

March 28, 2017
Bank of Japan

On-Site Examination Policy for Fiscal 2017

1. On-Site Examination by the Bank of Japan

The Bank of Japan (hereafter, the Bank) formulates the on-site examination policy every fiscal year based on the decision of the Policy Board.¹ This document, "On-Site Examination Policy for Fiscal 2017," briefly reviews on-site examinations carried out in fiscal 2016 and outlines the basic approach and key issues in the conduct of on-site examinations in fiscal 2017. The Bank will conduct on-site examinations in fiscal 2017 on the basis of this document.

2. On-Site Examinations in Fiscal 2016 and General Observations

(1) On-Site Examinations in Fiscal 2016

The Bank carried out on-site examinations of 85 financial institutions in fiscal 2016: 33 domestically licensed banks, 37 *shinkin* banks, and 15 other institutions, including securities companies as well as Japanese branches and subsidiaries of foreign banks.²

¹ The Bank of Japan Act stipulates that "the content of a contract concerning on-site examinations" and "important matters concerning the implementation of on-site examinations for each business year" shall be determined by the Policy Board (Article 15, paragraph 2, item v).

² "Securities companies" in this document refers to firms that conduct securities-related business activities among those classified as Type I Financial Instruments Business in Article 28 of the Financial Instruments and Exchange Act.

Number of Financial Institutions Examined

(number of entities)

	Fiscal 2014	Fiscal 2015	Fiscal 2016
Domestically licensed banks	33	30	33
<i>Shinkin</i> banks	40	36	37
Other institutions	12	12	15
Total	85	78	85

(2) Issues Observed in On-Site Examinations

In the fiscal 2016 on-site examinations, the Bank reviewed financial institutions' business operations and asset quality, and examined the effectiveness of their business management and risk management.

Given the declining trend in profitability, mainly against the backdrop of a prolonged low interest rate environment and the declining population, financial institutions have accelerated their risk-taking stance on the whole, including more active real estate-related loans and investment in foreign securities and investment trusts. Even under these circumstances, financial institutions' capital bases are generally adequate relative to the amounts of risks taken, and their capacity to absorb losses continues to be high.

Regarding risk management, financial institutions have continued to improve their risk management frameworks, but issues to be addressed were observed among some of them in areas including risk management, in response to accelerated risk taking, and flexible risk management, in response to heightened volatilities of financial markets at home and abroad and the rise in foreign currency funding costs.

By type of financial institution, major financial institutions have continued to advance their group-wide global business strategies with the aim to strengthen their profit bases, making it more important to assess and manage complex and global risks in a timely and appropriate manner. In this situation, while they have been utilizing impact assessment (including conducting comprehensive stress tests and developing recovery plans) in a variety of stress scenarios, issues to be addressed were observed among some; specifically, in terms of ensuring the plausibility and verifying the relevance of the exercise, and use of test results for management decisions.

On the other hand, with a generally accelerating downtrend in profitability and a projected population decline in many regional economies, it has become increasingly important for regional financial institutions to improve their profitability while contributing to raising the growth potential of local economies. Nevertheless, only some have made progress in their specific efforts to improve profitability, while some of those that currently have a relatively strong capital position did not sufficiently recognize the challenges to improving medium- to long-term profitability. Under these circumstances, quite a few regional financial institutions have taken an increasingly active stance toward risk taking in credit and market risks, while some have faced challenges in improving their management frameworks.

3. On-Site Examination Policy for Fiscal 2017

(1) Basic Approach

Financial institutions are expected to contribute to corporate and household economic

activities, and ultimately to raising the growth potential at both the national and regional levels by ensuring the appropriate functioning of financial intermediation. Financial institutions have a major role to play in addressing the challenges faced by the Japanese economy, including economic globalization as well as the decline in and aging of the population, thereby creating a vigorous industrial structure.

To perform this role in the current economic environment, financial institutions need to adopt a proactive approach toward risk taking based on solid financial bases and clearly defined business strategies. In order to maintain the soundness of their management alongside the above, it is essential for them to appropriately manage risks as well as secure profitability. In particular, such efforts have gained importance for regional financial institutions with a generally accelerating downtrend in profitability.

Moreover, efforts regarding FinTech, which creates new IT-enabled financial services, etc., as well as those for business process reengineering to improve the management efficiency of financial institutions, are gradually becoming widespread. Financial institutions are encouraged to translate these proactive efforts to improve profitability.

Against this background, and based on the challenges identified in the fiscal 2016 on-site examinations, the Bank intends to conduct fiscal 2017 on-site examinations from the following perspectives.³

First, the Bank will confirm how the board of directors and senior management of

³ In doing so, the *Financial System Report* will be referred to for analysis and evaluation of risks in the overall financial system in Japan.

financial institutions recognize the external environment, including financial and economic conditions, and examine their business strategies based on such recognition. The Bank will then review the financial institutions' current and future risk profiles, including their asset quality and funding and investment structure through examining their loans, securities investments, and new businesses. In particular, the Bank will examine the risks from more active real estate-related loans, and those from the rapid expansion of overseas businesses in recent years, from a range of perspectives including credit risks and the stability of foreign currency funding. Regarding market investment, the Bank will examine risks involved in securities portfolios by risk factor, taking into account the heightened volatility of financial markets at home and abroad, the rise in foreign currency funding costs, and the active stance of investment with complex risk profiles.

Second, the Bank will examine financial institutions' resilience against risks. Specifically, the Bank will examine whether the board of directors and senior management are properly involved in ensuring that (1) risk awareness is sufficiently shared when formulating business strategies or plans, (2) risk-taking policies are consistent with the financial institutions' financial positions and risk management frameworks are adequate for such policies, (3) risk-taking policies and risk management frameworks are reviewed in response to changes in the external environment, and (4) risk management is effective. In particular, the Bank will focus on the examination of market risk management by regional financial institutions that recently have been more actively investing in securities with complex risk profiles. Moreover, the Bank will examine the effectiveness of the board of directors, various committees, the audit committee and internal audits, and effectiveness governance by

the holding companies, while conducting interviews with external directors and others as necessary.

Third, the Bank will ascertain and assess financial institutions' profitability as well as examine their resilience to stress in light of their business strategies and profiles.

For major financial institutions, their active global business expansion and provision of a wide range of financial services on a group level in an effort to strengthen their profit base have resulted not only in more diversified profit sources but also more complexity in risks. Under these circumstances, major financial institutions now have an increasingly significant influence on financial markets and the economy. In light of these developments, the Bank, through on-site examinations, will ascertain and assess their profitability and examine the potential impact of and resilience to a variety of stress scenarios. In addition, it will examine potential channels and the impact of risks such as credit provision relationships with other major domestic and overseas financial institutions.

The profitability of regional financial institutions is on a generally accelerating downtrend, as developments such as the population decline have continued in many regions. Considering this situation, even those with a sufficient capital base at present face an important management issue; namely, of securing profitability from a medium- to long-term perspective. In its on-site examinations, the Bank will focus on ascertaining and assessing regional financial institutions' profitability to confirm their awareness of tasks and challenges as well as measures to take in response. In particular, regarding those with recognized concerns about their future profitability,

the Bank will deepen its dialogue with them to improve their profitability, as well as maintain dialogue with their top management in off-site monitoring after completion of on-site examinations, in view of a wide range of factors such as the appropriateness of profit management, and the feasibility of measures to increase profits and improve management efficiency. Moreover, the Bank will examine the impact on and responses to various assumed stress events.

Fourth, the Bank will continue to conduct on-site examinations in a flexible and efficient manner in accordance with risks observed as well as their effects. In fiscal 2017, in addition to "regular on-site examinations," the Bank will conduct "targeted on-site examinations" to efficiently and effectively ascertain and assess the profitability of regional financial institutions and examine market risk management, as stated above, by limiting the scope of examinations to such areas. Moreover, with regard to financial institutions that provide a wide range of financial services not only domestically but also internationally, the Bank will grasp and examine the actual situation of the management of major group companies, including their overseas branches and subsidiaries, and the functioning of governance of the whole group.

(2) Key Issues in the Conduct of On-Site Examinations

a. Profitability

Securing of Sustainable Profits

In order to continue to stably perform financial intermediation functions in the future, it is important for financial institutions to maintain the sustainability of management

by securing profitability, or the ability to acquire sustainable profits.

In the fiscal 2017 on-site examinations, principally with regard to major financial institutions, the Bank will ascertain and assess profitability by examining international business strategy, and their efforts for a wide range of financial services as a group, including the introduction and utilization of FinTech, aimed at diversifying the profit sources of the whole group.

On the other hand, with regard to regional financial institutions, where domestic deposit-taking and lending activities form their core business, the Bank will conduct a simulation on their future profitability, bearing in mind that the profitability has been on a generally accelerating downtrend, to ascertain and assess whether they have the ability to attain sustainable profits. The Bank will then confirm with the board of directors and senior management their awareness of issues for profitability and policies to improve it, based on the medium- to long-term prospects for regional economies and for their customer bases. As a result, regarding those with recognized concerns about their future profitability, the Bank will deepen its dialogue with them to improve their profitability, in view of a wide range of factors such as the appropriateness of profit management, and the feasibility of measures to increase profits and improve management efficiency.

b. Governance

Business Management Based on an Optimal Balance between Financial Bases and Risk Taking

To ensure profitability, it is important for financial institutions to conduct appropriate business and risk management by striking the right balance between financial bases and risk taking. In this regard, it is important to analyze the impact of any materialization of risk and systematically review the risk-taking policy and risk management frameworks based on the analysis results and financial bases.

In the fiscal 2017 on-site examinations, with regard to major financial institutions, the Bank will examine the following with regard to stress testing: (1) involvement of the board of directors and senior management and control functions of sections in charge; (2) sufficiency of scenarios and coverage of the subjects of the stress testing based on financial institutions' risk profiles and business strategies; (3) development of models and data and the verification systems for them; and (4) frameworks to utilize test results for business operations and the decision on management policies including risk-taking policies. To verify the appropriateness of the stress testing, a quantitative comparison with the results from the Bank of Japan model, etc. also will be utilized. The Bank will then confirm the awareness of the board of directors and senior management with regard to assessing the sufficiency of quality/quantity of the equity capital and the capital policy based on this assessment. In doing so, it will take into account the results of stress testing and responses to international financial regulations, and provide the necessary advices. The Bank will also examine progress with the establishment of the framework for controlling risk taking and risk management comprehensively based on the institutions' business strategies, including the risk appetite framework. Regarding Global Systemically Important Financial Institutions (G-SIFIs) and their equivalents, the Bank will examine the effectiveness of the recovery plans and contingency plans. In addition, it will confirm responses to

material changes in international environments, such as Brexit, as necessary.

With regard to regional financial institutions, the Bank will use simulations of future profits (see 3. (2) a) to assess the medium- to long-term trend of their profitability, and their impacts on the economic value of the institutions' asset holdings and the structures of assets and liabilities. Based on this, the Bank will confirm the awareness of the board of directors and senior management regarding the assessment of the sufficiency of quality/quantity of the equity capital and the capital policy based on such assessment, as well as other issues for business management, and provide the necessary advices. In addition, it will examine the following: (1) whether the adequacy of the risk-taking policy, business operations, and risk management frameworks are verified through the frameworks of asset-liability management (ALM) and risk capital allocation; (2) whether necessary reviews are conducted based on the verification results; and (3) whether they have analyzed the possible impact on financial bases and profits in the event of abrupt changes in financial and economic conditions, and considered appropriate responses. Taking into consideration the spread of the use of stress testing, the Bank will confirm its plausibility and examine the utilization in deciding management policies.

Ensuring the Effectiveness of Governance⁴

To ensure the effectiveness of business management and risk management for financial institutions, the board of directors and senior management need to develop a framework of governance that is suitable for business strategies, the diversified contents of business, customer bases, risk profiles, etc., and ensure its effectiveness.

⁴ In the on-site examinations, the Bank will refer to the "Corporate governance principles for banks" issued by the Basel Committee on Banking Supervision in July 2015.

In the fiscal 2017 on-site examinations, the Bank will examine the following: (1) whether the board of directors and senior management have developed business management and risk management frameworks and are overseeing implementation appropriately; (2) whether senior management executes and manages operations in accordance with the management policies and risk-taking policy determined by the board of directors or other relevant bodies; and (3) whether senior management provides reports appropriately so that the board of directors or other relevant bodies can oversee the business management and risk management practice. In doing so, the Bank also will (4) conduct interviews with external directors and so forth, as necessary to deepen dialogue on the effectiveness of governance. Moreover, for those that offer a wide range of financial services on a group basis not only in Japan but also overseas, it also will (5) examine the effectiveness of the group-wide business management and risk management, including their overseas branches and subsidiaries, as well as holding companies' business management function.

Confirmation of the Governance Framework at Overseas G-SIFIs' Japanese Branches

With regard to overseas G-SIFIs' Japanese branches and subsidiaries, the Bank will examine whether they have established an appropriate management framework in line with their business and major efforts, while understanding the roles of Japanese branches and subsidiaries within their group, particularly in transactions, bookings, and risk management. On this basis, the Bank will examine (1) impacts on Japanese branches and subsidiaries under the assumption of stress events for the group as a whole and responses to them, and (2) the situations for Japanese branches and

subsidiaries within the recovery plans, including their involvement in these matters. Regarding those subsidiaries with corporate status in Japan, the Bank also will examine the support system provided by headquarters in the event of deterioration in business conditions. If yen funding is managed by the bases other than Japanese branches and subsidiaries, (3) the Bank will confirm the state of the management of the bases and their system of communicating with the Bank in preparation for unexpected contingencies. Moreover, (4) the Bank will conduct examinations, including the collection of information from their headquarters, of the impact on the Japanese financial system in the case of expected stress events for the group as a whole.

Proactive Improvement of Risk Management with Internal Audits

Internal audits provide a basis for ensuring the proper conduct of business operations and play an important role in promoting the proactive improvement of business management and risk management. For this reason, the board of directors and senior management need to be aware of the importance of internal audits and ensure their effectiveness. In addition, the internal auditors need to evaluate the effectiveness of business management, risk management, and other control functions, and report to the board of directors or other relevant bodies as appropriate from an independent and objective standpoint.

In the fiscal 2017 on-site examinations, the Bank will examine the following: (1) whether the board of directors or other relevant bodies appropriately decide the scope of internal audits and allocate audit resources based on the risk assessment; (2)

whether the internal auditors adequately audit businesses, including those of overseas entities and subsidiaries; and (3) whether the board of directors or other relevant bodies make the most of auditors' observations and recommendations regarding their business management. To improve the effectiveness of on-site examinations, the Bank will conduct hearings with internal audit sections before on-site examination, if necessary.

Development of Management Information Systems

It is important for financial institutions to appropriately set up and employ mechanisms to gather the information necessary to manage business operations and risks. For financial institutions that actively expand their businesses domestically and internationally and offer a wide range of financial services on a group basis, it is important to appropriately assess in a timely manner various risks that extend over regions and business sectors.

In the fiscal 2017 on-site examinations, mainly with regard to major financial institutions, the Bank will examine, concerning the information required for the board of directors or other relevant bodies to make appropriate management decisions, (1) whether they have appropriately set up mechanisms to gather the necessary information, including those for information infrastructure such as the management information system (MIS), and (2) whether the comprehensiveness, reliability, and timeliness of information are appropriate. In doing so, the Bank also will confirm the status of preparations for the change of regulations that could affect management.

c. Credit Risk Management

Appropriate Credit Screening and Monitoring, and Establishment of a Framework Compatible with Lending Strategies

Given their increasingly active stance toward risk taking in terms of creditworthiness to improve profitability, financial institutions need to more appropriately assess the actual conditions of borrowers, and further ensure that credit screening and monitoring frameworks compatible with their lending strategies are in place.

In the fiscal 2017 on-site examinations, the Bank will examine the following: (1) whether financial institutions properly conduct credit screening of borrowing firms based on sufficient research and analysis of the business conditions of these firms; (2) whether financial institutions have developed follow-up monitoring frameworks to promptly ascertain changes in the creditworthiness of borrowing firms; and (3) whether financial institutions have a deep understanding of the actual conditions of large-risk borrowers and take proper measures in credit risk management. In addition, with regard to the business sectors and regions in which financial institutions are easing their lending stances, including sectors related to real estate with a focus on rental properties as well as medical and nursing care, the Bank will examine (4) whether financial institutions properly assess the viability of borrowing firms' business in conducting credit screening and management, taking account of such factors as lending periods and the business characteristics, and (5) whether they conduct an institutional review of the profitability of such efforts. Moreover, (6) with regard to real estate-related lending, the Bank will widely examine the existence of risks and the framework to manage them, including not only the real estate industry

but also industries other than real estate, as well as sole proprietors. Furthermore, (7) given the increased efforts for consumer loans and hybrid finance, the Bank will confirm their trends and risk management framework.

Support for Enhancing the Vitality of Firms

Financial institutions are expected to contribute to enhancing the vitality of firms by continuously supporting the efforts of borrowing firms to resolve their management challenges. Such support is expected to benefit local economies, and eventually to improve the future profitability of financial institutions.

In the fiscal 2017 on-site examinations, the Bank will examine (1) whether financial institutions adequately analyze the current business conditions and future prospects of the borrowing firms and share an awareness of the management challenges concerning the borrowers with them, and (2) whether financial institutions' headquarters and branches are cooperating in offering advice, recommendations, and necessary support to help borrowers overcome challenges including fostering of growth businesses and reforming of business structures. Furthermore, the Bank will examine, with regard to borrowers with unstable business conditions, (3) whether financial institutions take efforts toward more drastic solutions for management challenges by cooperating with other financial institutions and outside specialists, and (4) whether credit risk management measures are carried out as appropriate.

Strengthening the Management of Large Exposures/Concentration Risk

Financial institutions' equity capital and profits may be significantly affected by a

worsening of the business conditions of large-lot borrowers, or by the materialization of risks in their credit portfolios with common risk characteristics such as the same industries. For this reason, financial institutions need to properly ascertain and control large exposures/concentration risk inherent in their credit portfolios. As major financial institutions have been actively engaged in such efforts as lending related to M&A and overseas resource development, project financing, and the provision of committed facilities in recent years, it has become increasingly important to manage large exposures/concentration risk.

In the fiscal 2017 on-site examinations, the Bank will examine the following in particular: (1) whether financial institutions properly ascertain the status of large exposures/concentration risk, using measures such as stress testing, and (2) whether financial institutions have developed frameworks to control large exposures/concentration risk, taking into account their equity capital, etc. while ensuring their effectiveness. In doing so, the Bank will examine the effectiveness of management, using case examples of large-lot borrowers with deteriorated business performance, etc.

Strengthening the Management of Credit Exposure with Respect to Overseas Businesses

Major financial institutions are making efforts to expand their overseas businesses to support the global expansion of Japanese companies' activities and to capture the financial needs in other countries. Some regional financial institutions have increased credit to their existing customers, taking into account the business expansion of these

customers' overseas subsidiaries. As a result, it has become increasingly important for financial institutions to manage credit exposures with respect to businesses overseas.

In the fiscal 2017 on-site examinations of major financial institutions with large overseas exposures, the Bank will examine (1) the system to manage credit exposures through selected loans review ("line sheet review") of overseas exposures. The Bank also will examine the following: (2) whether financial institutions have put in place an adequate framework for credit screening and management for areas on which they recently have a focus -- such as cross-border M&A-related and overseas resource development-related credit -- and for the management of large exposures, mainly to non-Japanese firms, considering the differences in legislations and infrastructure depending on the country and the country risk; (3) whether financial institutions' headquarters have set out rules for credit risk management including reporting procedures that apply on a global basis and appropriately monitor the status of compliance with such rules; and (4) whether the headquarters adequately review credit risk-taking policies on a global basis by making use of stress testing, etc. The Bank will check whether regional financial institutions comprehend the business conditions of borrowing firms that have major businesses overseas.

d. Market Risk Management

Adequate Involvement of the Board of Directors and Senior Management in Market Risk Management

Financial institutions have taken an increasingly active stance toward risk taking in terms of market risks to improve profitability. Given these developments, they need to

develop risk management systems that correspond to the accumulation and the growing complexity of market risks. In this regard, it has become more important for the board of directors and senior management to be aware of the risks associated with securities portfolios and off-balance transactions, and to take a lead in ensuring the optimal balance between equity capital and risks.

In the fiscal 2017 on-site examinations, the Bank will examine the following: taking into account developments in financial markets at home and abroad, (1) whether the board of directors and senior management have clearly set out risk-taking policies, thereby having investment plans formulated in view of the optimal balance between risks and equity capital; (2) whether the board of directors and senior management have developed risk management frameworks in accordance with these policies and plans and reviews the frameworks as appropriate; and (3) whether the board of directors and senior management hold discussions and reach adequate decisions in a timely and appropriate manner based on reports on changes of risks in the event of abrupt changes in the financial and economic conditions.

Conduct of Risk Management Compatible with Investment Strategies and Methods

The targets and methods of market risk management need to be in line with the risk profiles of the securities portfolios and off-balance transactions and investment methods. In particular, regional financial institutions should ascertain and manage risks appropriately, given that an increasing number of them have become active in purchasing financial products they have not invested in before, including those with relatively complex risks such as privately placed investment trusts and REITs, as well

as subordinate bonds.

In the fiscal 2017 on-site examinations, the Bank will examine the following: (1) whether financial institutions appropriately identify and analyze risks, by looking at each risk factor involved in their securities and portfolios as a whole, including the risks of individual financial products and transactions such as their credit risk, foreign exchange risk, and stock price risk, in addition to interest rate risk; (2) whether the risk management division monitors the market prices of securities, the amount of risk and observance of various limits with proper granularity in accordance with the risk characteristics, investment methods, and hedging policies, etc.; and (3) whether the adequacy and limitations of the risk-measuring methods are examined regularly through, for example, the conduct of back testing, and necessary measures are taken. In doing so, the Bank also will examine, as necessary, whether frameworks of risk management will function effectively in line with stress scenarios.

e. Liquidity Risk Management

Liquidity Risk Management Based on Risk Profiles

To ensure stable liquidity management, it is necessary for financial institutions to (1) properly ascertain the liquidity risk profiles associated with funding and investment portfolios, (2) set risk limits in accordance with their funding capability, (3) establish a framework for monitoring and controlling risks to observe the limits, and (4) understand the funding conditions including their funding bases, markets, and their own ratings and stock price changes in normal times while establishing a framework to respond promptly to changes in the environment by ensuring sufficient liquidity

reserves for emergencies.

In the fiscal 2017 on-site examinations, the Bank will examine the situation of liquidity risk management from the above-mentioned standpoint. In doing so, mainly with regard to regional financial institutions, which have become active investors in foreign currency-denominated assets aiming to improve profitability, the Bank will examine the management of foreign currency liquidity risks, including whether they have funding portfolios that take excessive liquidity risks due to excessive emphasis on short-term profitability.

Ensuring the Effectiveness of Global Liquidity Risk Management

It is important for internationally active financial institutions to implement appropriate management of foreign currency liquidity risks, including local currency risks, as well as enhance stable funding bases, at their overseas branches and subsidiaries and at their financial groups as a whole.

In the fiscal 2017 on-site examinations, the Bank will examine the following, taking into account the rise in foreign currency funding costs in recent years: (1) whether financial institutions appropriately and in a timely manner ascertain the current and prospective funding conditions in terms of different currencies and locations, ensuring smooth communication between the headquarters and each overseas branch and subsidiaries, and (2) whether they disperse and diversify, across their financial groups as a whole, funding sources for the stable procurement of foreign currencies and review this dispersion and diversification carefully. The Bank also will examine the sufficiency of stress testing and the effectiveness of liquidity contingency plans, as

responses to stress, including (3) whether the conduct of stress testing is consistent across their financial group and (4) whether financial institutions assume specific amounts of foreign currency outflow with the lapse of time, secure corresponding funding tools, and conduct an institutional review of their appropriateness.

f. Operational Risk Management⁵

Ensuring the Effectiveness of Proactive Risk Management Cycles

The operational risks inherent in the business processing of financial institutions are diverse. In such a context, financial institutions need to identify the risks, focusing on those involving greater impacts on business management in the event of the materialization of risk, and establish a management framework. In this regard, it also is necessary to make further improvements while verifying the effectiveness of the measures taken.

In the fiscal 2017 on-site examinations, the Bank will examine (1) stability of the business processing and target operations that involve greater impacts on business management in the event of the materialization of risk. It also will examine whether financial institutions identify risk management issues through a survey of the processing of operations and analysis of fraud and accidents, and take effective remedial steps against such events. The Bank also will (2) examine whether financial institutions properly recognize changes in their risk profiles through their business reprocessing due to business process reengineering, as well as expansion into new

⁵ In on-site examinations, operational risk refers to risks related to overall business operations, including, for example, risks related to business procedures, compliance, IT systems, and business continuity.

business areas, and then review their management frameworks.

Establishment and Strengthening of IT Risk Management Frameworks

To ensure the reliability and security of IT systems, financial institutions need to ensure the effectiveness of (1) measures to prevent IT system failures and recovery frameworks in the event of a failure, (2) project management, (3) information security management, and (4) management of contractors.

In the fiscal 2017 on-site examinations, the Bank will examine the above-mentioned points focusing on critical IT systems and confirm the effectiveness of IT governance to ensure their effectiveness. In this regard, it also will examine (1) whether financial institutions conduct management corresponding to their use of new IT technologies and services and (2) whether financial institutions have secured the effectiveness of management frameworks for confidential information pertaining to customers, for example. Moreover, the Bank will look over the actual situation of the introduction and utilization of FinTech and the cooperation with FinTech companies, etc.

Establishment and Strengthening of Cyber Security Management Frameworks

It is important for financial institutions to ensure cyber security in providing financial services utilizing IT in a safe and stable manner.

In the fiscal 2017 on-site examinations, the Bank will examine whether financial institutions have been cyber security management frameworks, with an acute awareness and adequate involvement of the board of directors or other relevant bodies.

In this regard, the Bank also will examine (1) the appropriateness of collecting and sharing information, (2) the appropriateness of the management of access rights for important data, and (3) the allocation of necessary business resources. The Bank will then examine the effectiveness of measures to prevent cyberattacks and limit damage caused by such attacks on critical IT systems and external networks connected to these systems, taking into account individual financial institutions' businesses and presence in the payment and settlement systems. Moreover, it will examine the effectiveness of frameworks and contingency plans in preparation for the occurrence of cyber incidents.

Strengthening of Business Continuity Management and Enhancement of Its Effectiveness

The development of effective business continuity management is important to ensuring financial institutions' critical operations, as well as the smooth functioning of the payment and settlement systems in Japan.

In the fiscal 2017 on-site examinations, the Bank will examine, taking account of each financial institution's types of business, as well as these institutions' presence in payment and settlement systems and in their respective regions, whether business continuity management is reviewed proactively based on environmental changes or other relevant factors. Moreover, with regard to those engaged in international business among major financial institutions, the Bank also will confirm whether they are ensuring business continuity management in accordance with their business expansion.

(3) Operations of On-Site Examination

a. Enhancing of Efficiency and Effectiveness

The frequency, length, and scope of the Bank's on-site examinations, as well as the number of examiners involved, have been determined on the basis of a comprehensive assessment of each financial institution from two perspectives: (1) the impact on the financial system of the materialization of risks for a particular financial institution and (2) the financial soundness of financial institutions, such as their capital adequacy and the degree of risk taking.

In fiscal 2017, in addition to "regular on-site examinations" to comprehensively examine and assess -- through on-site visits over a period of about three weeks -- the business conditions and risk management frameworks of financial institutions, the Bank will conduct "targeted on-site examinations" that will limit the scope of examinations to profitability or market risk management for on-site visits over a period of about one week. Moreover, with regard to financial institutions that provide a wide range of financial services on a group basis, the Bank will examine major group companies, as necessary, to grasp the actual business conditions of a group as a whole. Furthermore, it will continue to focus on its examination of overseas branches and subsidiaries of such financial institutions, given the increased weight of international businesses.

b. Consideration of Administrative Burden and Understanding for Financial Institutions

Line sheet review is useful in specifically ascertaining the actual situation of regional economies and changes in behaviors of financial institutions.⁶ While continuing with these in the fiscal 2017 on-site examinations, the Bank will strictly limit the number of those eligible for line sheet review, in consideration of the administrative burden on financial institutions. Taking into account that the accuracy of self-assessments has improved on average, the Bank will no longer confirm the accuracy of self-assessments, with the exception of financial institutions with certain issues regarding their asset qualities, etc.

On-site examinations of financial institutions' branches are useful in ascertaining the actual situations of governance and the efficiency of branch management.⁷ While continuing on-site examinations of branches in the fiscal 2017, the Bank will strictly limit the number of sites to visit in consideration of administrative burden on financial institutions. Given the further concentration of business operations to headquarters and use of IT systems, the Bank will not conduct examinations aiming at the confirmation of the accuracy of business operations during its on-site examinations of branches, except for those that have particular problems, such as the occurrence of fraud and accidents in business operations.

In addition, the Bank will continue striving to reduce the burden of on-site

⁶ With regard to the selected individual borrowers, to conduct face-to-face meetings with branch managers, etc. based on the documents ("line sheets") that contain information including changes in financial situations, changes in borrowing and repayment, their future prospects, financial institutions' self-assessment results and policies for lending, etc., and to ascertain and confirm business environments for borrowers such as developments in regional economies and industries, as well as credit exposure managements, etc.

⁷ Through on-site examinations of branches, the Bank examines the actual situation of operational processing and risk management systems by questioning branch managers, managers, and staff in charge of actual operations, and confirms the understanding and the status of implementation of various measures directed by headquarters.

examinations by taking into consideration the degree of busyness among financial institutions, as well as deciding, in a prioritized manner, the documents to be submitted beforehand, and survey items at the time of on-site examinations.

Moreover, to further enhance the efficiency and effectiveness of on-site examinations, the Bank will continue to strengthen the linkage between its on-site examinations and off-site monitoring. It aims to share its awareness and strengthen cooperation with the Financial Services Agency, and with overseas regulators mainly on issues common to internationally active financial institutions.

The Bank will work to enhance its communication with institutions being examined and continue to take appropriate actions to gain their full understanding of and trust in the examination process and results. In the above process, it will improve on-site examination procedures by responding to opinions and requests gathered from examinee institutions through a post-examination survey. Following its on-site examinations, the Bank will revisit the financial institution as part of its efforts, conducting interviews as necessary.