conform to all applicable laws and ordinances, to corporate accounting principles, and to the framework set forth in this inspection manual?

Have formal insurance company procedures been followed by the board of directors in determining and codifying write-off and allowances standards?

Do write-off and allowances standards specify the scope of assets subject to write-off and allowances, the divisions responsible for performing and auditing write-off and allowances,

and the lines of responsibility for write-off and allowances standards and their application?

Are the opinions of the internal audit divisions (credit screening office, inspection division, etc.) and compliance management divisions sought in the formulation and revision of write-off and allowances standards, not just the opinions of divisions performing self-assessments (asset-related divisions and assets assessment divisions)?

Have write-off and allowances manuals been formulated and codified for use in appropriate provisions of write-off and allowances?

From the perspective of assuring the reliability of insurance company soundness, it is desirable that the specific content of write-off and allowances be actively disclosed along with the disclosure of self-assessment results under the provision of Article 59-2, paragraph 1-5-3 of the Insurance Business Law Enforcement Regulations that is based on the provision Article 111, paragraph 1 of the Insurance Business Law.

2. Status of write-off and allowances systems

Are there sufficient checks on divisions performing self-assessments and divisions performing settlement so that write-off and allowances values are calculated appropriately? For example, 1) a system in which divisions performing self-assessments calculate individual allowance for bad debt amounts and internal audit division audits this amount and calculates general allowance for bad debt amounts, or 2) a system in which individual allowance for bad debt amounts are calculated with the cooperation of the asset-related divisions by an asset assessment division that is independent of the asset-related divisions, and the asset assessment division calculates general allowance for bad debt amounts, or 3) a system in which divisions performing self-assessments calculate individual allowance for bad debt amounts, settlement-related divisions calculate general allowance for bad debt amounts, and internal audit divisions audit the result of these calculations.

Are personnel versed in write-off and allowances assigned to the divisions performing self-assessments and internal audit divisions?

Do internal audit divisions, etc. provide requisite education and training for divisions performing self-assessments?

Is internal audit division independent of the divisions performing self-assessments and divisions performing settlement (head bookkeeping office, etc.)? If directors in charge of internal audit divisions are also in charge of divisions performing self-assessments and divisions performing settlement, are there sufficient checks in place to ensure that audits are appropriate and not subject to the influence of the insurance company's results, etc.?

Does internal audit division verify that write-off and allowances are performed appropriately and in accordance with the write-off and allowances standards and write-off and allowances manual?

It is desirable that internal audit division does not just verify the accuracy of write-off and allowances results but also verifies the appropriateness of reserve rates, the appropriateness of the total serve amount, etc., and the appropriateness, etc. of the reserve amount, etc. in the previous term.

Does the insurance company keep sufficient records and documents in individual divisions that inspectors, accounting auditors and others are able to verify the performance of write-off and allowances after-the-fact?

3. Reporting of write-off and allowances results to the board of directors

Are write-off and allowances results reported regularly and appropriately to the board of directors?

Does the board of directors receive timely reports on the status of write-off and allowances systems (changes in divisions performing or auditing write-off and allowances, etc.)?

4. Auditing by auditors and accounting auditors of write-off and allowances systems

Do auditors and accounting auditors who are not subject to the influence of the directors appropriately audit the status of write-off and allowances systems as describe in 1-3 above?

IV. Verification of the appropriateness of write-off and allowances standards

Inspectors shall check whether the write-off and allowances standards formulated by the insurance company are clear and appropriate, whether their framework is justified by the Commercial Code and corporate accounting principles, etc., and whether they are based on self-assessment results. If the insurance company uses an original framework for its write-off and allowances standards, inspectors shall verify the relationship between the insurance company's framework and the model framework above, and shall determine whether individual rules within the insurance company's write-off and allowances standards are rational (for example, rules for calculating reserve rates based on credit ratings, rules for calculating reserve rates based on industry or location, etc.), and shall verify that specific costs and losses that are highly probable to be incurred in the future are estimated rationally.

Inspectors shall also verify that the basic concepts employed in write-off and allowances standards are consistent and continuous, and that there is a rational reason for any changes in the basic concepts used in write-off and allowances standards.

V. Verification of the appropriateness of write-off and allowances results

Inspectors shall use the methods described in the Attachment to verify that write-off and allowances are being calculated appropriately and in accordance with the write-off and allowances standards. This verification process should endeavor to form an accurate picture of the insurance company's systems for write-off and allowances, reporting of write-off and allowances results to the board of directors, and auditing of write-off and allowances systems by auditors and accounting auditors.

Note that write-off and allowances results will effect an insurance company's solvency margin ratio and therefore when the results of write-off and allowances calculations are deemed to be inappropriate, inspectors must fully endeavor to confirm and accurately identify the causes for the inaccuracy (because of write-off and allowances standards or because of the way in which write-off and allowances are performed, or because of poor business results) and improvements to be made by the insurance company under inspection in the future.

1. "Base date "

"Base date " shall be handle as per V:1 of the self-assessment manual.

2. Specific inspection methods, etc.

(1) Scope of verification

The scope of appropriateness verifications shall be write-off and allowances results for all assets on "base date ". Priority attention shall be given to verification of the accuracy of write-off and allowances for credits to debtors classified as "in danger of bankruptcy", "de facto bankrupt", or "bankrupt". Should debtors that should have been classified as "in danger of bankruptcy", "de facto bankrupt", or "bankrupt" be found to be classified as "normal" or "needs attention" in self-assessments, verification shall place priority on determining whether the needed write-off and allowances amounts have been calculated for these credits.

(2) Specific verification methods

Inspectors shall, in accordance with the debtor classifications from self-assessments, use the materials employed by the insurance company under inspection in its write-off and allowances calculations to verify the accuracy of write-off and allowances according to the write-off and allowances standards of the insurance company under inspection.

Should debtor classifications be changed in inspections, inspectors shall accurately measure the additional write-off and allowances amount required assuming that write-off and allowances are calculated according to the write-off and allowances standards of the insurance company under inspection using the new debtor classifications. Note that inspectors will also need to verify that the write-off and allowances standards of the insurance company under inspection are rational in these cases.

3. Standards for judging the appropriateness of write-off and allowances

Should the results of verifications of the appropriateness of write-off and allowances indicate that any of the following apply to the write-off and allowances results of the insurance company under inspection, inspectors shall judge it inappropriate.

- (1) There are problems with the appropriateness of write-off and allowances levels because inappropriate write-off and allowances amounts were calculated on "base date".
- (2) The insurance company failed to apply appropriate write-off and allowances levels for debtor classifications and credit categories in light of self-assessment results.
- (3) Appropriate write-off and allowances were not made because of mistakes in self-assessment results.

Attachment

Item	Verification of the appropriateness of write-off and allowances standards	Verification of the appropriateness of write-off and allowances results	Remarks
1. Allowance for bad debt	<p>Allowance for bad debt shall be made at least for credits (loans and credits similar to loans) using rational estimates of loans highly likely to be incurred in the future.</p> <p>However, credits to the state or local public entities and credits to banks temporarily owned by government and banks under government are treated as not having unrecovery risk and loss of value risk and therefore they are not subject to allowances.</p> <p>In the calculation of allowance for bad debt there should be a consistent linkage between the results of self-assessments based on credit ratings and write-off and allowances. In other words, perform self-assessments based on credit ratings that take account of debtor credit risks, and calculate write-off and allowances based on the results of these self-assessments.</p> <p>Note that for insurance companies utilizing rational and appropriate internal models to quantify credit risks, the total allowance for bad debt fully meet the expected default loss value for the portfolio as a whole as deduced from the quantification of credit risks.</p>	<p>Verify calculations of allowance for bad debt in principle by verifying that there is a consistent linkage between self-assessments and write-off and allowances that takes account of credit ratings and that write-off and allowances conform write-off and allowances standards.</p> <p>Next, verify that the total write-off and allowances of the insurance company under inspection are at sufficient levels for the credit risks to which the insurance company is exposed. If the insurance company employs a rational and appropriate internal model to quantify credit risks, verify that the total allowance for bad debt are at levels above the expected default losses deduced from the quantification of credit risks.</p>	
(1) General allowance for bad debt	<p>In calculating ordinary allowance for bad debt for credits against “normal” debtors and credits against “needs attention” debtors, calculate past default rates and bankruptcy probabilities in principle for each credit rating or at least for each debtor classification using the methods shown below. Find the loss rate expected to be incurred in the future (the expected loss rate), and calculate an expected loss amount by transitional analysis in principle for each credit rating and at least for each debtor classification by the expected loss rate. Post allowance for bad debt at values commensurate to the expected loss amount.</p>	<p>Verify that calculations of general allowance for bad debt for “normal” debtors and “needs attention” debtors rationally estimate expected loss amounts based on write-off and allowances standards for each credit rating and/or debtor classification.</p> <p>Specifically, verify the following items.</p> <p>1) Verification of average remaining period</p> <p>If the insurance company calculates expected loss amounts over a set period in the future by average remaining period, verify that the average remaining period is rational.</p> <p>Specifically, verify how the insurance company reflects average remaining period for credits that have in fact become long-term, fixed credits even though contractual periods are short-term, and other issues that would impinge upon the rationality of average remaining period.</p> <p>If the insurance company categorizes credits to “needs attention” debtors by degree of credit risk to calculate expected loss amounts for specific categories over a set period in the future, verify that the future periods used for individual credit risk categories are rational.</p> <p>2) Verification of default rates and bankruptcy probabilities</p> <p>If the insurance company employs a method based on default rates, verify that the expected loss amount reflects the amount of all losses, including direct write-off, indirect write-off, amount of debt forgiveness, and losses on credits sold. If the insurance company employs a method based on bankruptcy probabilities, verify that the number of bankruptcies at the very least reflects all loans to “de facto bankrupt” and “bankrupt” debtors.</p>	

Item	Verification of the appropriateness of write-off and allowances standards	Verification of the appropriateness of write-off and allowances results	Remarks
	<p>The basic principle for calculating general allowance for bad debt is to calculate expected loss amounts using a migration analysis of individual credit ratings and/or debtor classification.</p> <p>In addition, it is desirable that general allowance for bad debt be calculated in light of the nature of the credit risks associated with the credits held by the insurance company under inspection. For example, a method could be used in which expected loss amounts are calculated by specific groups as warranted by the nature of the insurance company's portfolio (debtor industry, debtor location, credit amount, size of debtor, individual/company, etc.).</p> <p>The expected loss rate is determined after making needed adjustments for changes in economic conditions, changes in credit policies, changes in portfolio make-up (credit ratings, debtor industry, debtor location, credit amount, size of debtor, individual/company, credit security, etc.), and correcting this for past default rates and/or bankruptcy probability forecasts.</p> <p>Should there be a rapid worsening of economic conditions in particular, the weight of more recent calculation periods should be increased in the determination of past default rates and bankruptcy probabilities or the expected loss rate should be adjusted to reflect recent increases in default rates and bankruptcy probabilities, or some other similar method should be employed.</p> <p>General allowance for bad debt calculation method Expected loss amount calculation method Expected loss amount = Credit amount x Expected loss rate Examples of specific methods for calculating expected loss rate</p>	<p>It is appropriate that the number of bankruptcies reflects the number of loans to "in danger of bankruptcy" debtors in some form. Verify that the method for doing so is rational, for example, adding to the number of bankruptcies a number found by multiplying the number of "in danger of bankruptcy" loans by the bankruptcy probability. If the insurance company does not reflect the number of "in danger of bankruptcy" loans in the number of bankruptcies, fully verify that the total amount of general allowance for bad debt are at levels commensurate to the credit risk exposure of the insurance company under inspection, that calculations of expected loss amounts in earlier periods were at sufficient levels, and that the insurance company compares expected loss amounts based on default rates.</p> <p>If the insurance company employs migration analysis by credit rating or debtor classification for the calculation of default rates, verify that there is rational value for this analysis.</p> <p>If the insurance company employs a method that uses bankruptcy probabilities and there is a likelihood that large losses will be incurred so that the expected loss amount as calculated from default rates is higher than the expected loss amount as calculated from bankruptcy probabilities, it is desirable that the insurance company post as allowance for bad debt the expected loss amount calculated using the default rate-based method.</p> <p>3) Verification of exclusion of abnormal values</p> <p>If the insurance company excludes losses or bankruptcies associated with specific debtors from its default rates and/or bankruptcy probabilities because these values are "abnormal," verify that there is rational value for the exclusion.</p>	

Item	Verification of the appropriateness of write-off and allowances standards	Verification of the appropriateness of write-off and allowances results	Remarks
	<p>1) Using default rate Default write-off loss amount / Credit amount</p> <p>2) Using bankruptcy probability (on number basis) Bankruptcy probability x (1 – forecast recovery rate) (Note: There is also a method that substitutes unsecured percentage or average loss percentage for “1-forecast recovery rate”)</p>	<p>Specifically, if the insurance company excludes losses and bankruptcies associated with specific debtors from calculations of default rates and/or bankruptcy probabilities as “abnormal” values by claiming that the debtor should have been classified as “in danger of bankruptcy” but was instead classified as “normal” or “needs attention,” verify that the losses and bankruptcies are reflected in calculations of allowance for bad debt in some form, for example, by including them in calculations of expected loss amount for credits to “in danger of bankruptcy” debtors.</p> <p>Verify whether the insurance company excludes as “abnormal” values losses or bankruptcies associated with specific industries or locations by claiming that there are sharp differences between losses and bankruptcies in these industries or locations and losses or bankruptcies in other industries or locations. In these cases it is not appropriate to exclude losses and/or bankruptcies to specific industries and/or locations as “abnormal.” Rather, it is desirable that the insurance company group credits by industry and/or location, calculate default rates and/or bankruptcy probabilities for each group, find expected loss rates for each, and calculate expected loss amounts as the credits to each group multiplied by the expected loss rate for the group.</p> <p>4) Verification of calculation period for default rates and bankruptcy probabilities Verify that calculations of expected loss amounts are based at the very least on default rates and bankruptcy probabilities for the preceding three calculation periods.</p> <p>If the calculation period is not past three periods, verify that there is a rational reason why, for example, data has not been accumulated. In such cases, identify the time at which sufficient data will have been accumulated to enable the use of default rates and bankruptcy probabilities for three calculation periods and verify that the methods used to calculate expected loss amounts during the interim are rational.</p> <p>5) Verification of expected loss rates Verify that the insurance company under inspection captures changes in economic conditions that would affect the debtor’s business, changes in credit policies, changes in portfolio make-up, and other relevant information in the determination of expected loss rates. If the insurance company corrects rates for changes in economic conditions etc., verify that there is rational value for the corrections in light of the way in which the insurance company captures changes in economic conditions, etc.</p> <p>If the insurance company under inspection has identified large changes in economic conditions, etc., but has not made necessary corrections, verify that there is rational value for not making corrections.</p>	

Item	Verification of the appropriateness of write-off and allowances standards	Verification of the appropriateness of write-off and allowances results	Remarks
		<p>6) Verification of expected loss amounts from before previous periods Compare expected loss amounts and actual defaults or bankruptcies from previous periods to verify that levels were adequate. If this verification indicates that expected loss levels were inadequate, verify the reasons why (for example, did past calculations of expected loss amounts correct for forecasts at the time of calculation?), and verify that expected loss rates are corrected at 'base date'.</p>	
<p>1) Allowance for bad debt for credits to "normal" debtors</p>	<p>Allowance for bad debt for credits to "normal" debtors should estimate an expected loss amount for a set period in the future that corresponds to the average remaining period of the credits. However, it is acceptable for expected loss amounts to be estimated for the next one year in the future. In calculating expected loss amounts, use average default rates or bankruptcy probabilities for at least the last three calculation periods (three year average of cumulative default rates or bankruptcy probabilities for a set period in the past corresponding to a set period in the future) to calculate past default rates, correct for expected future losses to find an expected loss rate, and multiply the amount of credits to "normal" debtors by the expected loss rate (if calculating the expected loss amount for the next one year, calculate the average one-year default rate and/or bankruptcy probability for the past three calculation periods).</p>	<p>Verify that allowance for bad debt for credits to "normal" debtors are rationally estimated based on write-off and allowances standards and utilizing an expected loss amount for a set period in the future or for the next one year that corresponds to the average remaining period of credits to "normal" debtors. When the insurance company estimates the expected loss amount for the next one year, verification of the rationality of the "set period in the future" vis-à-vis the average remaining period may be omitted.</p>	
<p>2) Allowance for bad debt for credits to "needs attention" debtors</p>	<p>Allowance for bad debt for credits to "needs attention" debtors should estimate an expected loss amount for a set period in the future that corresponds to the average remaining period of the credits. It is acceptable to classify "needs attention" debtors according to their degree of credit risk and to estimate expected loss amounts for set periods in the future deemed rational for each classification. For example, it would be acceptable to estimate expected loss amounts for the average remaining period or the next three years for credits to "need control" debtors and estimate expected loss amounts for the average remaining period or the next one year for other debtors.</p>	<p>Verify that allowance for bad debt for credits to "needs attention" debtors are rationally estimated based on write-off and allowances standards and utilizing an expected loss amount for a set period in the future that corresponds to the average remaining period of credits to "needs attention" debtors, or for a set period in the future deemed rational for each category when "needs attention" debtors are categorized by degree of credit risk. If the insurance company calculates an expected loss amount for a set period in the future based on credit risk categories, verify that the calculation of the expected loss amount is rational. If the insurance company calculates a three-year expected loss amount for "need control" debtors and a one-year expected loss amount for other debtors, verification of the rationality of the "set period in the future" vis-à-vis the average remaining period may be omitted.</p>	<p>Note: "Credits to 'need control' debtors" refers to credits to "needs attention" debtors when all or part of the credits to the debtor have been classified as requiring need control, and so throughout.</p>

Item	Verification of the appropriateness of write-off and allowances standards	Verification of the appropriateness of write-off and allowances results	Remarks
	<p>In calculating expected loss amounts, use average default rates or bankruptcy probabilities for at least the last three calculation periods (three year average of cumulative default rates or bankruptcy probabilities for a set period in the future) to calculate past default rates, correct for expected future losses to find an expected loss rate, and multiply the amount of credits to “needs attention” debtors by the expected loss rate (if calculating the expected loss amount for the next one year, calculate the average one-year default rate and/or bankruptcy probability for the past three calculation periods).</p>		
(2) Specific allowance for bad debt and direct write-off	<p>For specific allowance for bad debt and direct write-off, calculate in principle an expected loss amount for each individual “in danger of bankruptcy”, “de facto bankrupt”, and “bankrupt” debtor, and either post as allowance for bad debt or directly amortize an amount equivalent to the expected loss amount. Calculate required amounts for individual allowance for bad debt each period.</p>	<p>Verify that individual allowance for bad debt amounts and direct write-off are calculated in principle by estimating an expected loss amount for each individual “in danger of bankruptcy”, “de facto bankrupt”, and “bankrupt” debtor, and that an amount equivalent to the expected loss amount is either posted as allowance for bad debt or direct write-off.</p>	
1) Specific allowance for bad debt for credits to “in danger of bankruptcy” debtors	<p>For allowances against credits to “in danger of bankruptcy” debtors, estimate in principle an expected loss amount for a set period in the future deemed ration for credits to each individual “in danger of bankruptcy” debtor and post an amount equivalent thereto as allowance for bad debt. However, it is acceptable to estimate an expected loss amount for the next three years. Sample calculations of expected loss amount for credits to “in danger of bankruptcy” debtors A. The method of using Category III credit amounts multiplied by expected loss rate as the expected loss amount (including the use of a remainder after the amount recoverable from rationally estimated cash flow is deducted)</p>	<p>For individual write-off and allowances against credits to “in danger of bankruptcy” debtors, verify that the estimated loss value has been rationally estimated for a set period in the future. Specifically, verify the items below and verify that estimates cover the full value of Category III credits, including the difference between the appraisal value and estimated disposal value of general collateral. A. In the case of using Category III credit amounts multiplied by the expected loss rate as the expected loss amount a) Verification of the “set period in the future”</p>	

Item	Verification of the appropriateness of write-off and allowances standards	Verification of the appropriateness of write-off and allowances results	Remarks
	<p>When using Method A above, in principle calculate a past default rate or bankruptcy probability for each credit rating or at least for each debtor classification of “in danger of bankruptcy” debtors, find a loss rate expected for the future (expected loss rate), and in principle multiply the amount of Category III credits to the individual debtor by the expected loss rate to calculate an expected loss amount. Post an amount equivalent to the expected loss amount to allowance for bad debt.</p> <p>The expected loss rate should in principle be determined for each individual debtor based on past default rates or bankruptcy probabilities corrected for future forecasts in light of changes in economic conditions, forecasts for business conditions in the industry, etc. of the debtor, forecasts for local economic conditions in the business territory of the debtor, and other relevant information.</p> <p>In calculating expected loss amounts, use average default rates or bankruptcy probabilities for at least the last three calculation periods (three year average of cumulative default rates or bankruptcy probabilities for a set period in the past corresponding to a set period in the future) to calculate past default rates, correct for expected future losses to find an expected loss rate, and multiply the amount of Category III credits by the expected loss rate (if calculating the expected loss amount for the next one year, calculate the average one-year default rate and/or bankruptcy probability for the past three calculation periods).</p> <p>If the insurance company has a considerable number of debtors classified as “in danger of bankruptcy” debtors and it is difficult to calculate write-off and allowances amounts in light of the collateral and other security status for individual debtors, it is acceptable to use a single expected loss rate for each group of credits to “in danger of bankruptcy” debtors below a set threshold level, and to post an amount equivalent to the expected loss amount as allowance for bad debt. In such cases, the scope of credits to “in danger of bankruptcy” debtors below a set threshold value for which group expected loss rates are applied shall be within a range deemed rational in light of the size and nature of the assets of the insurance company under inspection, and calculations of expected loss rates must be rigorous and clear.</p>	<p>Verify that the “set period in the future” used to estimate “expected loss amounts” is rational. However, this verification may be omitted if the insurance company estimates expected loss amounts for a three-year period.</p> <p>b) Verification of default rates and bankruptcy probabilities</p> <p>If the insurance company employs a method based on default rates, verify that the amount of all losses, including direct write-off, indirect write-off, amount of debt forgiveness, and losses on credits sold.</p> <p>If the insurance company employs a method based on bankruptcy probabilities, verify that the number of bankruptcies at the very least reflects all number of bankruptcies to “de facto bankrupt” and “bankrupt” debtors.</p> <p>c) Verification of exclusion of abnormal values</p> <p>If the insurance company excludes losses or bankruptcies associated with specific debtors from its default rates or bankruptcy probabilities because these values are “abnormal,” verify that there is rational value for the exclusion.</p> <p>d) Verification of calculation period for default rates and bankruptcy probabilities</p> <p>Verify that calculations of expected loss amounts are based at the very least on default rates and bankruptcy probabilities for the preceding three calculation periods.</p> <p>If the calculation period is not three past periods, verify that there is a rational reason why, for example, data has not been accumulated. In such cases, identify the time at which sufficient data will have been accumulated to enable the use of default rates and bankruptcy probabilities for three calculation periods and verify that the methods used to calculate expected loss amounts during the interim are rational.</p> <p>e) Verification of expected loss rates</p> <p>Verify that the insurance company under inspection captures changes in economic conditions, forecasts for the industry, etc. of the debtor, and local economic conditions for the business territory of the debtor. If the insurance company under inspection has identified large changes in economic conditions, etc., but has not made necessary corrections for individual debtors, verify that there is rational reason for not making corrections.</p> <p>f) Verification of expected loss amounts from previous periods</p> <p>Compare expected loss amounts for individual debtors and actual defaults or bankruptcies for individual debtors from previous periods to verify that levels were adequate. If this verification indicates that expected loss levels were inadequate, verify the reasons why (for example, did past calculations of expected loss amounts correct for forecasts at the time of calculation?), and verify that expected loss rates are corrected at “base date”.</p>	

Item	Verification of the appropriateness of write-off and allowances standards	Verification of the appropriateness of write-off and allowances results	Remarks
		<p>g) Verification of amount recovery from cash flow, etc.</p> <p>If the insurance company excludes an amount recoverable from cash flow from the Category III amount for individual debtors, verify that the cash flow estimate is rational and that the remainder when the recoverable amount is deducted from the Category III amount is treated as the expected loss amount.</p> <p>If the insurance company has a considerable number of debtors classified as “in danger of bankruptcy” debtors and omits considerations of credit security in favor of expected loss amounts based on group expected loss rates for debtors below a set threshold value, verify that the calculation of group expected loss rates is rational. In these cases, it is acceptable to calculate expected loss rates for “in danger of bankruptcy” debtors below a set threshold value as a single group. Verify that the scope of credits for “in danger of bankruptcy” debtors below a set threshold value is rational.</p>	<p>Note: “Recover amount from cash flow” refers to the portion that is deemed certain of recovery from the amount of current profits for the individual debtor adjusted for depreciation charges and other non-financial items in principle for three years, or for five years in the case the debtor has formulated a business improvement plan, etc.</p>
	<p>B. Using a remainder found by subtracting a recoverable amount from the credit amount as the expected loss amount for credits that have a saleable market (deeming a rationally calculated saleable value as the recoverable amount)</p>	<p>B. Posting as allowance for bad debt an expected loss amount found as the remainder when a saleable amount is deducted from the Category III amount</p> <p>If credits have a market in which they can be sold and the insurance company uses the amount at which the credit can be sold as the recoverable amount, and the insurance company subtracts this recoverable amount from the credit amount to arrive at a remainder that is used as the expected loss amount, verify that the calculation of the saleable amount for the credit is rational, and verify that the remainder when the recoverable amount is subtracted from the Category III is used as the expected loss amount.</p>	
<p>2) Specific allowance for bad debt and direct write-off for “de facto bankrupt” and “bankrupt” debtors</p>	<p>For credits to “de facto bankrupt” and “bankrupt” debtors, use the amount of credits for each individual debtor classified as Category III or Category IV as the expected loss amount and either post allowance for bad debt or make direct write-off of an amount equivalent to the expected loss amount.</p>	<p>Verify that for credits to “effective bankrupt” and “bankrupt” debtors, the insurance company uses the amount of credits for each individual debtor classified as Category III or Category IV as the expected loss amount and either posts allowance for bad debt or makes direct write-off of an amount equivalent to the expected loss amount.</p> <p>Verify that the insurance company uses the total amount of credits classified as Category III or Category IV as the expected loss amount, and that it does not deem the portion certain of recovery as Category II and deduct the recoverable amount from the Category III amount.</p>	

Item	Verification of the appropriateness of write-off and allowances standards	Verification of the appropriateness of write-off and allowances results	Remarks
3) Allowances against specific foreign credits	<p>For reserves against specific foreign credits, determine the countries to be covered based on their financial conditions, economic conditions, foreign exchange conditions and other factors, and clarify which credits to the governments of these countries, private companies in these countries, and Japanese companies in these countries are subject to reserves against specific foreign credits.</p> <p>Multiply the relevant credits by an expected loss rate estimated from the financial conditions, economic conditions, foreign exchange conditions and other factors in specific countries to find an expected loss amount. Post an amount equivalent to this expected loss amount to the reserves against specific foreign credits.</p>	<p>Verify that the scope of countries and scope of credits subject to allowances against specific foreign credits, and the methods of calculating expected loss rates and expected loss amounts are rational. In particular, verify that calculations of expected loss rates are rational in light of the saleable value for credits from specific countries on saleable markets, and the credit rating given to specific countries by ratings agencies.</p> <p>Verify that reserves against specific foreign credits include expected loss amounts as found by multiplying all credits from relevant countries by an expected loss rate estimated from the financial conditions, economic conditions, foreign exchange conditions and other factors in the country. However, credits deemed recoverable because they are secured with deposits, or because they are secured with guarantees or insurance from parties domiciled outside of the country in question, credits denominated in the local currency of the country in question, and credits employing structures that avoid transfer risks may be excluded.</p> <p>Specifically, verify that for those credits to “normal” and “needs attention” debtors that are subject to reserves against specific foreign credits, the insurance company posts ordinary allowance for bad debt and also reserves against an expected loss amount found by multiplying the amount of the credit by an expected loss rate that estimates financial conditions, etc. in the country in question.</p> <p>For credits to “in danger of bankruptcy”, “de facto bankrupt, and “bankrupt” debtors that are subject to reserves against specific foreign credits, verify that the insurance company posts expected loss amounts based on the financial position, etc. of the individual debtor, and that it also posts as allowances against. Specific foreign credits or individual allowance for bad debt an expected loss amount found by multiplying the remainder when the initial expected loss amount is subtracted from the original credit to the debtor by an expected loss rate estimated from financial</p>	
4) Verification of the appropriateness of the total value of allowance for bad debt		<p>Verify that the total value of allowance for bad debt is at a level sufficient for the degree of credit risk to which the insurance company under inspection is exposed.</p>	
2. Allowances other than allowance for bad debt	<p>For allowances other than allowance for bad debt, rationally estimate and post highly probable contingency loss amounts. Note that the names of allowances used below are only examples and do not preclude the use of other names.</p>	<p>Verify that the insurance company rationally estimates and posts allowances for highly probable contingency losses in addition to allowance for bad debt.</p> <p>If the insurance company does not post allowances other than allowance for bad debt even though it is exposed to the potential for highly probable contingency losses, verify that there is rational value for not posting these allowances.</p>	

Item	Verification of the appropriateness of write-off and allowances standards	Verification of the appropriateness of write-off and allowances results	Remarks
(1) Allowances against losses from the sale of credits	<p>If the price of collateral real estate securing credits sold to a joint credit purchasing agency has fallen or in other similar conditions, calculate an expected loss deemed likely to be incurred as a result of the fall in the price of the sold credit, and post an amount equivalent to the expected loss amount as allowances against losses from the sale of credits.</p> <p>At the very least, when the market value of sold credits is more than 50% below the initial selling price, that portion of the difference between the initial selling price and the market value of the sold credit to be borne by the selling insurance company shall be posted as allowances. Likewise, if the credit is deemed certain of sale by the end of the next settlement period, that portion of the difference between the initial selling price and the estimated selling price of the collateral real estate to be borne by the selling insurance company shall be posted as allowances.</p> <p>Note: The expected loss amount from a fall in the price of collateral real estate is not an expected loss amount from a default of the credit to Cooperative Credit Purchase Corporation, and it is therefore not appropriate to classify the debtor as "in danger of bankruptcy", "de facto bankrupt", or "bankrupt" for Cooperative Credit Purchase Corporation or to post individual allowance for bad debt. However, credits to Cooperative Credit Purchase Corporation are subject to ordinary allowance for bad debt (except for credits for which there is a rational value for exclusion from ordinary allowance for bad debt).</p>	<p>Verify that calculation of the market value of real estate collateralizing sold credits is rational, that "allowance standards" are rational, and that these standards are at least at the levels described to the left.</p>	

Item	Verification of the appropriateness of write-off and allowances standards	Verification of the appropriateness of write-off and allowances results	Remarks
(2) Allowances against support for specific debtors	<p>If the insurance company is engaged in the rebuilding and support of debtors that have fallen into difficult economic straits by relinquishing credits or providing cash grants, they shall in principle calculate an expected loss amount for the support and post an amount equivalent to the expected loss amount as allowances against support for specific debtors.</p> <p>Specifically, in calculating the allowances for support to consolidated subsidiaries of the insurance company under inspection (including affiliated "non-banks"), the insurance company shall calculate an amount for the remaining Category III and Category IV values after deducting (allocating to Category IV credits first) a recoverable amount for the subsidiary (total amount posted to capital plus recoverable amount from cash flow during the period of the business improvement plan) from the categorized amount for the subsidiary in light of the assets assessment result for the subsidiary, and shall use the same methods as for write-off and allowances to calculate a write-off and allowances amount for the subsidiary which shall be posted to allowances against support for specific debtors as the expected loss amount from support to the subsidiary. In this case, the entire amount classified as Category IV and an amount from that is classified as Category III calculated using the same methods as the insurance company's write-off and allowances standards require for credits to "in danger of bankruptcy" debtors shall be posted to allowances against support for specific debtors as the expected loss amount from support to the subsidiary.</p> <p>The expected loss amount from support rendered to specific debtors through debt forgiveness and cash grants, etc. should basically be posted to the allowances against support for specific debtors, but when support is rendered by relinquishing credits and the expected loss amount from support to specific debtors with debtor classifications of "in danger of bankruptcy" is within the scope of this credit, and when the amount of the expected loss amount is negligible so that there is little need to set allowances against support for specific debtors, or when there is other rational value, the amount may be posted as individual allowance for bad debt.</p>	<p>Verify that all debtors expected to be given support by debt forgiveness or other cash grants, etc. are covered, and that the calculation of expected loss amount from support to specific debtors is rational.</p> <p>If the insurance company provides support by relinquishing credits and the expected loss amount from this support is posted as individual allowance for bad debt, verify that there is rational value for posting it as individual allowance for bad debt and that calculation of the expected loss amount is rational.</p>	

Item	Verification of the appropriateness of write-off and allowances standards	Verification of the appropriateness of write-off and allowances results	Remarks
(3) Other allowances against contingency losses	<p>If the insurance company is exposed to the potential for highly probable contingency losses other than (1) and (2) above, post a rationally estimated amount likely to be borne to other allowances against contingency losses as the expected loss amount.</p> <p>In particular, if the insurance company under inspection engages in credit liquidation schemes that take credits off the balance sheet but do not fully transfer credit risks to third parties so that the insurance company retains all or a part of the credit risk, post an amount equivalent to the expected loss amount from the Category III portion and the full amount of the Category IV portion to other allowances against contingency losses as the expected loss amount.</p>	<p>Verify that future losses are rationally estimated and posted to other allowances against contingency losses.</p> <p>In particular, when credit liquidation schemes are used to take credits off the balance sheet, verify that an expected loss amount is posted to other allowances against contingency losses as described left.</p>	
3. Securities appraisal	<p>I appraising securities, post an amount equivalent to the expected loss amount from the Category III portion to allowances against investment losses, and directly amortize the entire Category IV portion.</p>	<p>Verify that in the appraisal of securities the insurance company has posted an expected loss amount to the allowances against investment losses or has directly amortized an expected loss amount as described to the left.</p>	
(1) Bond appraisal	<p>For private offering bonds issued by “in danger of bankruptcy”, “de facto bankrupt”, or “bankrupt” debtors, calculate expected loss amounts using the same methods as for allowance for bad debt. Post an amount equivalent to expected loss amount from the Category III portion to allowances against investment losses, and directly amortize the entire Category IV portion.</p>	<p>Verify that bond appraisal methods are rational, and that the insurance company posts the expected loss amount to allowances against investment losses or directly amortize it.</p> <p>If the insurance company classifies private offering bonds using the same method as it does for credits, verify that expected loss amounts are calculated using the same methods as allowance for bad debt.</p> <p>If the insurance company uses the same classification methods as for credits but has not posted expected loss amount to allowances against investment losses or directly amortize them, or if it needs to make classifications but has not and therefore has not posted allowances or amortize, verify that there is rational value for not doing so.</p>	
(2) Equity appraisal	<p>For equities issued by “in danger of bankruptcy”, “de facto bankrupt”, or “bankrupt” debtors (excluding equities listed on stock exchange and other-the-counter-registered equities), calculate expected loss amounts using the same methods as for allowance for bad debt. Post an amount equivalent to expected loss amount from the Category III portion to allowances against investment losses, and directly amortize the entire Category IV portion.</p> <p>If there is a recognized need to reduce book values, directly amortize the Category IV portion as an expected loss amount.</p>	<p>Verify that equity appraisal methods are rational, and that the insurance company posts the expected loss amount to allowances against investment losses or directly amortize it as described to the left. If cost methods are used, and there are clear standards for forced write-downs of value pursuant to the provisions of the Commercial Code, verify that these standards are rational.</p> <p>If the insurance company classifies equities using the same methods as it does for credits, verify that expected loss amounts are calculated using the same methods as allowance for bad debt.</p> <p>If the insurance company uses the same classification methods as for credits but has not posted expected loss amount to reserves against investment losses or directly written them off, or if it needs to make classifications but has not and therefore has not posted allowances or amortized, verify that there is rational value for not doing so.</p>	

Item	Verification of the appropriateness of write-off and allowances standards	Verification of the appropriateness of write-off and allowances results	Remarks
(3) Foreign securities appraisal	For foreign securities classified with the same methods as used for credits and issued by "in danger of bankruptcy", "de facto bankrupt", or "bankrupt" debtors, calculate expected loss amounts using the same methods as for allowance for bad debt. Post an amount equivalent to expected loss amount from the Category III portion to allowances against investment losses, and directly amortize the entire Category IV portion.	Verify that foreign securities appraisal methods are rational, and that the insurance company posts the expected loss amount to allowances against investment losses or directly amortize it as described to the left. If the insurance company classifies foreign securities using the same method as it does for credits, verify that expected loss amounts are calculated using the same methods as allowance for bad debt. If the insurance company uses the same classification methods as for credits but has not posted expected loss amount to allowances against investment losses or directly amortize them, or if it needs to make classifications but has not and therefore has not posted allowances or amortized, verify that there is rational value for not doing so.	
(4) Securities investment trust beneficiary certificate appraisal	The Category IV portion for securities investment trust beneficiary certificates is directly amortized as the expected loss amount.	Verify that expected loss amounts are amortized for securities investment trust beneficiary certificates as described to the left.	
4. Appraisal of other assets		In the appraisal of other assets, verify that expected loss amounts are posted as allowances or directly amortize as described to the left.	
(1) Suspense payment appraisal	For suspense payments other than those similar to loans, post as allowances or directly amortize the Category IV portion as the expected loss amount.		
(2) Chattel and real estate appraisal	For chattels and real estate, post as allowances or directly amortize the Category IV portion as the expected loss amount.		
(3) Golf club membership appraisal	For gold club memberships, post as allowances or directly amortize the Category IV portion as the expected loss amount.		
(4) Appraisal of premium in arrears, credit of agency, credit of foreign agency, credit of foreign agency, credit of co-insurance, credit of re-insurance, credit of foreign re-insurance, and credit of proxy service	For premium in arrears, credit of agency, credit of foreign agency, credit of co-insurance, credit of re-insurance, credit of foreign re-insurance, and credit of proxy service, post an amount equivalent to expected loss amount from the Category III portion to allowances against investment losses, and post as allowances or directly amortize the Category IV portion as the expected loss amount.		

Item	Verification of the appropriateness of write-off and allowances standards	Verification of the appropriateness of write-off and allowances results	Remarks
(5) Miscellaneous assets appraisal	<p>A. For purchased monetary credits classified with the same methods as used for credits and issued by “in danger of bankruptcy”, “de facto bankrupt”, or “bankrupt” debtors, calculate expected loss amounts using the same methods as for allowance for bad debt. Post an amount equivalent to expected loss amount from the Category III portion to reserves against investment losses or to allowance for bad debt. For Category IV purchased monetary credits, post an amount equivalent to expected loss amount from the Category IV portion to reserves against investment losses or to allowance for bad debt, or directly amortize this amount.</p> <p>B. For loan credit investment trust beneficiary certificates classified with the same methods as used for credits and used to liquidated credits from “in danger of bankruptcy”, “de facto bankrupt”, or “bankrupt” debtors, calculate expected loss amounts using the same methods as for allowance for bad debt. Post an amount equivalent to expected loss amount from the Category III portion to reserves against investment losses or to allowance for bad debt. For Category IV purchased monetary credits, post an amount equivalent to expected loss amount from the Category IV portion to reserves against investment losses or to allowance for bad debt, or directly amortize this amount.</p>	<p>If the insurance company classifies purchased monetary credits or loan credit investment trust beneficiary certificates using the same method as it does for credits, verify that expected loss amounts are calculated using the same methods as allowance for bad debt.</p> <p>If the insurance company uses the same classification methods as for credits but has not posted expected loss amount to allowances against investment losses or directly amortized them, or if it needs to make classifications but has not and therefore has not posted allowances or amortized, verify that there is rational value for not doing so.</p>	