Liquidity Risk Management System Checklist

Liquidity risk could include two different types of risk: the risk that an insurance company will become unable to assure itself of adequate funding due to a decline in new premium income caused by a deterioration, etc. of its financial position, an increase in surrender value caused by large-lot cancellations, or an outflow of funds caused by a big disaster, or it will incur losses because it is forced to sell assets at markedly lower prices than normal and therefore unable to maintain cash flow (capital liquidity risk), and the risk that upheavals, etc. in the market will render it impossible to trade and therefore force the company to engage in transactions at prices that are markedly more disadvantageous than normal (market liquidity risk).

Inspectors will verify and inspect the liquidity risk management systems of insurance companies using the "Risk Management Systems Checklists (Common Items)", the "Market Risk Management Systems Checklist", and this checklist. This checklist is to be used for inspections of capital liquidity risk systems; the "Market Risk Management Systems Checklist" for inspections of market liquidity risk.

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

[Notes on the use of this manual in inspections]

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

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

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

Note: Explanation of check points

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

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

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

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

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

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

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

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

Item	Risk management System Check Point	Explanation of Risk Management Check Points	Remarks
I. Recognition of risk management, etc. 1. Recognition of directors and role of board of directors	(1) Understanding of capital liquidity risk	(1) Do directors understand that capital liquidity problems can in some cases lead directly to bankruptcy and the triggering of systemic risk?	
	(2) Articulation of strategic goals with reference to capital liquidity risk	(2) Does the board of directors take account of capital liquidity risks when setting strategic goals?	
	(3) Establishment of capital liquidity risk management systems	(3) Does the board of directors, in managing capital liquidity risk, put systems in place for sufficient mutual checking, for example, by separating the capital liquidity risk management division from the risk management division or otherwise providing for appropriate capital liquidity risk management? Does the system allow the capital liquidity risk management division to recommend measures for securing liquidity directly to the representative director as warranted by risk conditions?	Note: "Capital liquidity risk management division" refers to a division that manages and administers capital liquidity on a daily basis. "Risk management division" refers to a division that monitors compliance to internal standards etc. regarding capital liquidity, and so throughout.
	(4) Setting and review of limits	(4) Do the representative directors set and review limits, if necessary, on the management of assets for which there is no market or whose liquidity is very low so as to appropriately manage capital liquidity risk? Do the representative directors report such setting and review of limits to the board of directors? Does the board of directors verify that the information reported by the representative director adhere to liquidity risk management policies?	
2. Recognition and roles of manager	(1) Establishment of rules for capital liquidity risk management	(1) Does manager in the capital liquidity risk management division and risk management division formulate management methods, reporting methods, decision-making methods and other relevant rules based on categories of tightness of capital liquidity("normal," "needs attention," "crisis," "big disaster")? Do they seek the approval of the board of directors for these rules?	Note: "Manager" refers to branch office managers and persons in senior managerial positions (including directors) with equivalent levels of responsibility, and so throughout.
	(2) Appropriate capital liquidity risk management practice	(2) Does manager in the capital liquidity risk management division manage cash flow appropriately and in accordance with capital liquidity risk management policies and risk management rules?	
II. Establishment of appropriate risk management systems 1. Risk recognition and assessment	(1) Analysis of capital liquidity risk factors and development of countermeasures	(1) Does the capital liquidity risk management division gather and analyze information on self-equity price, reputation, and other matters that would have an impact on new contracts, cancellation, or renewal of maturing saving-type insurance? Does it formulate appropriate countermeasures? If the insurance company has separate capital liquidity risk management divisions for yen and foreign currencies or for domestic and foreign branches, does it have a means of providing integrated management of capital liquidity risk?	
	(2) Measurement of liquidity at consolidated subsidiaries	(2) The bankruptcy of a consolidated subsidiary because of a deterioration in its capital liquidity is likely to have a large impact on the insurance company. Does capital liquidity risk management capture conditions at consolidated subsidiaries and take them into account?	
	(3) Management of outward reinsurance	(3) Does capital liquidity risk management take fully into account that the company may not be able to receive reinsurance premiums depending on the financial position of inward reinsurance companies?	

Item	Risk management System Check Point	Explanation of Risk Management Check Points	Remarks
2. Capital liquidity risk management	(1) Implementation of liquidity assessments, management of risks on both the asset and liability sides	(1) Does the capital liquidity risk management division assess liquidity from both the asset and the liability sides? Does it monitor the status of liquidity assurance, for example, when and how much money the insurance company is able to raise for the payment of insurance claims, etc.?	Note: "Insurance claims, etc." refers to the amount of money that an insurance company pays to a policyholder or their beneficiary, such as insurance money, and no-claim return, and so throughout.
	(2) Appropriateness of capital liquidity risk management	(2) 1) Does the capital liquidity risk management division manage the following matters as necessary, endeavor to quickly grasp their impact on capital liquidity, and create daily statement of capital liquidity, and weekly, monthly and quarterly capital liquidity forecasts for yen and foreign currency assets? a) Integrated management of insurance money and premiums b) Management of investment by type of instrument and term structure c) Management of cash(include "ATM") d) Management of capital liquidity of foreign currency e) Management of capital liquidity taking account of exchanges between foreign currencies Etc.	
		2) Does the risk management division manage the following matters as necessary, endeavor to quickly grasp their impact on cash flow, provide information to the board of directors etc. and capital liquidity risk management division, and exert checks on the capital liquidity risk management division? a) Management and analysis of new contract and cancellation estimate plans and results b) Management of funding gap limits c) Management and analysis of contractual credit or credited limit Etc.	
	(3) Appropriateness of capital liquidity risk management methods	(3) Does the capital liquidity risk management division monitor planned investments (securities, lending, etc.) based on reports from business divisions, etc.? Does the capital liquidity risk management division take account of the following matters in endeavoring to monitor investment plans? 1) Off-balance sheet transactions (including currency swaps, etc.) 2) Measurement of actual investment periods (for example, investments that are formally short-term but in actually long-term)	Note: "Business divisions, etc." refers to business divisions and branch offices, and so throughout.
	(4) Operations and administration with recognition of liquidity risk	(4) Do business divisions operate and administer their functions taking liquidity risk into account as warranted by the capital liquidity status measured by the capital liquidity risk management division?	
3. Establishment of crisis management system	(1) Formulation of response plans for liquidity crises	(1) Do the capital liquidity risk management division and risk management division seek the approval of the board of directors in the formulation and major revision of liquidity crisis countermeasures? (Do they seek the approval of the board of directors, etc. for other revisions)? Do countermeasures include communication and reporting systems (a system for reporting directly to the representative director), response methods (assurance of means of capital), and chains of authority and decision-making? Are countermeasures reviewed as appropriate so that they are feasible at all times?	

Item	Risk management System Check Point	Explanation of Risk Management Check Points	Remarks
	(2) Assurance of means of fund-raising	(2) Does the capital liquidity risk management division always monitor trading environments, etc. so that it is able to smoothly liquidate assets to operate capital(for example, sell securities) in times of crisis, big disaster, etc.?	
4. Communication	(1) Reports from business divisions, etc. to capital liquidity risk management division, risk management division	(1) Do business divisions, etc. work in close coordination with the capital liquidity risk management division and risk management division to report movements of capital, such as insurance premiums and insurance money in a timely and accurate manner? It is desirable that the risk management division be equipped with the authority and computer systems, etc. to obtain information directly at all times.	
	(2) Reports from risk management division to board of directors, etc.	(2) Does the risk management division report the information measured in II:2(2)2) to the representative directors and managing directors regularly and at other times as warranted. Does it also report regularly and as needed to the board of directors, etc.?	
	(3) Reports from capital liquidity risk management division to board of directors, etc.	(3) Does the capital liquidity risk management division report capital liquidity status and forecast regularly and whenever necessitated by tightness of capital liquidity to the representative directors and managing directors? Does it also report regularly (whenever needed) to the board of directors, etc.?	
	(4) Installation of computer systems for capital liquidity risk management	(4) It is desirable that the capital liquidity risk management division and risk management division be equipped with computer systems that enable the appropriate measurement and management of risk?	