Market Risk Management System Checklist

“Market risk” is the risk that a financial institution will incur losses because of a change in the price of assets held (including off-balance-sheet assets) resulting from changes in interest rates, securities etc. prices, foreign exchange rates, and other market risk factors. (“Market-related risk” refers to this risk plus accompanying credit risks and other related risks.) There are three forms of market risk:

1) Interest-rate risk: the risk of losses because of changes in interest rates, and specifically, the risk of declining profits or losses because of changes in interest rates when an institution has a mismatch of interest rates and/or periods for its assets and liabilities.

2) Price fluctuation risk: the risk of a decline in asset prices because of changes in the prices of securities etc.

3) Foreign exchange risk: the risk of losses when an institution has a net asset or net liability position in its foreign-currency assets and liabilities and foreign exchange prices are different from the prices initially expected.

Inspectors will verify and inspect the market-related risk management systems of financial institutions using the Risk Management Systems Checklists (Common Items), and this checklist.

This checklist applies to all deposit-taking financial institutions, including the foreign offices of Japanese banks (foreign branch offices, foreign subsidiaries, and foreign liaison offices, etc., though whether or not to include these offices in the inspection will be determined in light of applicable laws and ordinances, including applicable foreign-country laws and ordinances) and the Japan offices of foreign banks. In inspections of cooperative financial institutions, inspectors should be aware that cooperative financial institutions are only required to select accounting auditors in limited cases.

Notes on the use of this manual in inspections

This manual is only a handbook to be used by inspectors in the inspection of financial institutions. 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 financial institutions will fully exercise their creativity and innovation to voluntarily create their own detailed manuals. These institutional manuals should make note of the content of this manual and be adapted to the size and nature of the institution.

The check points in this manual represent criteria to be used by inspectors in evaluating the risk management systems of financial institutions. They do not constitute direct statutory obligations to be achieved by institutions. Care must be taken that the manual is not employed in a manner that is mechanical and unvarying. There may be cases in which the letter of the checklist description has not been fulfilled, but the institution has nonetheless taken measures that are, from the perspective of ensuring the soundness and appropriateness of its operations, rational, and these measures are equivalent in their effects to the descriptions for the check point or are sufficient given the size and nature of the institution. In such cases, the institution’s measures should not be deemed inappropriate.

Inspectors will therefore need to engage in full discussion of relevant points with financial institutions during on-site inspections.

Explanation of check points

1) Unless explicitly stated otherwise, items expressed in the form of questions such as “does the institution” or “is the institution” are minimum standards that are expected of all financial institutions. 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” for all financial institutions. Inspectors need only confirm these items.

3) Items that are a combination of the two represent minimum standards for internationally active banks (those financial institutions calculating their capital adequacy ratios according to the Basle standards) but serve only as best practices for other financial institutions (those calculating their capital adequacy ratios according to domestic standards).

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 business steering committee, 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 controls in place, e.g., the results are reported to the board of directors, and auditors are allowed to participate in the management committee etc.

Types of financial institution

Below are descriptions of types of financial institution based on differences in their business strategies regarding market trading (including derivatives). Refer to the table below when categorizing institutions by specific forms of trading.

Inspectors will verify that individual financial institutions clearly categorize themselves with reference to the following table. (Note, however, that when there are substantial differences in forms of trading engaged in at individual offices, each office may categorize itself and adopt market-related risk management systems appropriate for its category.)

(1) Global Dealer (GD):

1) A financial institution that engages in dealing in major financial markets.

2) A financial institution that internally produces complex derivatives.

(2) Customer Dealer (CD):

1) A financial institution that hedges its own ALM position.

2) A financial institution that trades with customers but does not take large positions.

(3) Limited End User (EU): A financial institution that mainly hedges its own ALM positions.

Type of dealing / Type of financial institution	Pricing on interbank markets	Development of new derivatives	Pricing for customers	Trading of derivatives with complex structures	Continual derivatives trading	Trading of generally established derivatives	Hedging of own ALM positions
Global Dealer	○	○	○	○	○	○	○
Customer Dealer			○	○	○	○	○
Limited End User						○	○

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
I. Awareness of risk management etc. 1. Awareness of directors and role of board of directors	(1) Articulation of strategic goals based on management policies for the institution as a whole	(1) Different types of financial institution [GD, CD, EU] will require different risk management systems. Does the board of directors clearly specify the institution's type?	
	(2) Establishment of risk management systems	(2) Does the board of directors establish appropriate market-related risk management systems in line with finalized strategic goals and risk management guidelines, and commensurate to profit targets etc.?	
	(3) Formulation of concepts for establishment of position limits, etc.	(3) Does the board of directors articulate basic concepts to be used in setting position limits (interest-rate sensitivity and notional principal etc. ceilings), risk limits (ceilings for expected losses from VaR and similar concepts), and loss limits? These concepts should serve as guidelines for the financial institution's risk management. For example, does the board of directors set a goal of minimizing risk, or of actively taking on a certain level of risk and producing profits while managing that risk?	
	(4) Setting of appropriate position limits, etc.	(4) Does the board of directors etc. study the risk-taking operations of individual divisions based on the basic concepts used for setting position limits etc., and does it set appropriate limits for the services and risk categories handled by the division in light of the division's position within the overall business of the institution, and the institution's capital, profitability, risk management capacity, and personnel capacity? Does the board of directors etc. regularly (minimum of once per accounting period) restudy the nature of divisions' risk-taking operations and review limits? It is desirable that there be measurements of the total risk limits for all market divisions for the purpose of confirming whether resources have been allocated appropriately throughout the institution. The perspective in this should be to compare the institution's strength, as demonstrated by its capital etc., with the risk it has taken on to verify whether or not risks are excessive given its current strength level.	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
2. Awareness and roles of senior management	(1) Formulation of risk management rules	(1) Do market risk management rules clearly articulate the roles and authorities of the market divisions (front office), clerical management divisions (back office), and risk management divisions (middle office etc.), particularly with regards to market trading (including derivatives)?	Note: “Senior management” refers to branch office managers and persons in senior managerial positions (including directors) with equivalent levels of responsibility, and so throughout.
	(2) Appropriate management of position limits, etc.	(2) Does senior management have responsibility for providing appropriate management in accordance with the basic concepts used in setting position limits etc. and the limits set?	Note: “Risk management division” refers for GDs to “an independent risk management division with expert staffing,” for CDs and Eus, to “an independent risk management division with expert staffing or a division (person) in charge of risk management within the back office division.”
	(3) Personnel management designed to prevent incidents	(3) Does senior management, in accordance with the guidelines articulated by the board of directors etc., have programs in place to require employees (including managers) to stay away from their jobs for a minimum of one week a year for the purpose of preventing incidents? This might include continuous leave, training, internal reassignment, or any combination thereof. It is desirable that this period be at least two weeks. Does senior management manage the status of these programs and ensure that they are carried out faithfully? Does senior management engage in appropriate personnel rotation so that specific employees are not engaged in the same jobs in the same departments for prolonged periods of time? If specific employees must be engaged in the same jobs in the same departments for prolonged periods of time, does senior management have other appropriate measures to prevent incidents from occurring?	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
II. Establishment of appropriate risk management systems 1. Risk recognition and assessment	Establishment of integrated risk management organizations	Does market-related risk management cover both designated trading divisions (i.e., "trading divisions") and non-designated trading divisions (i.e., "banking divisions"). It is desirable that at some point in the future the institution has an integrated management system that also covers credit risks and market risks from both designated trading divisions and non-designated trading divisions. If the institution does not have an integrated management system that covers credit risks and markets from non-designated trading divisions, does it utilize "ALM management" as described in 2.(2) except as specifically provided for otherwise in 2.(1) ("Market risk management").	
2. Management (1) Market-related management 1) Customer risk management system	(1) Establishment of systems to manage and deal with disputes between the institution and its customers	(1) [GD, CD] When customer-side risk management is insufficient, customers can incur substantial losses, which may result in the financial institution being subject to lawsuits that place it at risk of losses. Does the institution have systems in place to manage and deal with disputes with customers, including a clearly designated division to respond to disputes? Does the division responsible for responding to disputes with customers quickly investigate the causes of the dispute and take measures to prevent recurrence?	
	(2) Development of derivatives products	(2) [GD, CD] Derivative products can potentially have an extremely large impact on a financial institution because of disputes with customers and lawsuits resulting from them. In light of this, does the institution provide legal and technical checks of newly handled high-risk derivative products by risk management experts and does it seek the approval of the board of directors etc. before handling these products? Does the institution refrain from developing high-risk derivative products in response to inappropriate demands from customers?	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
	(3) Sales to customers	(3) [GD, CD] It is desirable that derivative products be sold to customers with the ability and capacity to adequately manage product risks. Does the institution respond with particular caution when customers seek to purchase derivative products for speculative purposes rather than for their own position hedges?	
	(4) Explanation of products to customers and confirmation of customer intent	(4) [GD, CD] In selling derivative products to inexperienced customers, does the institution provide specific, easily-understood documents and explanations about the nature of the product and the risks involved, including concrete examples (not just best-case scenarios but also worst-case scenarios and the expected maximum loss)? When selling products to customers in which the customer himself bears risk, does the institution, when necessary, obtain written confirmation from the customer that explanations have been provided?	
	(5) Reporting of trades to customers	(5) [GD, CD] After selling products, does the institution provide the customer with information on the market value of the customer's position regularly and at other times as necessary, when so requested by the customer? Do indications of market price clarify how the market price is expressed (whether it takes account of hedge costs, for example)? Does the institution have measures and systems to provide customers with accurate market price information, for instance, by having information provided by a risk management division (or back office division) that is independent of the market division?	
2) Performance management	Analysis of profit/loss status and checking for inappropriate handling	Does the institution refrain from unsound handling of derivative trades etc. for the purpose of manipulating the settlement of accounts etc.? Should profit divisions generate excessive profits, does the risk management division analyze the factors involved and verify whether or not there has been inappropriate handling that is inconsistent with rules governing risk management? Does the risk management study profits and losses in relation to contracted values, notional principal, and trading volumes?	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
3) Monitoring of price and risk	(1) Measurement of accurate market prices	(1) Does the institution accurately measure the market price of positions (including fair prices calculated by models etc.) for both designated trading divisions and non-designated trading divisions? Does it attempt to measure, to the extent possible, the market price of loans and other instruments for which there is no established technology for measuring market prices? It is desirable that measurements also be made on a consolidated basis.	
	(2) Monitoring and measurement of risk factors	(2) For example, for interest rates, does the institution measure risk in terms of changes in the shape of the yield curve and changes in spreads between products and markets as well as in terms of rises (or falls) for interest rates as a whole? [GD, CD] If the institution engages in substantial amounts of option trading or “writes” any options no matter how small the volume, does it measure the need for changes in hedge rates and appropriate hedging levels because of changes in market prices or changes in the expected rate of change of market prices, or because of fluctuations in market prices?	
	(3) Measurement of risk with uniform indicators	(3) Does the institution quantitatively measure risk using uniform indicators for all divisions? It is desirable that uniform indicators capture and measure all necessary risk factors. However, should there be risks that are not adequately captured and measured by uniform indicators, does the institution ensure that all necessary factors are taken into account in business decision-making by supplementing uniform indicators with other information that measures these risks? [GD] Does the institution use risk measurement methods that are rational and objectively precise, for example, VaR methods based on statistical techniques? [CD, EU] It is desirable that the institution use VaR methods based on statistical techniques, but if it does not, does it use simplified measurements such as BPV?	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
	(4) Establishment of organizations to verify appropriateness of model and manage model	(4) Is the appropriateness of pricing models and risk measurement models verified by organizations that are independent of the front office and organizations developing financial products (for example, by the risk management division, inspections division, or outside consultants)? Should inadequacies be found in models, are appropriate corrections made? Are systems and rules in place that do not allow the content of models to be easily changed? Are models managed appropriately and in accordance with pre-established rules? It is desirable that all models be reviewed regularly (about once per year).	
	(5) Verification of the effectiveness of risk measurement functions	(5) Does the risk management division, inspections division, or other division regularly measure the impact of changes in interest rates and foreign exchange rates etc. on profits and capital? Are measurements compared against actual profit/loss trends to verify the effectiveness of risk measurement functions?	
	(6) Appropriate implementation of stress testing	(6) VaR is a technique that only measures the maximum risk under normal market conditions. Does the institution also perform regular stress testing in addition to VaR measurement? If the institution primarily performs sensitivity analyses based on BPV, does it regularly analyze worst case scenarios? Is there clear rationale for the assumptions used in the stress testing and is this rationale appropriate? [GD, CD] Does the institution perform stress testing as frequently as possible (for example, about once per quarter) in relation to changes in market conditions, the size of the positions it holds, and the content of its portfolio etc.? [EU] It is desirable that the institution perform tests/analyses as frequently as possible depending on the content etc. of its portfolio (for example, about once a year).	

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	(7) Frequency of position monitoring, market price appraisal, and risk measurement	(1) [GD, CD] Does the institution monitor positions, appraised market prices, and measure risks at least once per day for major products on designated trading accounts? It is desirable that the institution make general measures that also include non-designated trading accounts as frequently as possible (at least once per month) and that measurements consolidate major branches and offices. [EU] Frequent market price appraisals and risk measurements are not required, but it is desirable from ALM perspectives that the institution make general measures that include non-designated trading accounts at least once per month.	
4) Position limit, risk limit, and loss limit management	(1) Formulation of clear rules for position limit management, etc.	(1) Does the institution have a clearly established system for reporting to managers and chain of authority (guidelines, procedures etc.) for cases in which position limits, risk limits, and loss limits have been exceeded or are likely to be exceeded? Do rules prohibit the continued holding of positions in excess of position limits, risk limits, and loss limits?	
	(2) Delegation of authority of position limits, etc.	(2) Does the institution clearly specify the extent of authority given to dealers etc. by delegating authority in writing for positions, profit targets, and loss limits to each managing director, senior management, and dealer, and seeking the signature of the dealer etc. to confirm all changes in limits? Does the institution regularly (at least once per half-year) review the position limits set for individual divisions?	
	(3) Compliance with rules for position limit management, etc.	(3) Does the institution rigorously apply management rules for position limits etc.? When problems are found in rules or their application, does the institution make appropriate improvements? Should risk management problems be encountered, is information speedily and accurately communicated to the risk management division etc. rather than just dealing with the problem inside the division?	

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	(4) Position management, etc.	(4) [GD] Does the risk management division have systems in place allowing it to monitor positions and losses on major products during the day should there be a need to do so? Does it have and appropriately use systems to manage position profits by dealer and portfolio? [CD, EU] Does the risk management division at a minimum have systems in place that allow it to monitor positions and losses on major products on a daily basis?	
5) Market liquidity risk	(1) Appropriate management of market liquidity	(1) Does the risk management division accurately measure the status of market liquidity (or receive reports thereon)? When necessary, does it report to the representative director and/or board of directors etc. on the status of market liquidity?	
	(2) Setting and review of position limits, etc.	(2) Market conditions may make it impossible to execute trades in the market at the prices initially planned for. In light of this, does the risk management division, when necessary and with the approval of the board of directors etc. (decisions to be made by the managing director in emergencies and reported to and verified by the board of directors etc. afterwards), set position limits taking market liquidity conditions into account? Are position limits regularly (at least once per half-year) reviewed to take account of changes for investment products and market conditions? Are they also reviewed from time to time as necessitated by changes in conditions?	
	(3) Operations taking account of market liquidity risk, etc.	(3) Are investments made with reference to market size, depth, and liquidity for individual products?	
	(4) Monitoring	(4) Does the risk management division measure daily positions for each product and monitor changes in market size and credit status?	
	(5) Reporting	(5) Does the risk management division report measured position status etc. accurately to the managing director (or when necessary to the representative director or board of directors) as required in the rules? If position limits are exceeded, and in times of crisis or potential crisis, does it report as frequently as possible to the representative director and/or board of directors and take appropriate countermeasures?	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
6) Operational management	(1) Back-office processing in accordance with rules	(1) Does the institution handle foreign exchange, funds, securities trades, and derivatives thereof in accordance with applicable rules and manuals? For example: 1) Does the back office division monitor all trading without exception (for example, final confirmation of system input, confirmation with ticket stamping and serial numbers etc.) 2) Are trading details input without delay? 3) Do managers approve corrections to errors in dealing tickets discovered at the confirmation/adjustment stage? 4) Are "incomplete" deal tickets (because processing will be performed in the future) appropriately managed and recorded? 5) Are confirmations sent by someone other than the person responsible for the trade? 6) Are confirmations and dealing tickets appropriately checked against each other? 7) Are dealing tickets, dealing sheets, and confirmations kept and stored in an appropriate manner? Is documentary evidence (for example, individual trading records) from the market division and the back office division checked by the internal inspections division and stored for a storage period specified in the rules (minimum of 1 year)?	
	(2) Data cross-checking	(2) Is trading data from the market division and back office division cross-checked? When mistakes are found, are the causes quickly investigated and supplementary procedures taken in accordance with preestablished methods? For example, in securities trading, does the institution regularly (at least once per month) check positions as shown in the dealing system of the market division against securities balances on the accounts of the back office division that have been confirmed with securities companies and the custody division?	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
7) Management of credit risks associated with market trading	(1) Measurement of credit risk associated with market trading	(1) [GD, CD] Does the institution use current exposure (total replacement cost and potential exposure) to measure credit risk? Does it also measure payment risk? [EU] Do measurements of credit risk at a minimum use the nominal principal method or original exposure method (nominal or contracted principal multiplied by a multiplier for the product or trading period)? Is the institution considering a switch to current exposure if it is planning to establish foreign offices in the future? Does it also measure payment risk?	
	(2) Integrated on/off-balance-sheet management of positions, market price appraisals, and credit risks	(2) [GD, CD] It is desirable that the institution monitor individual trading for individual counterparties, that it provide integrated management of on- and off-balance sheet market prices and credit risks, and that it provide information on exposures and credit limits to credit risk senior management in an accurate and timely manner. Do branch offices accurately measure on- and off-balance sheet credit risks for individual counterparties at least once per month and at any time new credit is granted or credit is renewed (or at the most recent time this has taken place)? [EU] Do branch offices accurately measure on- and off-balance sheet credit risks for individual counterparties at least once per month and at any time new credit is granted or credit is renewed (or at the most recent time this has taken place)?	
	(3) Clear systems for credit approval, independent credit approval functions	(3) [GD, CD] Does the institution analyze the credit risk of counterparties at least once per year? Does it set credit limits ahead of time for counterparties with which it engages in frequent and on-going trading? Are the setting, review, and management of credit limits performed by a credit review division that is independent of market-related divisions? It is desirable that the credit limits set are consistent with other credit standards. [EU] Does the institution fully study the credit risk etc. of counterparties when selecting counterparties for trades?	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
	(4) Formulation of credit limit rules and appropriate management of credit limit	(4) Does the institution have clearly defined negotiations guidelines (policies on credit supplements etc.) when credit limits are approached, and rules on reporting to managers, authorization, and procedures to be followed when credit limits are exceeded? Does the institution manage credit limits appropriately and in accordance with the rules? [GD, CD] When credit risk volumes reach credit limits, does the institution suspend trading that would result in the extension of new credits, report to the senior management as set forth in the rules (or when necessary to the representative director and/or board of directors), and decide on and implement reviews of credit limits and other responses with the approval of the manager (or when necessary of the representative director and/or board of directors)? It is desirable that the institution also take measures to mitigate risk for existing trades, for example, by collecting additional collateral. In managing credit limits, it is effective to establish appropriate alarm points at stages prior to counterparty's credit limit with rules for initiating discussions of supplementing credit risk measures for the counterparty when the alarm points are reached.	
	(5) Use of risk mitigation measures	(5) It is desirable that credit risk be mitigated with netting contracts, additional collateral, and guarantees, after having confirmed the legal validity of contracts.	
8) Market risk rules (verify only for institutions calculating their capital adequacy ratios according to international standards)	(1) Rules governing exceptions for instruments not counted in calculations of market-risk equivalents	(1) Do items excluded by both financial institutions with designated trading accounts and financial institutions without designated trading accounts under the rules governing exceptions for instruments not counted in calculations of market-risk equivalents (the Notice [Financial Supervisory Agency/Ministry of Finance Notice No. 16 of 1998] and so throughout) meet the conditions in the Notice?	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
	(2) Rules on scope of market risk calculations	(2) Do both financial institutions with designated trading accounts and financial institutions without designated trading accounts include all trading and assets specified in the Notice (Article 10)?	
	(3) Accurate calculation of market-risk equivalents	(3) Does the institution calculate market risk equivalents accurately using an internal model or the standard method as set forth in the Notice (Attach 3)? [GD] Financial institutions engaged in dealing on major financial markets and internally developing complex derivatives need to use more precise methods to quantify market risk. It is therefore desirable that they use internal models. If they do not, do they calculate using the standard methods? Internal models need to be used in a consistent manner. Does the institution take appropriate corrective procedures if back testing results indicate there to be inadequacies in its risk measurement model (including notifications to the Financial Supervisory Agency)? When internal models are used, do the models meet the following standards? 1) Is there a “risk management division” established independent from divisions engaged in trading covered by market risk equivalent calculations? 2) Does the risk management division perform appropriate back testing and stress testing, and does it create documents noting the procedures used? 3) Is the board of directors etc. actively involved in risk management procedures? For example, does it receive reports on risk status and make necessary decisions? 4) Does the institution create documents noting the internal guidelines, management, and procedures for the administration of risk measurement models? Does it take steps to ensure compliance? 5) Is the risk measurement process subject to internal audit at least once per year? Is it also subject to regular external audit by external auditors etc.?	

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		6) Do external auditors confirm that the risk measurement model meets the quantitative requirements in the official model? For the standard method, does the institution make calculations in accordance with the method set forth in the Notice (Attachment 3)? [CD, EU] Use of the standard method is acceptable. Does the institution make calculations in accordance with the method set forth in the Notice (Attachment 3)?	
	(4) Awareness of differences between official model and actual model	(4) The internal model for market risk found in the international standards may assume different trading techniques than are actually used, for example, it assumes that investments are held for a period of 10 days. It is desirable that institutions are aware of this and that they modify their internal risk management model as suits their trading practices.	
	(5) Understanding of model in risk management division	(5) It is conceivable that an institution would use different risk measurement models for each office and product. Does the risk management division use several types of model? Does it determine model components in a consistent fashion? Does it verify that there are no problems with risk aggregation procedures? And does it understand the nature of models and procedures? Is the institution able to explain the causes and appropriateness of any differences in risk as measured by the market, risk management, and back office divisions?	
(2) ALM management 1) ALM organizations	(1) Establishment of ALM Committee etc.	(1) Does the institution establish an ALM Committee etc. as an organization to provide general management of assets and liabilities and to formulate strategic goals and the like?	
	(2) Coordination between ALM Committee etc. and relevant divisions	(2) Does the ALM Committee etc. make effective use as reference data of the analyses and trading patterns of divisions responsible for interest-rate and foreign exchange-rate forecasting, risk measurement, and hedging transactions? Does the institution have a system in place for reporting important information from relevant divisions to the ALM Committee etc.? (Is the definition of “important information” clearly articulated in the rules?)	

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	(3) Participation of directors in ALM Committee etc.	(3) Do the directors and the senior management responsible for relevant divisions (including the representative director when there are sharp fluctuations in the market environment) attend all meetings of the ALM Committee etc. and participate in discussions?	
	(4) Installation of ALM systems	(4) It is desirable that the institution have systems in place that are able to cover and perform multifaceted analyses of all major sources of interest-rate revision risk, yield curve risk, basis risk and other forms of interest-rate risk, and also foreign exchange risk, price fluctuation risk and other forms of market risk.	
2) Interest-rate risk monitoring	(1) Multifaceted risk management using a variety of techniques	(1) Does the institution integrate on- and off-balance sheet products and does it perform multifaceted analyses of them (for example, does it make concurrent use of different analytical methods such as gap analysis and simulation analysis)?	
	(2) Analysis of interest-rate risk and use of analytical results	(2) Does the institution regularly (at least once per quarter) create and analyze maturity ladders in line with interest-rate revision periods? Does it regularly (at lest once per quarter) measure risk using multifaceted analytical methods (for example, simulation analysis and interest-rate sensitivity analysis)? Is this information used by the ALM Committee etc.? It is desirable that the institution regularly (if possible, at least once per quarter) perform stress testing and use this information in the ALM Committee etc.	
3) Foreign exchange risk monitoring	(1) Appropriate monitoring of foreign exchange risk	(1) Does the institution appropriately manage the risks to which it is exposed, for example, by using appropriate financial techniques for the foreign exchange risks associated with foreign-currency assets (including yen-invested foreign-currency assets) and liabilities?	
	(2) Analysis of foreign exchange risk and use of analytical results	(2) Does the institution regularly (at least once per quarter) measure risk and use these measurements in the ALM Committee etc.? It is desirable that the institution regularly (if possible, at least once per quarter) perform stress tests and use this information in the ALM Committee etc.	

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4) ALM operations	(1) Appropriate setting and review of position limits	(1) Are position limits and risk limits for overall management of assets and liabilities set in accordance with the basic risk management guidelines determined by the board of directors and with reference to the capital and net profits on core businesses etc. of the institution? Are position limits reviewed regularly (at least once per half year) and as necessary?	
	(2) Appropriate risk control	(2) Are interest-rate, foreign exchange, price fluctuation and other market risks controlled in accordance with risk management guidelines determined by the board of directors?	
	(3) Use of findings from ALM Committee etc. in management strategy	(3) Does the board of directors refer to the analytical results of the ALM Committee etc. when formulating strategic goals and risk management guidelines? Does the risk management division constantly verify that risk controls and other business operations are performed in accordance with the risk management guidelines determined by the board of directors? Does it report its findings to the board of directors? If it finds that business operations are not in accordance with guidelines, are remedial measures quickly taken?	
(3) Designated trading issues (verify only for financial institutions engaged in designated trading or establishing designated trading accounts)	(1) Formulation of rules	(1) Segregated accounting requires that arbitrary decisions be eliminated and transparency assured, and this in turn requires that the board of directors etc. formulate clear rules and that these rules be consistently adhered to. At minimum, does the institution formulate rules regarding the following matters? Does it handle these rules etc. as important rules and does it handle changes under procedures similar to those used in formulating the rules? 1) Clear administrative rules for segregated account based on the legal definition of “designated trading purposes.” • Definition of designated trading purposes • Clear organizational divisions by trading purpose (divisions of personnel into units) and independent decision-making authority • Restrictions on concurrent service of dealers in organizations involved in designated trading and other	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		organizations • Bans on transfers between accounts • Creation of ledgers in designated trading accounts for each type of designated trading on the account • Limits on the markets of counterparties to designated trading of securities, and awareness of hedging purposes 2) Authority and responsibilities of the managers of the divisions engaged in designated trading and the managers of the divisions calculating market values etc. 3) Compliance with rules and procedures for changing rules 4) Basic concepts for the calculation of market prices etc. • Adherence to calculation methods specified in the Banking Law or other laws or in ministerial ordinances • Calculation of market prices by a different organization independent of the organization engaged in designated trading • Calculation methods for market prices etc. (notation when the calculation of market prices etc. is to use the “Fair Price Calculation Procedures” or another document) • When the “new foreign exchange accounting standards” are used in the calculation of market prices etc., clear notation of the scope of coverage • Performance of internal audits and inspections of compliance to rules regarding calculation of market prices etc. • Method by which organizations with “front office functions” will be involved in the calculation of market prices etc. when there is need for their involvement 5) Rules and management methods for internal trading • Definition and scope of internal trading	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		• Basic guidelines for internal trading • Approval of internal trades by an organization independent from front-office organizations • Approval procedures for internal trades, storage of documents 6) Rules for consigned trading • Performance of internal audits and inspections of compliance to rules regarding internal trading	
	(2) Separation of organizations and personnel	(2) It is desirable that organizations engaged in trading for designated trading accounts (at least, organizations with "front office functions") be at the level of units (for example, an "office," "department," or "group") or larger, and that their organization and staffing be different from the organizations engaged in trading for non-designated trading accounts on which the same kinds of trades are made but for different purposes. Organizational divisions are not necessarily required, however, when there is an objective and clear segregation of designated trades and the assets involved therein from other trades and their assets and there is little risk of accounts being manipulated (for example, when a designated trading division engages in trades other than those listed as designated trades).	
	(3) Bookkeeping/ledgers	(3) Do the books for designated trading accounts enable designated trades and the assets involved therein to be clearly segregated from other trades and the assets involved therein? Are there appropriate notations in the category ledgers created at the time applications are filed with the authorities? Are these ledgers used effectively in actual operations? (Does the institution refrain from using other ledgers in actual operations?)	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
	(4) Prohibition against organizations trading for designated trading accounts from trading on other trading accounts	(4) Does the institution refrain from having organizations engaged in trading for designated trading accounts engage in trading for non-designated trading accounts (and vice versa)? (However, this does not apply when there is an objective and clear segregation of designated trades and the assets involved therein from other trades and their assets and there is little risk of accounts being manipulated)	
	(5) Prohibition against arbitrary account selection	(5) Does the institution refrain from making arbitrary decisions about accounts? For example, does it refrain from using, because of market risk concerns, designated trading accounts for trading that should be on non-designated trading accounts?	
	(6) Appropriateness of internal trading	(6) Internal trading within the same financial institution has the potential to utilize differences in accounting systems to post profits or losses. Such arbitrary handling must be eliminated. From this perspective, does internal trading appropriately comply with the “Documents Noting Matters Related to the Handling of Internal Trades” created at the time approval was received for the establishment of designated trading accounts (or with other rules governing designated trading accounts)?	
	(7) Separation of divisions involved in designated trading from divisions calculating market prices	(7) Calculations of market prices must ensure that prices are fair. From this perspective, does the institution assign different divisions to calculate market prices from the divisions involved designated trading?	
	(8) Creation and storage of materials providing basis for market price etc. calculations	(8) Internal and external inspections and audits of the financial institution must verify the fairness of market price calculations. To facilitate this, does the institution keep and manage for set periods of time documents that enable market price calculations to be reproduced?	
	(9) Assurance of objectivity in fair price calculations	(9) Is the institution aware of the following in the assurance of the objectivity of fair price calculations? 1) Does the institution create and consistently use “Fair Price Calculation Procedures” based on rules etc. Should there be need to modify calculation methods because of institutional changes or the development of new appraisal techniques etc., does the	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		institution revise its procedures in a timely manner and in accordance with the rules etc.? Are changes in calculation methods clearly noted? 2) To check the internal fairness and appropriateness of the "Fair Price Calculation Procedures," are the "Fair Price Calculation Procedures" subject to prior approval from divisions engaged in trading for designated trading accounts (organizations with "front office functions") and organizations independent of organizations developing financial products (for example, the risk management division or the inspections division etc.)? Do the organizations above regularly check the application and administration of these procedures (for example, the risk management division or the inspections division etc.; however, divisions performing calculations are excluded)? 3) Is assurance of the objectivity of fair price calculations included as a priority item in internal inspections? Are the following included as points to be noted in inspections? a) Violations of the scope of trading set by ministerial ordinance (now allowed to engage in inter-account trading for exchange trades, securities trades, and acquisition or transfer of monetary credits) b) Effectiveness of internal checks, for example, appropriate handling of internal trading at fair prices and in accordance with rules c) Clear indications of internal trades on trading tickets and segregated storage thereof d) Intentional profit/loss adjustments	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
	(10) Calculation of fair prices	10) Are fair price calculations made by organizations independent of organizations with front-office functions and in accordance with the following concepts? 1) Exchange trades Are prices calculated using rational methods based on published closing prices (trading prices on the exchange [closing price <including liquidation price> etc.])? 2) Non-exchange trades (a) Non-exchange trades for which quotes are obtainable Are prices in principle calculated using quotes from brokers (including screens), dealers, and others? (b) Other trades Does the institution use the following? a) Obtainable quotes for financial products of a similar nature b) Estimates based on appraisal methods (discounted present value, option price calculation model etc.) Is it aware of the following? 1) Efforts to ensure fair calculations of the price of over-the-counter derivatives a) Are calculations generally the same for the time of the trade and the end of the term? b) Are calculations checked by external auditors? c) Are calculations checked during internal inspections? 2) Compliance with and consistent use of the following as defined in the “Fair Price Calculation Procedures”” a) Types and sources of basic data b) Time at which basic data is obtained c) Method of creating yield curves from basic data	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		d) Method and period of basic data storage e) Correction methods when corrections are made	
	(11) Information disclosure	(11) It is necessary to disclose “important accounting guidelines.” From this perspective, does the institution disclose the following matters in relation to appropriate segregated accounting and the measurement and management of objective market prices? 1) Framework for designated trading accounts (definition of “trading for designated trading purposes,” specific lists of products covered, organizational divisions etc.) 2) Market price concepts (use of fair price concepts in market price calculations, outline of fair price calculation procedures, means of assuring objectivity etc.) 3) Financial information related to designated trading accounts	
3. Segregation of duties	Erection of mutual-checking systems	When the market divisions and back office divisions operate multiple computer systems, does the risk management division obtain position information from both the market divisions and back office divisions and confirm that there are no discrepancies between them (not necessary if integrated systems are used)? Does the risk management division monitor compliance to position limits and other management rules? Does it play an appropriate role in enhancing and operating risk management systems, gathering and processing information, and reporting to the board of directors etc.? Does the risk management have adequate personnel to monitor trading? Does the risk management division regularly perform precise checks and analyses to search for abnormalities in the calculation of intra-term profits and losses (including appraisal profits and losses)? [GD] Does the institution have an independent risk management division staffed with experts in market trading and risk management techniques? [CD, EU] It is desirable that the institution have an independent risk management division staffed with experts in market trading and risk	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		management techniques, but if it does not, does it take other steps, for example, by establishing a risk management group in the planning department? * Is the institution aware of the following matters regarding mutual checking functions? 1) Do familiarity between the chief dealer and the back office division manager place the dealers in the position of being able to directly manipulate and issue instructions regarding accounting? 2) Are veteran dealers personally so trusted by superiors (branch office managers and relevant executives) that they are considered “unquestionable” by other employees? Is the institution aware that human risks are increased when they are dependent on specific personnel and does it carefully control this? 3) Are organizations run so that separations between organizations do not function? For example, is there a “confirmation team” below the market division manager or does the same person function as the manager for both the market division and the back office division? 4) Is all information communicated quickly and accurately to the risk management division? Should risk management problems be encountered, is information speedily and accurately communicated to the risk management division etc. rather than just dealing with the problem inside the division? 5) Does the institution have an independent risk management division and is expert staff assigned to it? Is the risk management division able to report directly to the relevant directors etc. without influence from the trading divisions? 6) Area audio recordings made of dealer trading twenty-four hours a day? Is the content of recordings checked against trading records using regular sampling or other techniques? Are recorded tapes stored for a set	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		period of time (are tapes stored and managed by sections independent of the market division and back office division (for example, the risk management division) or by a section of the back office division with separate work responsibilities)? It is desirable that telephones be recorded for the back office division as well for purposes of after-the-fact confirmation. When comparing the content of dealer trading recordings with the dealing tickets (trading records), do not check dealing tickets against recordings. Rather, check whether the entire content of recordings is on the dealing ticket. 7) Is at-home dealing only used under restricted conditions for the purpose of avoiding risks from after-hours operations? Does the institution specify trading volumes, types, and dealers? (Are their written rules?) Are answering machines and the like installed so that trading is recorded? 8) Are dealers fully aware that dealing recordings are regularly checked against dealing tickets?	
4. Communication of information	(1) Risk management division's access to information	(1) Is the risk management division able to obtain trading information and other internal data and market data from the market divisions directly and in an appropriate and comprehensive manner? Is the risk management division able to directly instruct and supervise the middle offices of other divisions?	
	(2) Installation of dealing support systems	(2) [GD] Does the institution provide a dealing support system that provides dealers (or units) with real-time and/or daily-appraised market prices for the positions of each office for all major products with which they are involved? [CD] Does the institution provide a dealing support system that provides dealers (or units) with daily-appraised market prices for the positions of each office for all major products with which they are involved?	
	(3) Installation of computer systems suited to back-office processing	(3) Does the institution install and manage accounting and information computer systems that are sufficiently able to perform all basic clerical processing, settlement, and management	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		of all trading in which the institution is engaged?	
	(4) Establishment of back-up systems	(4) Does the institution have a back-up system, including effective contingency plans?	
	(5) Assurance of system safety	(5) Does the institution engage in appropriate and adequate management designed to prevent unauthorized access to computer systems, for example, management of entry and exit from work areas and use of passwords?	
	(6) Communication of information to the risk management division	(6) Do the market divisions etc. communicate all information quickly and accurately to the risk management division? Should risk management problems be encountered, is information speedily and accurately communicated to the risk management division etc. rather than just dealing with the problem inside the division?	

Liquidity Risk Management System Checklist

Liquidity risk could include two different types of risk: the risk that a financial institution will incur losses because it is forced to raise funds at markedly higher interest rates than normal, or because a deterioration etc. of its financial position renders it unable to assure itself of adequate funding and therefore unable to maintain cash flow (cash flow risk), and the risk that upheavals etc. in the market will render it impossible to trade and therefore force the institution 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 financial institutions 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 cash flow risk systems; the Market Risk Management Systems Checklist for inspections of market liquidity risk.

This checklist applies to all deposit-taking financial institutions, including the foreign offices of Japanese banks (foreign branch offices, foreign subsidiaries, and foreign liaison offices, etc., though whether or not to include these offices in the inspection will be determined in light of applicable laws and ordinances, including applicable foreign-country laws and ordinances) and the Japan offices of foreign banks. In inspections of cooperative financial institutions, inspectors should be aware that cooperative financial institutions are only required to select accounting auditors in limited cases.

Notes on the use of this manual in inspections

This manual is only a handbook to be used by inspectors in the inspection of financial institutions. 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 financial institutions will fully exercise their creativity and innovation to voluntarily create their own detailed manuals. These institutional manuals should make note of the content of this manual and be adapted to the size and nature of the institution.

The check points in this manual represent criteria to be used by inspectors in evaluating the risk management systems of financial institutions. They do not constitute direct statutory obligations to be achieved by institutions. Care must be taken that the manual is not employed in a manner that is mechanical and unvarying. There may be cases in which the letter of the checklist description has not been fulfilled, but the institution has nonetheless taken measures that are, from the perspective of ensuring the soundness and appropriateness of its operations, rational, and these measures are equivalent in their effects to the descriptions for the check point or are sufficient given the size and nature of the institution. In such cases, the institution's measures should not be deemed inappropriate.

Inspectors will therefore need to engage in full discussion of relevant points with financial institutions during on-site inspections.

Explanation of check points

1) Unless explicitly stated otherwise, items expressed in the form of questions such as “does the institution have” or “is the institution doing” are minimum standards that are expected of all financial institutions. 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” for all financial institutions. Inspectors need only confirm these items.

3) Items that are a combination of the two represent minimum standards for internationally active banks (those financial institutions calculating their capital adequacy ratios according to the Basle standards) but serve only as best practices for other financial institutions (those calculating their capital adequacy ratios according to domestic standards).

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 business steering committee, 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 are adequate internal checks in place, i.e. 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 controls in place, e.g., the results are reported to the board of directors, and auditors are allowed to participate in the management committee etc.

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
I. Awareness of risk management etc. 1. Awareness of directors and role of board of directors	(1) Understanding of cash flow risk	(1) Do directors understand that cash flow problems can in some cases lead directly to bankruptcy and the triggering of systemic risk?	Note: "Cash flow risk management division" refers to a division that manages and administers cash flow on a daily basis. "Risk management division" refers to a division that monitors compliance to internal standards etc. regarding cash flow, and so throughout.
	(2) Articulation of strategic goals with reference to cash flow risk	(2) Does the board of directors take account of cash flow risks when setting strategy goals?	
	(3) Establishment of cash flow risk management systems	(3) Does the board of directors, in managing cash flow risk, put systems in place for sufficient mutual checking, for example, by separating the cash flow risk management division from the risk management division or otherwise providing for appropriate cash flow risk management? Does the system allow the cash flow risk management division to recommend measures for securing liquidity directly to the representative director as warranted by risk conditions?	
	(4) Setting and review of limits	(4) Do the representative directors set and review limits as required by the nature of the institution's asset investments and fund-raising conditions so as to appropriately manage cash flow 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 adheres to liquidity risk management guidelines?	
2. Awareness and roles of senior management	(1) Establishment of rules for cash flow risk management	(1) Does senior management in the cash flow risk management division and risk management division formulate management methods, reporting methods, decision-making methods and other relevant rules based on categories of cash flow tightness ("normal," "needs attention," "crisis")? Do they seek the approval of the board of directors for these rules?	Note: "Senior Management" refers to branch office managers and persons in senior managerial positions (including directors) with equivalent levels of responsibility, and so throughout.
	(2) Appropriate cash flow risk management practice	(2) Does senior management in the cash flow risk management division manage cash flow appropriately and in accordance with cash flow risk management guidelines and risk management rules?	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
II. Establishment of appropriate risk management systems 1. Risk recognition and assessment	(1) Analysis of cash flow risk factors and development of countermeasures	(1) Does the cash flow risk management division gather and analyze information on the institution's share price, reputation, and other matters that would have an impact on fund-raising? Does it formulate appropriate countermeasures? If the institution has separate cash flow risk management divisions for yen and foreign currencies or for domestic and foreign branches, does it have a means of providing integrated management of cash flow risks?	
	(2) Measurement of liquidity at consolidated subsidiaries	(2) The bankruptcy of a consolidated subsidiary because of a deterioration in its cash flow is likely to have a large impact on the institution. Does cash flow risk management capture conditions at consolidated subsidiaries and take them into account?	
2. Cash flow risk management	(1) Implementation of liquidity assessments, management of risks on both the asset and liability sides	(1) Does the cash flow 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 institution is able to raise, how much collateral it can provide and how much funding it will generate?	
	(2) Appropriateness of cash flow risk management	(2) 1) Does the cash flow risk management division manage the following matters as necessary, endeavor to quickly grasp their impact on cash flow, and create daily cash flow tables, and weekly and monthly cash flow forecasts for yen and foreign currency assets? (Do those financial institutions calculating their capital adequacy ratios according to the Basle standards also create quarterly cash flow forecasts? It is also desirable that financial institutions calculating their capital adequacy ratios according to domestic standards create quarterly cash flow forecasts.) a) Central management of large fund movements b) Management of market-based fund-raising c) Management of investment and fund-raising instruments by type of instrument and term structure d) Management of collateral status	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		e) Management of deposit etc. maturity f) Management of contractual credit balances received and granted g) Management of payment reserve assets h) Management of cash (including ATMs) i) Management of foreign currency cash flow j) Management of cash flow 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 cash flow risk management division, and exert checks on the cash flow risk management division? a) Management and analysis of deposit and lending plans and results b) Management of market fund-raising limits c) Management of funding gap limits d) Management and analysis of contractual credit balances received and granted e) Management of status of fund-raising dependent on specific lenders/investors (concentration of risk) f) Management of dependence on Bank of Japan fund-raising Etc.	
	(3) Appropriateness of cash flow risk management methods	(3) Does the cash flow risk management division monitor planned investments (planned amount of loans, guarantees etc. to be disbursed) and potential fund-raising (amount able to raise on interbank open markets, incoming deposits, forecast cancellations etc.) based on reports etc. from business divisions etc.? Does the cash flow risk management division take account of the following matters in endeavoring to monitor investment plans and fund-raising potential?	Note: "Business divisions etc." refers to business divisions, branch offices, and foreign offices, and so throughout.

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		1) Off-balance sheet transactions (including currency swaps etc.) 2) Commitment lines 3) Current account overdrafts 4) Measurement of actual investment periods (for example, investments that are formally short-term but in actually long-term) 5) Status of fund-raising dependent on specific lenders/investors (concentration of risk) 6) Dependence on Bank of Japan fund-raising 7) Tightness of cash flow (for example, "normal," "needs attention," "crisis" etc.) Do money position financial institutions set and review cash gap limits from time to time as required?	
	(4) Awareness of liquidity risk in operations and administration	(4) Do business divisions operate and administer their functions taking liquidity risk into account as warranted by the cash flow status measured by the cash flow risk management division?	
	(5) Assurance of payment reserves and means of fund-raising	(5) Does the cash flow risk management division secure means of fund-raising as warranted by the tightness of cash flow (for example, "normal," "needs attention," "crisis" etc.) and does it secure payment reserve assets (cash on hand, deposits etc.) for withdrawals of deposits etc.?	
3. Communication of information	(1) Reports from business divisions etc. to cash flow risk management division, risk management division	(1) Do business divisions etc. work in close coordination with the cash flow risk management division and risk management division to report large movements of funds in a timely and accurate manner? Do branch offices etc. measure expected funds movements and report it to the cash flow risk management division so there are no large discrepancies between forecasts and actual cash flow? It is desirable that the risk management division be equipped with the authority and systems etc. to obtain information directly at all times.	Note: "Branch offices etc." refers to branch offices and foreign offices.
	(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	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		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 cash flow risk management division to board of directors etc.	(3) Does the cash flow risk management division report cash flow status and forecasts regularly (one per week) and whenever necessitated by cash flow tightness to the representative directors and managing directors? Does it also report regularly and whenever needed to the board of directors etc.?	
	(4) Installation of systems for cash flow risk management	(4) Are the cash flow risk management division and risk management division equipped with systems that enable the appropriate measurement and management of risk?	
4. Establishment of crisis management system	(1) Formulation of response plans for liquidity crises	(1) Do the cash flow 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 fund-raising), and chains of authority and decision-making? Are countermeasures reviewed as appropriate so that they are feasible at all times?	
	(2) Assurance of means of fund-raising	(2) Does the cash flow risk management division monitor at all times the institution's domestic holdings of assets that can be immediately sold or used for collateral (government bonds etc.) and the time and amount of funds that can be raised from yen investments and yen conversions etc.? Does the institution have lines of credit, etc. that will enable fund-raising from central banks and commercial financial institutions so that it is assured of a means of fund-raising in times of crisis? Does the institution constantly monitor trading environments etc. so that it is able to smoothly liquidate assets to raise funds (for example, sell securities)?	

Operational Risk Management System Checklist

1) Operational risk is the risk that a financial institution will incur losses because personnel (including executives) fail to perform operations accurately, or engage in actions that result in mishaps or improprieties.

2) Inspectors will verify and inspect the operational risk management systems of financial institutions using the Risk Management Systems Checklists (Common Items),and this checklist.

This checklist applies to all deposit-taking financial institutions, including the foreign offices of Japanese banks (foreign branch offices, foreign subsidiaries, and foreign liaison offices, etc., though whether or not to include these offices in the inspection will be determined in light of applicable laws and ordinances, including applicable foreign-country laws and ordinances) and the Japan offices of foreign banks. In inspections of cooperative financial institutions, inspectors should be aware that cooperative financial institutions are only required to select accounting auditors in limited cases.

Notes on the use of this manual in inspections

This manual is only a handbook to be used by inspectors in the inspection of financial institutions. 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 financial institutions will fully exercise their creativity and innovation to voluntarily create their own detailed manuals. These institutional manuals should make note of the content of this manual and be adapted to the size and nature of the institution.

The check points in this manual represent criteria to be used by inspectors in evaluating the risk management systems of financial institutions. They do not constitute direct statutory obligations to be achieved by institutions. Care must be taken that the manual is not employed in a manner that is mechanical and unvarying. There may be cases in which the letter of the checklist description has not been fulfilled, but the institution has nonetheless taken measures that are, from the perspective of ensuring the soundness and appropriateness of its operations, rational, and these measures are equivalent in their effects to the descriptions for the check point or are sufficient given the size and nature of the institution. In such cases, the institution's measures should not be deemed inappropriate.

Inspectors will therefore need to engage in full discussion of relevant points with financial institutions during on-site inspections.

Explanation of check points

1) Unless explicitly stated otherwise, items expressed in the form of questions such as “does the institution have” or “is the institution doing” are minimum standards that are expected of all financial institutions. 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” for all financial institutions. Inspectors need only confirm these items.

3) Items that are a combination of the two represent minimum standards for internationally active banks (those financial institutions calculating their capital adequacy ratios according to the Basle standards) but serve only as best practices for other financial institutions (those calculating their capital adequacy ratios according to domestic standards).

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 business steering committee, 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 are adequate internal checks in place, i.e. 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 controls in place, e.g., the results are reported to the board of directors, and auditors are allowed to participate in the management committee etc.

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
I. Awareness of risk management etc. 1. Awareness of directors and role of board of directors	Directors' understanding and awareness of risk management	Do the directors understand the locus of operational risk throughout the operations of the bank? Are they aware of the importance of mitigating operational risk? Do they take appropriate measures to do so?	
2. Awareness and roles of senior management	Senior management's understanding and awareness of risk management	Is senior management aware of the importance of mitigating operational risk? Does it take appropriate measures to cause the staff of the divisions it oversees to understand the importance of and take steps to mitigate operational risk? In monitoring operational risk, it is desirable that senior management endeavor to analyze quantitatively operational risk from the perspective of the latent size of operational losses to which the institution is exposed and the potential for operational losses to be realized.	Note: "Senior management" refers to branch office managers and persons in senior managerial positions (including directors) with equivalent levels of responsibility, and so throughout.
II. Auditing and correction of deficiencies 1. Internal audits	Methods and content of audits by the auditing division	1) Does the auditing division create techniques and content for head office audits and self-audits in the form of implementation standards and implementation procedures? If business divisions etc. create implementation standards and implementation procedures for self-audits, are these documents approved by the auditing division? 2) Does the auditing division analyze the results of head office audits and self-audits and accurately notify business divisions and branch offices thereof? Do business division managers and branch office managers use audit findings to improve the level of clerical work?	Note: "Internal audit" refers to head office audits by the auditing division, and self-audits by individual business divisions and branch offices, and so throughout. Note: "Branch offices etc." refers to branch offices and foreign offices. Note: "Branch office manager" refers to the manager of a branch office or foreign office.

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
2. Correction of deficiencies	Reports of deficiencies to board of directors and senior management	Are audit results and other necessary matters reported to the board of directors regularly (or timely if needed)? In particular, is the board of directors given timely reports of improprieties that would have a serious impact on the operation of the institution? Is the representative director furnished with reports that provide accurate and specific notations of the frequency, importance, cause, and planned improvements for operational misses.	
3. Improprieties	(1) Improprieties	(1) 1) Are improprieties reported to the supervisory authorities and dealt with appropriately as mandated by applicable laws and ordinances. Are the police and other relevant agencies quickly informed of facts that potentially impinge upon criminal provisions? 2) Are problems that would have a serious impact on the operation of the institution quickly reported to the clerical division, auditing division, and also to the board of directors? 3) Are improprieties investigated and resolved by divisions independent of the division involved in the improprieties (for example, by the auditing division)? Does the institution analyze the causes of improprieties, provide division managers and branch office managers with analytical results from the perspective of preventing future incidents, and take measures to provide recurrence in a timely manner. 4) Does the institution have a system in place for investigating the facts related to improprieties, holding relevant parties accountable, and clarifying supervisory responsibilities?	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
	(2) Complaints etc. from customers	(2) 1) Does the institution have procedures established for dealing with complaints etc. (including inquiries that could be related to improprieties) from customers? 2) Does the institution deal quickly with complaints etc. (including inquiries that could be related to improprieties) from customers in a coordinated effort between the clerical division and other related business divisions? 3) Does the institution make and store records of the content of complaints etc. (including inquiries that could be related to improprieties) from customers and the results therefrom? Are the clerical division and auditing division furnished with regular reports? 4) Are problems that would have a serious impact on the operation of the institution quickly reported to the clerical division, auditing division, and also to the board of directors?	
III. Operational risk management systems 1. Role of operations division	(1) Organization of clerical division	(1) 1) Does the institution have a division that is clearly designated to formulate operational rules etc.? 2) Does the institution have a division that is clearly designated to provide operational supervision and training and a system that enables this division to function fully? 3) Does the clerical division have a system able to respond quickly and accurately to inquiries etc. from branch offices recording clerical processing? 4) Is the clerical division independent of business promotion divisions and able to exert sufficient checks on them?	
	(2) Formulation of rules etc.	(2) 1) Are operational rules comprehensive and in conformity with all applicable laws and ordinances?	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		Do the operational rules contain clear procedures for handling exceptions and differences of interpretation? 2) Does the clerical division analyze business operations, establish the locus of operational risk and formulate rules to prevent risks from being incurred? 3) Do operational rules contain clear provisions, particularly regarding the handling of cash, physical certificates etc., important documents, and exceptional treatments? 4) Do the operational rules contain clear provisions regarding the operations of other business divisions as well as the branch offices? 5) Are operational rules reviewed and improved as needed in light of problems identified from audit results, improprieties, complaints, and inquiries? 6) Are operational rules reviewed and improved as necessary in light of changes in laws, ordinances, and other exogenous factors?	
	(3) Internal control	(3) Does the clerical division: 1) Take measures to constantly check the operational management of branch offices? 2) Have systems in place to prevent branch office managers from concealing improprieties? 3) Endeavor to improve the operational levels of branch offices in coordination with the auditing division etc.?	
2. Role of branch offices	(1) Role of branch manager	(1) Does the manager of the branch office: 1) Constantly monitor risks associated with clerical processing? 2) Check compliance to appropriate clerical processing guidelines and rules etc., and other matters for which risk is inherent? 3) Endeavor to prevent situations in which those responsible for accuracy and checking	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		are too busy to be able to adequately function in their checking capacity? 4) Understand where the problems are in the branch's clerical processing and endeavor to make improvements? 5) Deal strictly with exceptional treatments in particular? 6) Deal responsibly and in coordination with the clerical division and other related business divisions when exceptional treatment is provided?	
	(2) Rigorous operational management	(2) 1) Is clerical processing performed in a rigorous manager? 2) Are accuracy checks performed in a fundamentally rigorous manner and not just as a perfunctory formality? 3) Is the branch office manager informed immediately when there are cash incidents? Are reports provided to the clerical division, auditing division, and other necessary divisions? 4) Does the institution follow the standards specified by the authorities in rigorously verifying identities before beginning dealings or engaging in large cash dealings? 5) Are exceptional treatments only processed after approval from the branch office manager or other executive? 6) Are exceptions to the rules handled as instructed by the branch office manager in coordination with the clerical division and other relevant business divisions?	
	(3) Customer protection	(3) 1) Is the institution's clerical processing fair to its customers? 2) Does the institution provide customers with appropriate and sufficient explanation of the content and nature etc. of transactions when engaging in transactions with customers?	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		3) In particular, does the institution provide appropriate and sufficient explanation to customers when selling products in which the customer himself/herself incurs risk? When necessary, does it ask the customer to confirm that he/she has received explanations? 4) Does the institution take care not to disclose customer information to third parties except as permitted by law or as agreed to by the customer himself/herself? 5) Does the institution handle information concerning individual companies, for example, financial information concerning borrowers, with particular rigor and care?	
	(4) Functions of self-audits	(4) Do branch offices perform effective self-audits based on implementation standards and implementation procedures? Do they report the results to the auditing division?	

1) The following are provided merely as examples to be used by inspectors when they perform on-site inspections of operational risk management. No attempt has been made to exhaustively cover all of the operations of financial institutions.

2) Note that the financial institution's auditing division has basic responsibility for checking the actual operational processing of the institution. Inspections do not need to inspect all of the examples listed below on-site as long as inspectors are able to confirm that the auditing division and other relevant divisions are functioning effectively. Likewise, if it appears that divisions are not functioning effectively, inspectors may need to delve further into other operations of the institution in their checks.

3) On-site inspections need to cover the start-up of new businesses and new product sales even if they are not listed in the examples.

4) The point of the following is not to identify simple, negligible clerical mistakes, but to confirm the functioning of the risk management system.

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
IV. Handling of clerical work	(1) Internal operations	(1) Is the institution aware of the following in the handling of internal operations (examples only)? 1) Cash and physical certificate etc. management a) Balance management by executive personnel b) Communication of incidents involving cash 2) Exceptional treatments a) Records of exceptional treatments b) Approval of branch office manager or other executive c) Supplementary processing of exceptional treatment d) Prevention of overly frequent, or persistent exceptional treatment, checks by appropriate individuals etc. 3) Transactions using executive keys a) Check for base-date transactions and other unusual transactions b) Selection of important transactions requiring executive keys 4) Overdrafts a) Establishment of customers allowed overdrafts (for example, customers for whom settlement is not in doubt)	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		b) Prior approval of transactions that involve monetary burdens 5) Handling of documents and certificates etc. 6) Collection of fees, payment of costs 7) Handling of loss reports 8) Management of general transfers and transfers prior to liquidation 9) Management of objects held in custody at the branch 10) Management of CD cards 11) Bill handling, check handling, domestic transfer handling and transmission, foreign exchange 12) Money laundering issues a) Failure to confirm identity (Operational Guidelines, “Attached Information Documents”, Prevention of Money Laundering from Illegal Narcotic and other Drug Transactions) When opening accounts, leasing safe-deposit boxes, accepting protective custodial responsibilities, and engaging in trust results or large cash transactions (Supervisory Guidelines by FSA) b) Notification of dubious transactions (Law Concerning Exceptions for Narcotics, Article 5) c) Concealment, receipt, and payment of illegal profits etc. (Law Concerning Exceptions for Narcotics, Article 9 and Article 10)	
	(2) Outside liaison work	(2) Does the institution pay attention to the following in the handling of outside liaison work (examples only)? 1) Transfers of delivered funds and transfers based on telephone requests 2) Issuing and collection of receipts 3) Handling of cash and physical certificates	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		etc. between the outside liaison and the internal clerical division 4) Long-term custody of cash, passbooks, and ledgers etc. 5) Prevention of incidents at customers to whom outside collection services are provided 6) Outside payments	
	(3) Deposit operations	(3) Does the institution pay attention to the following in the handling of deposits and related matters (examples only)? 1) Provision of information to depositors a) Display in the branch office of major deposit interest rates b) Availability fee list for perusal in the branch office c) Indication of deposit products covered by deposit insurance d) Provision of information regarding the entire line of products offered e) When offering floating-interest deposits based on specific indexes, appropriate information on index levels, interest rates, and calculation methods. 2) Cooperative deposits, Buzumi-Ryodate deposits a) Prevention of excessive cooperative deposits, excessive Buzumi deposits, and excessive Ryodate deposits. b) Measures to prevent deposit solicitation campaigns from becoming excessive c) Attention to business plans that emphasize term-end figures 3) Betsudan deposits, suspense receipts, suspense payments 4) Insured time deposits 5) Handling of products without guaranteed principal	Note: Buzumi-Ryodate deposits A general name for compulsory deposits created in conjunction with bill discounts and loans. Buzumi deposits A compulsory deposit of part of the money generated by a bill discount or a loan collateralized with a commercial bill. Ryodate deposits A deposit made in conjunction with a loan as all or part of the collateral on the loan or as a

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		6) Actions that impinge on laws regarding deposit-taking	consideration or recompense (*de facto* collateral) for the loan. Betsudan deposits An accounting title of convenience for money temporarily held on deposit that cannot be assigned to any other kind of deposit or that would be inappropriate to assign to any other title. Examples would include unsettled or unliquidated amounts generated in conjunction with financial institution deposit-taking, lending, foreign exchange, securities, custodial services, or other businesses.
	(4) Lending operations	(4) Does the institution pay attention to the following in the handling of lending and related matters (examples only)? 1) Identification (confirmation of the intentions of the borrower, guarantor, and provider of collateral etc.) 2) Appraisal and management of collateral property a) Documented, objective appraisals by real estate appraisers or using standard values etc. b) Notation on collateral ledger and management ledgers etc. of collateral property and guarantee certificates etc. c) Provision and renewal of fire insurance d) Confirmation of intentions of joint and separate guarantors (guarantee confirmation) 3) Financial loan for premium payment 4) Progress on applications 5) Management of large borrowers and loss-making borrowers	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
	(5) Securities operations	(5) Does the institution pay attention to the following in the handling of securities and related matters (examples only) 1) Over-the-counter bond sales a) Operations that pay special attention to prohibited actions such as false trading indications, promotion of large volume sales of specific securities held by the institution, and actions involving the use of credit. b) Conformity to statutory requirements in the Securities and Exchange Law etc. and to the rules of the Association of Securities Dealers of Japan c) Education and training of employees 2) Investment trust sales a) Appointment of accountable internal supervisors, sales supervisors, and internal managers etc. b) Operations that pay special attention to prohibited actions such as solicitation of investment with positive judgement statements, trading on discretionary accounts, covering of losses, and provision of additional profits etc. c) Conformity to statutory requirements in the Securities and Exchange Law, Securities Investment Trust Law etc. and to the rules of the Association of Securities Dealers of Japan d) Appropriate and sufficient explanation to customers of the risk of loss of principal incurred e) Establishment of special spaces in offices for direct sales and redemptions etc. of investment trusts clearly separated from other services (for institutions “loaning space” for investment trust sales) f) Education and training of employees	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
	(6) Other operations	(6) Does the institution pay attention to the following in the handling of other operations (examples only)? 1) Commodities funds a) Operations that pay special attention to regulations designed to protect investors, including regulations against such prohibited actions as loaning names, loaning money and mediating loans, and improper solicitation. b) Appropriate and sufficient explanation to customers of the risk of loss of principal incurred c) Education and training of employees 2) Mortgage-backed securities a) Operations that pay special attention to regulations designed to protect purchasers, including regulations against such prohibited actions as loaning names and improper solicitation. b) Appropriate and sufficient explanation to customers of the nature of the product, including explanations of whether the contract guarantees principal c) Education and training of employees 3) Loan cash receipts and disbursements trusts a) Solicitation as warranted by customer knowledge and experience b) Appropriate and sufficient explanation to customers c) Education and training of employees 4) Small-lot credit sales 5) Liquidation of credits from local public bodies etc. 6) Liquidation of general loan credits 7) Loan participation 8) Foreign exchange	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		a) Notification of dubious transactions (Law Concerning Exceptions for Narcotics, Article 5) b) Concealment, receipt, and payment of illegal profits etc. (Law Concerning Exceptions for Narcotics, Article 9 and Article 10) c) Confirmation of identity by the financial institution etc. d) Reporting of confirmations of identity by the financial institution etc. 9) Exchange a) Notification of dubious transactions (Law Concerning Exceptions for Narcotics, Article 5) b) Concealment, receipt, and payment of illegal profits etc. (Law Concerning Exceptions for Narcotics, Article 9 and Article 10) c) Confirmation of identity by the financial institution etc.	

Computer System Risk Management System Checklist

1) Computer system risk is the risk that a financial institution will incur losses because of down or malfunctioning computer systems or other computer system inadequacies, or because of improper use of computer systems.

2) Inspectors will verify and inspect the operational risk management systems of financial institutions using the Risk Management Systems Checklists (Common Items), and this checklist. Should problems be identified in management systems and it be deemed necessary to engage in a deeper and more specific verification, inspectors shall refer to "Safety Standards for the Computer Systems of Financial Institutions" and the accompanying explanatory materials (edited by the Financial Institution Information Systems Center); for contingency plans they shall refer to "Contingency Plan Procedures for Financial Institutions" and Contingency Plan Formulation Manual for Financial Institutions" (edited by the Financial Institution Information Systems Center).

3) This checklist applies to all deposit-taking financial institutions, including the foreign offices of Japanese banks (foreign branch offices, foreign subsidiaries, and foreign liaison offices, etc., though whether or not to include these offices in the inspection will be determined in light of applicable laws and ordinances, including applicable foreign-country laws and ordinances) and the Japan offices of foreign banks. In inspections of cooperative financial institutions, inspectors should be aware that cooperative financial institutions are only required to select accounting auditors in limited cases.

Notes on the use of this manual in inspections

This manual is only a handbook to be used by inspectors in the inspection of financial institutions. 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 financial institutions will fully exercise their creativity and innovation to voluntarily create their own detailed manuals. These institutional manuals should make note of the content of this manual and be adapted to the size and nature of the institution.

The check points in this manual represent criteria to be used by inspectors in evaluating the risk management systems of financial institutions. They do not constitute direct statutory obligations to be achieved by institutions. Care must be taken that the manual is not employed in a manner that is mechanical and unvarying. There may be cases in which the letter of the checklist description has not been fulfilled, but the institution has nonetheless taken measures that are, from the perspective of ensuring the soundness and appropriateness of its operations, rational, and these measures are equivalent in their effects to the descriptions for the check point or are sufficient given the size and nature of the institution. In such cases, the institution's measures should not be deemed inappropriate.

Inspectors will therefore need to engage in full discussion of relevant points with financial institutions during on-site inspections.

In inspecting computer system risk management, inspectors will need to be fully aware of the importance and nature of individual systems.

- System importance refers to the size of the impact that a system has on customer transactions and management decisions.
- System nature refers to centralized main frame systems in computer centers, decentralized systems such as client/server configurations, stand-alone systems in user divisions, and the like, and the use of management methods that are appropriate to the system.

Explanation of check points

1) Unless explicitly stated otherwise, items expressed in the form of questions such as “does the institution” or “is the institution” are minimum standards that are expected of all financial institutions. 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” for all financial institutions. Inspectors need only confirm these items.

3) Items that are a combination of the two represent minimum standards for internationally active banks (those financial institutions calculating their capital adequacy ratios according to the Basle standards) but serve only as best practices for other financial institutions (those calculating their capital adequacy ratios according to domestic standards).

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 business steering committee, 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 controls in place, e.g., the results are reported to the board of directors, and auditors are allowed to participate in the management committee etc.

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
I. Awareness of risk management etc. 1. Awareness of directors and role of board of directors	(1) Articulation of strategic goals based on management philosophies for the institution as a whole	(1) Does the board of directors articulate strategic goals? Do these strategic goals include strategic guidelines for computer systems that see computer systems as part of management strategy in light of advances in information technology? Do strategic guidelines for computer systems specify: 1) system development priorities (priorities in institutional response, for example, adaptation of computer systems for Y2K, European integration, consolidated accounting and the like), 2) computerization progress plans, 3) computer system investment plans and other relevant matters?	
	(2) Establishment of risk management guidelines	(2) Does the board of directors articulate basic guidelines for risk management? Do the basic guidelines for risk management include security policies (basic policies for the appropriate protection of the information assets of the organization)? Do security policies specify: 1) information assets to be protected, 2) reasons for protection, 3) locus of responsibility etc. for protection, and other relevant matters?	Note: "Internal inspections" refers to head office inspections by the inspections division and to self-inspections by the business divisions and branch offices.
II. Establishment of appropriate risk management systems 1. Awareness and evaluation of risk	Identification of the locus and types of risk to be managed	1) Is the institution aware of and does it evaluate risks across the entire system, including evaluations of systems for different operational functions such as the accounting system, information system, external system, securities system, and international system? 2) If divisions other than the computer systems division build their own computer systems, are they aware of and do they evaluate the risks in these systems? 3) Is the institution aware of and does it evaluate the increasing diversity and degree of risk from the expansion of networks (the Internet, electronic mail) and the spread of personal computers?	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
2. Division of responsibilities	Erection of mutual checking systems	1) Do institutions calculating their capital adequacy ratios according to international standards divide responsibilities between a computer systems development division and administration division in order to eliminate individual mistakes or malicious actions? For foreign offices, the standards in “2)” below are acceptable. 2) It is desirable that institutions calculating their capital adequacy ratios according to domestic standards engage in the separation of responsibilities described in “1)” above. However, if it is difficult for them to clearly separate the development and administration divisions because of staffing constraints, do they provide mutual checking, for example, in the form of regular rotations of staff between the development and administration divisions? 3) Regardless of the organizations described in “1)” and “2)” above, does the inspections division etc. provide checking functions for systems that by nature make it difficult to separate development and administration organizations, for example, end user computing (EUC)? 4) Does an inspections division independent of the systems divisions perform regular systems inspections? 5) Are inspection results regularly reported to the board of directors etc.?	
III. Monitoring activities and correcting deficiencies 1. Internal inspections	(1) Organization of inspections division	(1) Does the inspections division have personnel versed in computer systems?	
	(2) Methods and content of inspections performed by inspections division	(2) 1) Do inspections cover all operations that are related to computer system risk? 2) Are computer systems divisions and divisions that erect their own systems inspected by the head office in principle at least once per year? 3) Are the procedures for use of computer	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		equipment outside the computer systems divisions (for example, terminals and ATMs in branch offices) checked? 4) It is desirable that internal inspections enable confirmation of auditing trails (journals and other records that trace processing content and the like) and provide evidence of the content of system operations.	
	(3) Computer crime and accidents	(3) Does the institution have organizations that are fully aware of computer crime (introduction of viruses and unauthorized programs, destruction of CD/ATM equipment and theft of cash, card fraud etc.) and computer accidents (hardware and software failures, operational misses, telecommunications line failure, power outages, external computer failures etc.)? Does it have systems for after-the-fact checking (administrative and maintenance inspections)?	
2. External audits	Use of external auditors	Do institutions calculating their capital adequacy ratios according to international standards undergo external audits of computer system risk at least once every three years? (It is desirable that institutions calculating their capital adequacy ratios according to domestic standards also be audited.)	
IV. Planning and development systems 1. Planning and development organizations	(1) Planning and development organizations	(1) 1) Does the institution formulate planning and development rules to encourage the introduction of extremely reliable and efficient computer systems? 2) It is desirable that the institution have a Computerization Committee or other company-wide screening organization. 3) Does the institution formulate medium- and long-term development plans? 4) Does the institution study the effects of investments in computer systems and report findings to the board of directors when necessary in light of the importance and nature of the system (and always for findings regarding investment effects for computer systems divisions as a whole)? 5) Does the institution have clear rules for studying and approving development	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		proposals? 6) Are modifications etc. to functioning systems subject to approval?	
	(2) Development management	(2) 1) Does the institution standardize development documentation and programming methods? 2) Does the institution assign responsibilities for individual development projects? Does the board of directors etc. check projects in light of the importance and nature of the system?	
	(3) Formulation of rules and manuals	(3) 1) Does the institution have rules and manuals for design, development and administration? 2) Does the institution review computer systems as warranted by the nature of operations? 3) It is desirable that the institution formulate standard requirements for design and development documents and create documents in conformance with these standards. 4) It is desirable that computer systems leave auditing trails (journals and other records that trace processing content and the like) . 5) Are manuals and development documentation easily understood by technically competent third parties?	
	(4) Testing	(4) 1) Is testing appropriate and sufficient? 2) Does the institution have testing implementation organizations in place so as to prevent inadequate testing and reviews from causing problems that would have a prolonged influence on customers or serious malfunctions in the creation of risk management documents and other materials used in managerial decision-making? 3) Does the institution create testing plans? 4) It is desirable that user divisions participate	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		in general tests. 5) Are acceptances made by executive personnel fully capable of understanding systems?	
	(5) Training	(5) 1) Does the institution train personnel in the operations for which systems are being developed, not just in development technology? 2) It is desirable that development personnel be versed in derivatives, electronic payments, and other areas requiring high degrees of specialization, and also in new technologies.	
	(6) Outside provider management	(6) 1) Does the institution sign confidentiality agreements when consigning computer systems development to outside vendors etc.? 2) Does the institution place necessary restrictions on the data accessible by personnel seconded from outside vendors etc.? 3) Does the institution monitor the implementation of outsourced work through management ledgers and the like?	
2. Expansion into new areas	Expansion into new areas	It is desirable that the institution gather and research information on new fields and new technologies, and study its position vis a vis management strategy.	
V. Organizational issues 1. Management organizations	(1) Security management	(1) 1) Does the institution assign security managers to appropriately manage security in accordance with preestablished guidelines, standards, and procedures? Note: The following are examples of perspectives that might be used in security. a) Physical security (explanation) • Measures to prevent physical intrusion • Crime-prevention equipment • Enhancements to computer operations	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		environments • Maintenance and inspections of equipment etc. b) Logical security (explanation) • Mutual checking among and within development and administrative organizations • Development management organizations • Measures to prevent electronic intrusion • Program management • Evaluation and management of outside software packages at the time of introduction • Operational security management etc. 2) Do security managers control the management organizations for computer systems, data, and networks?	
	(2) Computer system management	(2) 1) Does the institution have computer system management procedures in place to ensure safe and smooth operation of computer systems and prevent unauthorized access? Does it assign computer system managers to provide appropriate management? 2) It is desirable that the institution assign system managers to individual systems or individual operations. 3) Does the institution study its computer system assets at least once per year and engage in appropriate scrap-and-build programs? 4) Does the institution have appropriate and adequate organizations to manage the equipment and machinery in its head office, branch offices, and computer center? 5) Does the institution have appropriate and adequate organizations to manage computers used off-premises? 6) Do divisions other than computer systems divisions who build their own computer systems have system managers?	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
	(3) Data management	(3) 1) Does the institution assign data managers to ensure the confidentiality, completeness, and utility of data? 2) Does the institution provide for safe and smooth utilization of data by formulating rules and manuals covering data management procedures and use authorization procedures etc. and ensuring that relevant employees are thoroughly familiar with these rules and manuals? 3) Does the institution have appropriate and adequate organizations to protect data, prevent unauthorized use of data, and prevent the introduction of unauthorized programs?	
	(4) Network management	(4) 1) Does the institution assign network managers to appropriately manage network operations and control and monitor access? 2) Does the institution provide for safe and smooth network operations by formulating rules and manuals covering national management procedures and use authorization procedures and ensuring that relevant employees are thoroughly familiar with these rules and manuals? 3) Do institutions calculating their capital adequacy ratios according to international standards provide for alternative means should networks be down? (It is desirable that institutions calculating their capital adequacy ratios according to domestic standards also provide this.)	
2. System administration organizations	(1) Clarification of work responsibilities	(1) 1) Does the institution clearly separate responsibilities for data reception, operations, work results verification, and data program storage? 2) Does the institution ban operators from accessing data and programs outside of their areas of responsibility?	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
	(2) Systems operation management	(2) 1) Does the institution engage in operations based on work schedules, instructions and the like? 2) Does the institution engage in operations based on approved work schedules and instructions? 3) Does the institution record all operations and have managers check them based on predefined checklists? 4) It is desirable that the institution enable important operations to be performed by multiple employees or, wherever possible, automate their performance. 5) Does the institution provide for report outputs and obtain and keep work histories so that managers are able to check operations processing results? 6) Does the institution ban developers in principle from accessing operations? Does the institution provide for identification of developers and after-the-fact inspections of access by operations managers in the event that development personnel must access operations, for example, in order to remedy failures?	
	(3) Incident management	(3) 1) Does the institution require records to be filled out and when necessary reports to be issued to the head office in the event of problems? 2) Does the institution regularly analyze the nature of problems and take necessary countermeasures? 3) In the event of important problems that would have a serious influence on business, do divisions speedily work in coordination with the head office to find solutions and do they report to the board of directors?	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
	(4) Outside provider management	(4) 1) Does the institution sign confidentiality agreements when consigning computer systems development to outside vendors etc.? 2) Does the institution place necessary restrictions on the data accessible by personnel seconded from outside vendors etc.? 3) Does the institution monitor the implementation of outsourced work through management ledgers and the like?	
	(5) Protection of customer etc. data	(5) 1) Does the institution in principle prohibit the disclosure of customer data to third parties except as permitted by law or agreed to by the customer himself/herself? Does the institution provide for appropriate management of customer data handling by assigning managerial responsibilities and formulating management methods and handling methods? 2) Does the institution have appropriate safety measures to counteract the risk of unauthorized access to customer data, or the loss, damage, falsification, or disclosure of customer data?	
	(6) Improper access prevention	(6) 1) Does the institution have systems to prevent unauthorized access by confirming the identity of the person or terminal accessing systems as appropriate for the nature of the operation and the connection method? 2) Does the institution obtain system operations histories as an auditing trail to manage unauthorized access and enable after-the-fact auditing and regular checking?	
	(7) Computer viruses etc.	(7) Does the institution have measures in place to prevent the introduction of computer viruses and other unauthorized programs? Does it have systems in place to quickly discover and eliminate these programs in the event of introduction? • Computer virus infection	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		• Records of programs that have not gone through standard procedures • Intentional modification of authorized programs	
VI. Crime prevention, disaster mitigation, back-ups, and prevention of unauthorized access	(1) Crime prevention	(1) 1) Does the institution have an anti-crime organization and manager in order to prevent criminal activities? 2) Does the institution engage in appropriate and adequate management designed to prevent actions that would threaten the safety of computer systems, for example, management of entry and exit from work areas, management of important keys etc.?	
	(2) Disaster mitigation	(2) 1) Does the institution have a disaster-mitigation organization and manager to mitigate damage and carry on work in the event of disaster? 2) Are these organizations in line with disaster-mitigation organizations and business organizations, and are there clear assignments of responsibility for individual operations? 3) Does the institution have measures to combat damage from fire, earthquake, and flooding? 4) Does the institution have predetermined evacuation points for important data etc.?	
	(3) Improper access prevention	(3) Does the institution clearly set and manage authority to use terminals and access data and files as warranted by the degree of importance of the terminals, data, and files?	
	(4) Back-ups	(4) 1) Does the institution obtain back-ups to enable response in the event of damage or failure of important data files and programs? Does it formulate clear management methods therefor? 2) Does the institution take care to provide decentralized storage and remote-location storage when it obtains back-ups?	

Item	Risk Management System Check Point	Explanation of Risk Management Check Points	Remarks
		3) Do institutions calculating their capital adequacy ratios according to international standards have off-site back-up systems for their branch office on-line systems and other important computer systems? (It is desirable that institutions calculating their capital adequacy ratios according to domestic standards also have off-site back-up systems.) 4) Does the institution document its back-up cycle?	
	(5) Formulation of contingency plans	(5) 1) Does the institution formulate contingency plans to prepare for disasters and other events that would prevent computer systems from functioning in a normal manner? 2) Does the institution seek approval from the board of directors in the formulation and any important reviews of its contingency plans? (Does it seek the approval of the board of directors etc. for other, less-important reviews?) 3) Does the institution base its contingency plans on “Contingency Plan Procedures for Financial Institutions” and Contingency Plan Formulation Manual for Financial Institutions” (edited by the Financial Institution Information Systems Center)? 4) Does the institution envision causes from within and outside the institution in the formulation of its contingency plans, not just disasters and other emergencies? 5) Does the institution analyze the impact on the payments system and the damage to customers in the formulation of contingency plans?	