Checklist for Asset Assessment Management

I. Development and Establishment of Asset Assessment Management System by Management

【Checkpoints】
- Asset assessment refers to examining individual loan assets held by a financial institution and categorizing them according to the degree of risk of default and impairment of the asset value. Asset assessment enables judgment with regard to the degree of safety secured by the quality of assets for funds deposited by customers and, in other words, with regard to the degree of risk to which the institution is exposed due to possible deterioration of the quality of its assets. Self-assessment, conducted by financial institutions themselves, is not only a means for the institutions to manage credit risk and but also a preparation for implementing write-offs and loan loss provisions in an appropriate manner. Implementing write-offs and loan loss provisions is equivalent to calculating the amount of estimated future credit losses in a timely and appropriate manner based on the self-assessment and in light of the actual status of defaults and other factors.

- The development and establishment of a system for asset assessment management is extremely important from the viewpoint of ensuring the soundness and appropriateness of a financial institution’s business. Therefore, the institution’s management is charged with and responsible for taking the initiative in developing and establishing such a system.

- The inspector should determine whether the asset assessment management system is functioning effectively and whether the roles and responsibilities of the institution’s management are being appropriately performed by way of reviewing, with the use of check items listed in Chapter I., whether the management is appropriately implementing (1) development of internal rules and organizational frameworks and (2) development of a system for assessment and improvement activities.

- If any problem is recognized as a result of reviews conducted with the use of the check items listed in Chapter II. and later, it is necessary to exhaustively examine which of the elements listed in Chapter I. are absent or insufficient, thus causing the said problem, and review findings thereof through dialogue between the inspector and the financial institution.

- If the institution’s management fails to recognize weaknesses or problems recognized by the inspector, it is also necessary to explore in particular the possibility that the Internal Control System is not functioning effectively and review findings thereof through dialogue.
- The inspector should review the status of improvements with regard to the issues pointed out on the occasion of the last inspection that are not minor and determine whether or not effective improvement measures have been developed and implemented.

1. Development of Internal Rules and Organizational Frameworks

(1) Development and Dissemination of Standards

(i) Does the Board of Directors have the Managers of the Asset Assessment Management Divisions\(^1\) (hereinafter simply referred to as the “Managers” or “Manager” in this checklist) develop standards that clearly specify the arrangements for conducting self-assessment in an appropriate and accurate manner (hereinafter referred to as the “Self-Assessment Standards”) and standards that clearly specify the arrangements for implementing write-offs and loan loss provisions in an appropriate and accurate manner (hereinafter referred to as the “Write-Off/Loan Loss Provision Standards”) and disseminate them throughout the institution?

(ii) Has the Board of Directors approved the Self-Assessment Standards and the Write-Off/Loan Loss Provision Standards based on the opinions of the Compliance Control Division and the Internal Audit Division, etc.?

(2) Development of Asset Assessment Management System

Does the Board of Directors or equivalent organization to the Board of Directors have Asset Assessment Management Divisions established and have the divisions prepared to undertake appropriate roles in accordance with the Self-Assessment Standards and the Write-off/Loan-loss Provision Standards?\(^2\)

(i) Self-Assessment Management System

a. Does the Board of Directors or equivalent organization to the Board of Directors provide a system to ensure that self-assessment is conducted appropriately by securing a sufficient check-and-balance system against Sales-Related Divisions\(^3\) through the following

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\(^1\) The Asset Assessment Management Divisions are those in charge of controlling self-assessment and write-off and loan loss provision.

\(^2\) When an Asset Assessment Management Division is not established as an independent division (e.g., when the division is consolidated with another risk management division to form a single division or when a division in charge of other business also takes charge of asset assessment management or when a Manager or Managers take charge of asset assessment management instead of a division or a department), the inspector shall review whether or not such a system is sufficiently reasonable and provides the same functions as in the case of establishing an independent division commensurate with the scale and nature of the institution and its risk profile.

\(^3\) Sales-Related Divisions are sales branches and the sales and Loan Approval Divisions of the headquarters.
arrangements, for example?
- Sales branches and the Sales Division of the headquarters conduct a first-stage assessment, to be followed by a second-stage assessment conducted by the Loan Approval Division of the headquarters, and then a division independent from the Sales-Related Divisions verifies the appropriateness of the assessment.
- A division independent from Sales-Related Divisions conducts a self-assessment in cooperation with such divisions.

b. Has the Board of Directors allocated to the Self Assessment Management Division a Manager with the necessary knowledge and experience to supervise the division and enabled the Manager to implement management operations by assigning him/her the necessary authority therefor?

c. Has the Board of Directors or equivalent organization to the Board of Directors allocated to the Self-Assessment Management Division, etc.\(^4\) an adequate number of staff members with the necessary knowledge and experience to execute the relevant business and assigned such staff the authority necessary for implementing the business?\(^5\)

d. Does the Board of Directors or equivalent organization to the Board of Directors have each division store sufficient documents and other records to enable follow-up reviews on the status of implementation of self-assessment in audits by accounting auditors, etc.?

(ii) Systems for Write-Offs and Loan Loss Provisions

a. Does the Board of Directors or equivalent organization to the Board of Directors ensure that the amounts of write-offs and loan-loss provisions are calculated appropriately by securing a sufficient check-and-balance system against divisions in charge of conducting self-assessment and Account Settlement-Related Divisions through the following arrangements, for example?

- A division in charge of implementing self-assessment calculates the amount of specific loan loss provisions while Account Settlement-Related Divisions calculate the amount of general loan loss provisions, and then a division independent from Sales-Related Divisions and Account-Settlement Divisions verifies the appropriateness of the calculation.

- A division independent from Sales-Related Divisions and Account-Settlement Divisions calculates the amount of specific loan loss provisions and general loan loss provisions in

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\(^4\) The “Self-Assessment Management Division, etc.” refers to divisions equipped with functions necessary for conducting self-assessment appropriately and established as necessary according to the scale and nature of the financial institution, including the Self Assessment Management Division and divisions in charge of conducting self-assessment and verifying the self-assessment that are independent from Sales-Related Divisions.

\(^5\) When a department or a post other than the Board of Directors or equivalent organization to the Board of Directors is empowered to allocate staff and assign them authority, the inspector shall review, in light of the nature of such a department or post, whether or not the structure of the Self-Assessment Management Division is reasonable in terms of a check-and-balance system and other aspects.
cooperation with Sales-Related Divisions.

b. Has the Board of Directors allocated to the Write-Off/Loan Loss Provision Division a Manager with the necessary knowledge and experience to supervise the division and enabled the Manager to implement management operations by assigning him/her the necessary authority therefor?
c. Has the Board of Directors or equivalent organization to the Board of Directors allocated to the Write-Off/Loan Loss Provision Division, etc. an adequate number of staff members with the necessary knowledge and experience to execute the relevant business and assign such staff the authority necessary for implementing the business?
d. Does the Board of Directors or equivalent organization to the Board of Directors have each division store sufficient documents and other records to enable follow-up reviews on the status of implementation of write-offs and loan loss provisions in audits by accounting auditors, etc.?

(3) Development of Asset Assessment Management System in First- and Second-Stage Assessment Divisions

Does the Board of Directors or equivalent organization to the Board of Directors provide a system to fully disseminate the relevant internal rules and operational procedures to the divisions in charge of first- and second-stage assessments and have such divisions observe them? For example, does the Board of Directors or equivalent organization to the Board of Directors instruct the Managers to identify the internal rules and operational procedures that should be observed by the divisions in charge of first- and second-stage assessments and to carry out specific measures for ensuring observance such as providing effective training on a regular basis?

(4) Arrangement for System of Reporting to Board of Directors or equivalent organization to Board of Directors and Approval

Has the Board of Directors or equivalent organization to the Board of Directors appropriately specified matters that require reporting and those that require approval and do they make sure to obtain a report with regard to the current status in a regular and timely manner or on an as needed basis or require application for approval on the relevant matters? In particular, do they make sure to

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6 The “Write-Off/Loan Loss Provision Management Division, etc.” refers to divisions equipped with functions necessary for implementing write-offs and loan loss provisions appropriately and established as necessary according to the scale and nature of the financial institution, including the Write-Off/Loan Loss Provision Management Division and divisions in charge of calculating the write-off and loan loss provision amounts and verifying the write-offs and loan loss provisions that are independent from Sales- and Account Settlement-Related Divisions.

7 When a department or a post other than the Board of Directors or equivalent organization to the Board of Directors is empowered to allocate staff and assign them authority, the inspector shall review, in light of the nature of such a department or post, whether or not the structure of the Write-Off/Loan Loss Provision Division is reasonable in terms of the absence of problems such as conflicts of interest.
obtain a report without delay with regard to any matters that would seriously affect corporate management?

(5) Arrangement for System of Reporting to Corporate Auditor

In the case where the Board of Directors has specified matters to be directly reported to a corporate auditor, has it specified such matters appropriately and does it provide a system to have the Managers directly report such matters to the auditor?  

(6) Development of Internal Audit Guidelines and an Internal Audit Plan

Does the Board of Directors or equivalent organization to the Board of Directors have the Internal Audit Division appropriately identify the matters to be audited with regard to asset assessment management, develop guidelines that specify the matters subject to internal audit and the audit procedure (hereinafter referred to as “Internal Audit Guidelines”) and an internal audit plan, and approve such guidelines and plan? For example, does it have the following matters clearly specified in the Internal Audit Guidelines or the internal audit plan and provide a system to have these matters appropriately audited?

(i) Internal Audit Guidelines concerning self-assessment
- Status of development of the self-assessment management system
- Appropriateness of the self-assessment management process
- Accuracy of self-assessment results
- Status of improvement of matters pointed out in an internal audit or in the last inspection

(ii) Internal Audit Guidelines concerning write-offs and loan loss provisions
- Status of development of the write-off and loan loss provision system based on self-assessment
- Appropriateness of the process of posting write-offs and loan loss provisions based on self-assessment results
- Appropriateness of results of write-offs and loan loss provisions (It is desirable to verify the appropriateness of the loan loss provision ratio, the total amount of loan loss provisions, etc. and the amount of loan loss provisions in the past fiscal years)
- Status of improvement of matters pointed out in an internal audit or in the last inspection

(7) Revision of Development Process of Internal Rules and Organizational Frameworks

Does the Board of Directors or equivalent organization to the Board of Directors revise the

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8 It should be noted that this shall not preclude a corporate auditor from voluntarily seeking a report and shall not restrict the authority and activities of the auditor in any way.

9 The Board of Directors or equivalent organization to the Board of Directors only needs to have approved the basic matters with regard to an internal audit plan.
development process of the Self-Assessment Standards, the Write-off/Loan Loss Provision Standards and organizational frameworks in a timely manner by reviewing their effectiveness based on reports and findings on the status of asset assessment management in a regular and timely manner or on an as needed basis?

2. Assessment and Improvement Activities

1) Analysis and Assessment

(1) Analysis and Assessment of Asset Assessment Management

Does the Board of Directors or equivalent organization to the Board of Directors appropriately determine whether there are any weaknesses or problems in the asset assessment management system and the particulars thereof, and appropriately examine their causes by precisely analyzing the status of asset assessment management and assessing the effectiveness of asset assessment management, based on all the information available regarding the status of asset assessment management, such as the results of audits by corporate auditors, internal audits and external audits, findings and reports from various divisions? In addition, if necessary, does it take all possible measures to find the causes by, for example, establishing fact findings committees, etc. consisting of non-interested persons?

(2) Revision of Analysis and Assessment Processes

Does the Board of Directors or equivalent organization to the Board of Directors revise the analysis and assessment processes in a timely manner by reviewing their effectiveness based on reports and findings on the status of asset assessment management in a regular and timely manner or on an as needed basis?

2) Improvement Activities

(1) Implementation of Improvements

Does the Board of Directors and the Board of Directors or equivalent organization to the Board of Directors provide a system to implement improvements in the areas of the problems and weaknesses in the asset assessment management system identified through the analysis, assessment and examination referred to in 2. 1) above in a timely and appropriate manner based on the results obtained by developing and implementing an improvement plan as required or by other appropriate methods?

(2) Progress Status of Improvement Activities

Does the Board of Directors or equivalent organization to the Board of Directors provide a system to follow up on the efforts for improvement in a timely and appropriate manner by
reviewing the progress status in a regular and timely manner or on an as needed basis?

(3) Revision of Improvement Process

Does the Board of Directors or equivalent organization to the Board of Directors revise the improvement process in a timely manner by reviewing its effectiveness based on reports and findings on the status of asset assessment management in a regular and timely manner or on an as needed basis?
II. Development and Establishment of Asset Assessment Management System by Managers

【Checkpoints】
- This chapter lists the check items to be used when the inspector examines the roles and responsibilities to be performed by the Managers in charge of operations concerning asset assessment management and Asset Assessment Management Divisions.

- If any problem is recognized as a result of reviews conducted with the use of the check items listed in Chapter II., it is necessary to exhaustively examine which of the elements listed in Chapter I. are absent or insufficient, thus causing the said problem, and review findings thereof through dialogue between the inspector and the financial institution.

- If the institution’s management fails to recognize problems recognized by the inspector, it is also necessary to strictly explore in particular the possibility that the systems and processes listed in Chapter I. are not functioning appropriately and review findings thereof through dialogue.

- The inspector should review the status of improvements with regard to the issues pointed out on the occasion of the last inspection that are not minor and determine whether or not effective improvement measures have been developed and implemented.

1. Roles and Responsibilities of Managers and Asset Assessment Management Divisions
   (1) Development and Dissemination of Self-Assessment Standards and Write-Off/Loan Loss Provision Standards
       Have the Managers developed the Self-Assessment Standards and the Write-off/Loan Loss Provision Standards based on a full understanding of the importance of asset assessment management? Have the Self-Assessment Standards and the Write-off/Loan Loss Provision Standards been disseminated throughout the institution upon approval by the Board of Directors?

   (2) Details of Self-Assessment Standards and Write-off/Loan Loss Provision Standards
       (i) Validation of Self-Assessment Standards
           a. Are the Self-Assessment Standards in accordance with the relevant laws and the frameworks specified in this checklist (including Attachment 1), and are they clear and valid? Do they include clear statements with regard to the following matters in particular, exhaustively cover necessary procedures and specify them appropriately?
- Scope of assets to be covered by self-assessment
- Self-assessment management system
- Implementation standards for self-assessment
- Allocation of responsibilities with regard to the conduct of self-assessment

When there are specific rules established by the institution within the Self-Assessment Standards (e.g. rules concerning collateral evaluation and simplified assessment of securities), are they reasonable and compatible with the standards, and are there sufficient reasons for any difference with the relevant frameworks?

b. Does the institution have a consistent basic policy with regard to the Self-Assessment Standards and operate based on it on a continuous basis? When the institution changes its basic policy concerning Self-Assessment Standards, is there a rational and legitimate reason?

(ii) Validation of Write-off/Loan Loss Provision Standards

a. Are the Write-off/Loan Loss Provision Standards in accordance with the relevant laws, corporate accounting standards generally accepted as fair and valid and the frameworks specified in this checklist (including Attachment 2), and are they clear and valid? Do they include clear statements with regard to the following matters in particular, exhaustively cover necessary procedures and specify them appropriately?
- Scope of assets to be covered by write-offs and loan loss provisions
- Write-off/loan loss provision management system
- Standards for calculating the write-off and loan loss provision amounts
- Allocation of responsibilities with regard to the implementation of write-offs and loan loss provisions

When there are specific rules established by the institution with regard to write-offs and loan loss provisions (e.g. rules concerning the calculation of the loan loss provision ratios based on credit ratings and those concerning the calculation of the loan loss provision ratios according to the industrial sector, the region, etc.), are they reasonable and compatible with the Write-off/Loan Loss Provision Standards, and are there sufficient reasons for any difference with the relevant frameworks? For example, are specific costs and losses that are highly likely to arise in the future estimated appropriately?

b. Does the institution have a consistent basic policy with regard to the Write-off/Loan Loss Provision Standards and operate based on it on a continuous basis? When the institution changes its basic policy concerning the Write-off/Loan Loss Provision Standards, is there a rational and legitimate reason?

(3) Development of Organizational Frameworks by Managers

(i) Does the Manager, in accordance with the Self-Assessment Standards and the Write-off/Loan
Loss Provision Standards, provide for measures to have the self-assessment and Write-Off/Loan Loss Provision Management Divisions exercise a check-and-balance system in order to ensure that the institution implements write-offs and loan loss provisions appropriately?

(ii) Have the Managers developed detailed and rational operational procedures (a self-assessment manual and a write-off/loan loss provision manual) in accordance with the Self-Assessment Standards and the Write-off/Loan Loss Provision Standards, in order to ensure an appropriate implementation of self-assessment, write-offs and loan loss provisions?

(iii) Have the Managers in place computer systems\(^\text{10}\) with the high reliability suitable for conducting self-assessment and implementing write-offs and loan loss provisions in an appropriate and accurate manner?

(iv) Do the Managers ensure the system of training and education to enhance the ability of employees to conduct self-assessment and implement write-offs and loan loss provisions in an appropriate and accurate manner, thus developing human resources with relevant expertise?

(v) Do the Managers provide a system to ensure that matters specified by the Board of Directors and the Board of Directors or equivalent organization to the Board of Directors are reported in a regular and timely manner or on an as needed basis? In particular, do the Managers provide a system to ensure that matters that would seriously affect corporate management are reported to the Board of Directors and the Board of Directors or equivalent organization to the Board of Directors without delay?

(4) Revision of Asset Assessment Management Standards and Organizational Frameworks

Do the Managers conduct monitoring on an ongoing basis with regard to the status of execution of operations at the Self-Assessment Management Division and Write-Off/Loan Loss Provision Management Division? Do the Managers review the effectiveness of the self-assessment management system and write-off/loan loss provisions management system in a regular and timely manner or on an as needed basis, and, as necessary, revise the Self-Assessment Standards and Write-off/Loan Loss Provisions Standards as well as the relevant organizational framework, or present the Board of Directors or equivalent organization to the Board of Directors with proposals for improvement?

\(^{10}\) It should be noted that the computer system may be a centralized dataprocessing environment system, distribution processing system, or EUC (end user computing) type.
III. Accuracy of Self Assessment Results and Appropriateness of Write-Offs/Loan Loss Provisions

【Checkpoints】
- This chapter lists the check items to be used when the inspector reviews the accuracy of the results of self-assessment and the appropriateness of the results of write-offs and loan loss provisions.

- In the process of examining the accuracy of the results of self-assessment, the inspector should precisely grasp the actual status of development of the self-assessment system, the actual status of reporting of the results of self-assessment to the Board of Directors and the actual status of internal audits and audits by corporate auditors and accounting auditors of the status of the development of the self-assessment system.

- In the process of examining the appropriateness of the results of write-offs and loan loss provisions, the inspector should precisely grasp the actual status of the development of the write-off/loan-loss provision system, the actual status of reporting of the results of write-off/loan-loss provisions to the Board of Directors and the actual status of internal audits and audits by corporate auditors and accounting auditors of the status of the development of the write-off/loan-loss provisions system.

- If any problem is recognized as a result of reviews conducted with the use of the check items listed in Chapter III., it is necessary to exhaustively examine which of the elements listed in Chapters I. and II. are absent or insufficient, thus causing the said problem, and review findings thereof through dialogue between the inspector and the financial institution.

- If the institution’s management fails to recognize problems recognized by the inspector, it is also necessary to strictly explore in particular the possibility that the systems and processes listed in Chapter I. are not functioning properly, and review findings thereof through dialogue.

- The inspector should review the status of improvements with regard to the issues pointed out on the occasion of the last inspection that are not minor and determine whether or not effective improvement measures have been developed and implemented.

Accuracy of Self-Assessment Results and Appropriateness of Write-Off/Loan Loss Provision Results
(1) **Accuracy of Self-Assessment Results**

(i) Does the institution actually conduct self-assessment accurately in accordance with the Self-Assessment Standards with a method listed in Attachment 1?

(ii) When the results of self-assessment are deemed as inappropriate or inaccurate, does the institution grasp and analyze the cause thereof (e.g. a problem with the Self-Assessment Standards or a problem with the conduct of self-assessment) and consider and implement necessary improvement measures in a timely and appropriate manner?

(iii) Does the institution provide necessary education and guidance to divisions in charge of conducting first- and second-stage self-assessments?

(2) **Appropriateness of Write-Off/Loan Loss Provision Results**

(i) Does the institution actually implement write-offs and loan loss provisions appropriately in accordance with the Write-off/Loan Loss Provision Standards with a method listed in Attachment 2?

(ii) When the results of write-offs and loan loss provisions are deemed as inappropriate or inaccurate, does the institution grasp and analyze the cause thereof (e.g. a problem with the Write-off/Loan Loss Provision Standards or a problem with the calculation of loan loss provisions) and consider and implement necessary improvement measures in a timely and appropriate manner?

(iii) Does the institution provide necessary education and guidance to divisions in charge of calculating the write-off and loan loss provision amounts?