March 11, 2025

Bank of Japan

On-Site Examination Policy for Fiscal 2025

1. Introduction

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]

In conducting on-site examinations and off-site monitoring, it is becoming important to assess financial institutions' soundness and risk management in a swifter and more continuous manner and to monitor changes in the financial system as a whole in a timely fashion, in light of changes in the environment surrounding the financial system and various challenges faced by financial institutions.

In fiscal 2024, the Bank conducted integrated operation of on-site examinations and off-site monitoring. In addition, it deepened coordination with the Financial Services Agency (FSA) through a wide range of initiatives, including joint surveys with the FSA targeting major financial institutions, and worked on monitoring the financial system in detail.[2]

In the "On-Site Examination Policy for Fiscal 2025," the Bank outlines the situation of financial institutions' business management and risk management as assessed from on-site examinations and off-site monitoring in fiscal 2024. It also compiles issues key to conducting on-site examinations in fiscal 2025 and operations of on-site examinations while also taking into account recent changes in the environment. Moreover, with regard to off-site monitoring, while taking key issues in the on-site examination policy into account in order to ensure that off-site monitoring is well integrated with on-site examinations, the Bank will respond flexibly to changes in the environment.

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[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] Topics of the joint surveys in fiscal 2024 include the following: the supervisory simultaneous stress testing based on common scenarios; joint surveys on foreign currency liquidity risk management and on cybersecurity management; and climate scenario analysis. Topics will be reviewed as appropriate in consultation with the FSA in line with their importance to the financial system.

2. On-Site Examinations in Fiscal 2024 and General Observations

(1) On-Site Examinations in Fiscal 2024

The Bank carried out on-site examinations of 68 financial institutions: 20 domestically licensed banks, 41 *shinkin* banks, and 7 other institutions, including securities companies as well as Japanese branches and subsidiaries of foreign banks.[3] From fiscal 2023, the Bank focused on hybrid-type examinations that combine on-site examinations and remote methods, and it continued to do so during fiscal 2024.

Number of Financial Institutions Examined

(number of entities)

	Fiscal 2022	Fiscal 2023	Fiscal 2024
Domestically licensed banks	20	20	20
Shinkin banks	37	42	41
Other institutions	4	5	7
Total	61	67	68

(2) Issues Identified through On-Site Examinations and Off-Site Monitoring

Financial institutions' profitability and financial soundness, business management, as well as their risk management examined in on-site examinations and off-site monitoring in fiscal 2024, are as follows.

Profitability, Financial Soundness, and Business Management

Looking at financial institutions' financial soundness, their capital levels are adequate relative to the amounts of various types of risk taken on, and they have sufficient capacity to absorb losses. The smooth functioning of financial intermediation has been maintained even amid the global changes in financial and economic conditions and the resultant various types of stress.

[3] "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.

Major financial institutions have strengthened the profitability of their domestic deposit-taking and lending activities that take into account rising yen interest rates. They have also pushed ahead with inorganic growth strategies involving acquisitions and investments at home and abroad and have continued to strengthen group-wide profitability across commercial banks, securities companies, trust banks, nonbanks, etc. belonging to the same holding company and to broaden their revenue sources.

Regional financial institutions have improved the profitability of their domestic deposit-taking and lending activities due to rising yen interest rates. They have also been active in pursuing risk taking in areas they are promoting, such as structured finance that includes financing for leveraged buyout (LBO) loans, renewable energy-related investment, and loans for the acquisition of vessels and aircraft, and investment in private equity (PE) funds. On the other hand, core profitability of some regional financial institutions continued to be pushed down due to structural factors such as the declining population and to the increase in investment in computer systems and human capital, in addition to increases in interest payments on deposits following rising yen interest rates.

Against this background, in terms of business management, there were some financial institutions that faced challenges in estimating the impact of interest rate hikes on their profitability and in ascertaining the feasibility of the pass-through of these rates to loan and deposit interest rates, which is a prerequisite for estimating the impact. Moreover, the Bank held discussions with financial institutions that had actively pursued risk taking and returns to shareholder with the aim of improving their return on equity (ROE), etc., regarding the sophistication of their profit management indicators, such as return on risk-weighted assets (RORA), and institutions' use of such indicators in management. On the other hand, with some institutions seeing their business operations being affected by personnel constraints, there were also examples of institutions trying to solve such constraints through the use of digital transformation (DX) and the consolidation of their branch networks.

Meanwhile, with the use of DX, including open application programming interfaces (APIs), cloud computing, and generative artificial intelligence (AI), an increasing number of financial institutions have been improving the efficiency of their operations and enhancing non-face-to-face services for customers. Against this background, the Bank, together with the FSA, implemented a self-assessment survey for regional financial institutions, securities companies, and some major financial institutions, etc., in fiscal 2024, to encourage them to make their own efforts to strengthen cybersecurity management, making a further contribution by returning the aggregated results of the survey to financial institutions, and exchanging views with the relevant industry associations. It was confirmed that a growing number of financial institutions were continuing to address climate-related financial risks. Based on the report released with the FSA, titled "Climate-Related Scenario Analysis -- Next Step in the Banking Sector," the Bank has conducted joint climate scenario analysis with the FSA for some major financial institutions.

Credit Risk

Looking at financial institutions' credit provision, some major financial institutions have been focusing on financing for non-bank financial intermediaries (NBFIs), including investment funds, along with merger and acquisition (M&A) financing, real estate-related lending, and sustainable finance, whereas some regional financial institutions are focusing on real estate-related lending, especially for the sale and purchase of real estate, and on structured finance, and "cross-border" lending. Moreover, both major and regional financial institutions have been actively providing financing support to firms and support for firms to improve their business conditions. There have been cases of corporate turnaround through the provision of drastic financial support, including debt-debt swap (DDS) and debtor-in-possession (DIP) finance.

Against this background, after increasing in fiscal 2020, due mainly to the pandemic, credit costs have continued to level out. Many financial institutions expected that credit costs would remain more or less flat. However, major financial institutions have recorded large credit costs related to financing for global business activities, as have some regional financial institutions due to the sudden bankruptcy of cross-border borrowers and non-main borrower firms, and to financing for borrowers whose business conditions were unfavorable even before the pandemic.

With regard to risk management, there were some cases where financial institutions had problems in assessing borrowers' financial and funding conditions, analyzing their repayment capacity, and providing effective support for low-performing firms to improve their business conditions. There were cases in which credit screening and monitoring were not keeping pace with the expansion in the business scope of promoted areas. For example, in the case of real estate-related loans for the sale and purchase of real estate, there were issues in the examination of projects, the assessment of sellers, and progress management of property sales; in the case of structured finance, there were issues in formulating income and expenditure forecasts of LBO financing and the review of plans when borrowers' business performance deteriorated; and in the case of renewable energy-related loans, there were issues in the progress management of projects and the examination of cash flows.

Market Risk

Looking at developments in securities investment, financial institutions have continued to maintain a restrained investment stance, due mainly to increasing uncertainty in domestic and foreign interest rates. Moreover, some financial institutions, particularly regional ones, have sustained valuation losses on securities holdings, reducing their risk-taking capacity. In this situation, some financial institutions have increased the amount outstanding of their yen-denominated bond investment to be held to maturity.

In terms of risk management, some financial institutions, especially regional ones, have suffered an increase in valuation losses due to inadequate organization-wide consideration of loss limit frameworks and action plans in case of a breach of loss limits. Moreover, some did not adequately grasp or examine on an organization-wide basis their risk tolerance, with some not taking valuation losses into account in their framework for allocating capital and others not capturing the impact of stress on their distributable profits and their net asset values. In addition, the Bank had discussions with financial institutions holding large valuation losses regarding the adequacy of their reduction plans for valuation losses, the effectiveness of hedge transactions by inverse mutual funds, and the appropriateness of holding limit frameworks for held-to-maturity bonds.

Liquidity Risk

Major financial institutions have been making efforts with regard to foreign currencies to maintain funding stability by increasing foreign currency deposits, the stickiness of which is relatively high, and extending the maturity of FX and currency swap funding. Moreover, reflecting the failure of some banks in the United States, they have been examining the stickiness of deposits in the U.S. branches and working on increasing funds transfer from the head office. In this context, there were cases where liquidity stress testing and contingency funding plans required refinement.

Many regional financial institutions have sufficient yen liquidity and have no problems in managing it. However, while there were financial institutions for which deposits have been declining as a trend and those for which increases in deposits have been sluggish, some have failed to sufficiently analyze developments in deposits, and others have not reviewed their emergency responses that take into account the downsizing of branch networks and the reduction of staff. As for foreign currency funding, those institutions that have had somewhat of an increase in funding needs compared with investment were facing challenges in securing stable funding means in response to changes in funding conditions and in strengthening their ability to respond in the event of stress.

In addition, some financial institutions that work on raising funds through internet banking deposits had not adequately grasped the risks of deposit outflows in the event of stress.

***Operational Risk*[4]**

With regard to IT system risks, while both major and regional financial institutions are increasingly using new digital technologies, cyber threats such as ransomware attacks are becoming more prevalent.

Against this background, regarding cybersecurity management, there were some cases where basic operations, such as ensuring that operating systems were kept up to date and the management of firewall settings, were not implemented thoroughly, and there were also cases where the management of third parties, such as group companies and outsourcee companies, was insufficient. Moreover, there were some institutions that had inadequate risk management frameworks for the use of cloud computing, such as risk management standards and security settings. In addition, there were cases where there were issues in the management framework for computer system development projects.

As in fiscal 2023, the Bank looked into financial institutions' frameworks for anti-money laundering and countering the financing of terrorism while sharing its awareness and perspectives with the FSA through the framework of coordination between the FSA's

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[4] Operational risk refers to risks related to overall business operations, including, for example, risks related to business procedures, compliance, computer systems, and business continuity.

inspections and the Bank's on-site examinations. The examinations showed that, while institutions overall were taking steps to improve their frameworks, the responses of some institutions were inadequate.

3. On-Site Examination Policy for Fiscal 2025

On-site examination policy for fiscal 2025 is as follows (see attachment for more details on the key issues). Moreover, with regard to off-site monitoring, while taking key issues in the on-site examination policy into account in order to ensure that off-site monitoring is well integrated with on-site examinations, the Bank will respond flexibly to changes in the environment.

(1) Outlook for Profitability and Financial Soundness as well as Efficacy of Business Management

The Bank will examine (1) the respective boards of directors and senior management's view of the external environment, including changes in financial and economic conditions at home and abroad, (2) the feasibility of their medium- to long-term business strategies, (3) the outlook for profitability and financial soundness on that basis, and (4) the effectiveness of the financial institutions' business management. In doing so, the Bank will pay particular attention to the following issues:

- For major financial institutions, the status and efficacy of efforts in a wide range of financial services through their global activities and group strategies and the status and feasibility of the use of DX.
- For regional financial institutions, the principles behind and the status of efforts toward building a sustainable business model, taking into account regional economies and management resources. In addition, (1) efforts to strengthen top-line earnings, (2) measures to enhance resource management, such as a review of branch networks and staff allocations, and (3) the efficacy of measures to improve business efficiency, such as the reengineering of business processes. Furthermore, for those that have been pushing ahead with strengthening business foundations through business integration, enhancement of group-wide business activities, and especially business collaborations with other firms, and the status and efficacy of such efforts.

-- Through examinations of these issues, the Bank will continue dialogue with regional financial institutions on the status of implementing measures to support regional economies and strengthen their business foundations in coordination with off-site monitoring.

-- With regard to regional financial institutions that are facing more severe staff constraints, the Bank will also examine the effects on their business operations and the sufficiency of resource management, and have dialogue with these institutions on countermeasures, including the use of DX and raising human capital, and the efficacy of the measures.

- Profit outlook in light of interest rates factored in by the markets and asset-liability management (ALM), such as regarding loans and deposits as well as securities investment under such circumstances.

  -- The Bank will check through profitability simulations, etc., that are based on interest rates factored in by the market, the feasibility of the pass-through of interest rates to loan and deposit interest rates and of the outstanding amount of loans and deposits that take into account changes in the composition of financial institutions' assets and liabilities and ALM. The Bank will also have dialogue with financial institutions on countermeasures.
- The effectiveness of profit management (including how RORA and other profitability indicators are used) to improve profitability at institutions that actively pursue risk taking and returns to shareholders with the aim of improving their ROE, etc.
- Management of financial soundness mainly based on the valuation losses on securities holdings and the amount of risk, including the effects on distributable profits and net asset values.
- ALM that takes into account interest rate risk in the banking book (IRRBB).
- In the case of financial institutions for which there is concern about their future profitability and financial soundness, the effectiveness of risk-weighted asset management and capital policies including dividend distributions.
- Whether financial institutions identify and manage climate-related financial risks, their information disclosure, and their engagement with corporate customers.

(2) Status and Efficacy of Governance Framework

The Bank will examine the status and efficacy of financial institutions' governance framework necessary to ensure the effectiveness of business management and risk management. In doing so, it will pay particular attention to the following issues:

- In the case of financial institutions that have overseas branches and subsidiaries and financial holding companies, their business management commensurate with their group strategies, global activities, as well as financial regulatory and supervisory frameworks in different jurisdictions.
- The effectiveness of internal audit functions and efforts to enhance them.
- The framework for the collection of the information necessary for effective business and risk management.

(3) Status of Various Risks and Risk Management Frameworks

Taking into account major risks that the respective boards of directors and senior management are aware of and the countermeasures against these risks, the Bank will review current developments and future directions of various risks faced by financial institutions and then examine the effectiveness of their risk management. (In the on-site examinations, the Bank will avoid overlapping with joint surveys conducted with the FSA on subjects such as foreign currency liquidity risk management and cybersecurity management at some major financial institutions.) In doing so, the Bank will pay particular attention to the following issues:

Credit Risk

- Whether financial institutions ascertain borrowers' financial and funding conditions, including resilience to stress from rising interest rates, and portfolio characteristics, as well as changes therein. Moreover, whether their initial screening and interim management based on such information are appropriate, and the status of deliberations on methods for write-offs and loan-loss provisions (including the sufficiency of loan-loss provisions for large borrowers with unfavorable business conditions).
- Implementation of credit screening, monitoring, and portfolio analysis of real estate-related loans, such as loans for the sale and purchase of real estate and for residential real

estate leasing businesses, and housing loans. Frameworks for credit screening and monitoring with regard to other promoted areas (financing for NBFIs and M&A financing at major financial institutions, structured finance such as LBO loans and "cross-border" lending at regional financial institutions, etc.).

- Whether financial institutions are identifying borrowers that require support for improving their business conditions based on borrowers' financial conditions and loan coverage ratios, as well as the status of financial institutions' effective support for and management of their borrowers. The efficacy of support measures to address management challenges for large borrowers with unfavorable business conditions (including the use of various measures for corporate turnaround to achieve drastic solutions). Whether financial institutions are providing support for business succession and M&A, etc.
- Estimation of future credit costs and downside risks in light of financial and economic conditions and default cases.

Market Risk

- Whether financial institutions appropriately ascertain and share organization-wide their risk tolerance relative to their profitability and financial soundness, and determine their market risk-taking policies (including hedging policies) based on changes in the interest rate environment, gains/losses on securities holdings, etc.
- The effectiveness of the management of loss limits and the status of deliberations on management actions to be taken in the event of market turmoil.
- Policies for dealing with valuation losses on securities, and the status of investments in and risk management frameworks for inverse mutual funds and held-to-maturity bonds.
- Whether financial institutions ascertain and have management frameworks for risk profiles for promoted areas, such as PE fund investments and private real estate investment trust (REIT) investments amid the continuing diversification of securities portfolios.

Liquidity Risk

- Major financial institutions' frameworks for ascertaining and managing foreign currency liquidity risk, including the status of a management information system (MIS).

- Whether regional financial institutions that focus on foreign currency-denominated loans and investments have secured foreign currency funding bases that take into account changes in the funding environment.
- Whether the analysis of developments in deposits and countermeasures is effective at financial institutions for which deposits have been declining and those for which increases in deposits have been sluggish, and whether, given the downsizing of branch networks and the reduction of staff, emergency responses are effective.
- Financial institutions' analysis of the stickiness of their deposits in response to rising interest rates, etc., and policies for dealing with risks of deposit outflows through the internet.

Operational Risk

- The appropriateness of management frameworks for large-scale projects such as the upgrading of core banking systems and the effectiveness of measures to prevent computer system failures and of recovery systems in the event of a failure (including with regard to cloud computing).
- The thoroughness of the implementation of basic operations amid advances in digitalization and the rising threat of cyberattacks. Whether financial institutions have ensured cybersecurity for third parties, such as group companies and outsourcee companies, including the security of cloud computing. The effectiveness of recovery frameworks in the event of an incident.[5]
- The functioning of internal controls, including measures to prevent the occurrence and recurrence of fraud, etc., organizational checks and balances, and internal audits and compliance frameworks. Whether financial institutions have developed frameworks to manage the abuse of dominant bargaining positions and conflicts of interest in relation to sales of financial instruments and advisory services.

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[5] As for surveys on cybersecurity management frameworks, the Bank will conduct such surveys depending on the business scope and characteristics of financial institutions, while referring to "Guidelines for Cybersecurity in the Financial Sector" released by the FSA in October 2024.

- Whether financial institutions have developed frameworks for anti-money laundering and countering the financing of terrorism.[6]
- Whether financial institutions have developed administrative risk management frameworks that take into account changes in risk profiles due to the consolidation of their branch networks, the reduction of staff, the centralization of administrative work at headquarters, etc.

4. Operations of On-Site Examinations

(1) Continuation of Hybrid-Type Examinations That Combine On-Site Examinations and Remote Methods

Since fiscal 2023, the Bank has focused on hybrid-type examinations that combine on-site examinations and remote methods, and it will continue to do so during fiscal 2025.

Specifically, during the "regular examinations," which take about three weeks and consist of a comprehensive examination and assessment of regional financial institutions' business conditions and risk management frameworks, the first two weeks or so will basically be spent conducting on-site examinations, while the last week or so will be spent conducting examinations using remote methods. However, depending on factors such as examinee institutions' circumstances, the Bank may adjust the relative length, etc. of on-site and remote examinations and/or may conduct examinations entirely on-site.

(2) Giving Consideration to Financial Institutions' Operational Burden and Improving Efficiency

While making use of the information obtained through off-site monitoring, the Bank efficiently conducts examinations (hereafter referred to as on-site examinations or examinations using remote methods) based on a risk-based approach by deciding, in a flexible and efficient manner, the frequency, length, and scope of its examinations, as well as the documents to be submitted and the number of examiners involved, on the basis of a comprehensive assessment of individual financial institutions, such as from the following

[6] The Bank will conduct examinations while sharing its awareness and perspectives with the FSA through the framework of coordination between the FSA's inspections and the Bank's on-site examinations.

perspectives: (1) the impact on the financial system of the materialization of risks inherent in financial institutions; and (2) financial institutions' soundness and profitability, as well as the degree of risk taking.

Since fiscal 2022, in order to reduce the operational burden on examinee institutions and further improve the operational efficiency of examinations, the Bank has conducted "short-term examinations" of some regional financial institutions, and will continue with such examinations in fiscal 2025; "short-term examinations" are examinations that have been shortened to about two weeks and are based on a risk-based approach, in which operational risk management, etc. are excluded from the scope of the examination.

In addition, the Bank will continue to strengthen its coordination with the FSA by coordinating the planning of the FSA's inspections and the Bank's on-site examinations through the Joint Group for Coordinating FSA's Inspections and BOJ's On-Site Examinations and by sharing the findings of inspections and examinations. In conducting on-site examinations, the Bank will avoid overlapping with various joint surveys that it conducted with the FSA to take into account the operational burden on examinee financial institutions.

Moreover, the Bank will continue to share its awareness and strengthen cooperation with overseas regulators, mainly on issues regarding internationally active financial institutions.

(3) Gaining of Financial Institutions' Understanding

The Bank will work to enhance its communication with financial institutions being examined through a post-examination survey and interviews conducted after the examinations as necessary to gain their full understanding of and trust in the examination process and results. The Bank has constantly worked on improving on-site examination procedures by responding to opinions and requests gathered from examinee institutions, and it will continue with such efforts.

Moreover, through the regular exchange of views with members of the financial industry that started in fiscal 2021, the Bank intends to continue exchanging views on the operation of its examination and monitoring, while focusing on efforts to further strengthen coordination between the FSA and the Bank.

Attachment

Issues Key to On-Site Examinations in Fiscal 2025

I. Outlook for Profitability and Financial Soundness as well as Business Management

The Bank will examine whether financial institutions are making necessary efforts from the perspective of both Subsections A and B below, in order to build a sustainable business model into the future.

In relation to this, in the on-site examinations, the Bank will examine whether financial institutions can ensure sustainable profits and maintain their financial soundness by conducting simulations of their profitability based on the interest rates factored in by the markets.[1] It will also conduct a profitability, capital adequacy ratio level, and distributable profit simulation under certain standard stress scenarios and discuss with the respective boards of directors and senior management their awareness of issues regarding profitability and financial soundness, as well as policies to improve these. As for some major financial institutions, the Bank, together with the FSA, will conduct supervisory simultaneous stress testing based on common scenarios as part of off-site monitoring to gain a deep understanding of risk profiles inherent in their business models, thereby developing a comprehensive perspective for evaluating their financial soundness. The Bank will also have dialogue with these financial institutions on their business challenges, such as the sophistication of risk management frameworks.

A. Efforts to Achieve Profits and the PDCA Cycle for Business Operations

The Bank will examine whether financial institutions, in order to achieve the profits that they should aim for, have appropriately established and operate a system (a so-called PDCA cycle for business operations) under which they formulate and implement business strategies and plans while accurately understanding the domestic and overseas business environment, examine the results, and review such strategies and plans in a timely manner in response to changes in the business environment.

[1] Profits here are defined as pre-provision net revenue (PPNR, excluding profits and losses from investment trusts due to cancellations) minus credit costs and losses on the redemption of mutual funds.

The Bank will collect information on changes in the environment surrounding financial institutions' business in a forward-looking manner, including through off-site monitoring. For example, it will continue to examine a wide range of issues such as (1) uncertainties over financial and economic conditions at home and abroad, (2) geopolitical risks, (3) the effects of the growing presence of NBFIs, (4) structural challenges faced by regional economies, (5) progress in DX, (6) developments in financial regulation and supervision at home and abroad, and (7) responses to climate change, including through the conduct of hearings on financial institutions' recognition of these issues and their innovative initiatives.

Based on such recognition of the environment, in the case of major financial institutions, the Bank will examine the following, in coordination with off-site monitoring: their global activities and group strategies (including those with regard to overseas branches and subsidiaries and inorganic growth) in light of changes in foreign currency funding conditions, international financial regulations, and financial regulatory and supervisory frameworks in different jurisdictions; efforts in a wide range of financial services, such as those for adapting to DX; and business process reengineering aimed at raising business efficiency. It will then analyze the details of their efforts and effectiveness from the standpoint of group-wide profitability.

With regional economies facing structural factors such as declining and aging populations, it is important for regional financial institutions to continue to push ahead with efforts to support their region's economy and their customers in tackling the challenges they face and enhancing their growth, and for the institutions to continue to endeavor to strengthen their own business foundations in order to firmly provide such support into the future. From this perspective, the Bank will examine the status and feasibility of efforts to strengthen top-line earnings, such as loan and deposit income and income from fees and commissions, in order to build a sustainable business model, and of measures to improve business efficiency, such as a review of branch networks and staff allocations and the reengineering of business processes. Moreover, as for regional financial institutions that are facing more severe staff constraints, mainly due to moves to contain costs and to recruitment difficulties, the Bank will also examine the effects on their business operations and the sufficiency of their resource management under these circumstances, and discuss possible countermeasures, including the use of DX and efforts toward increasing human capital, and the efficacy of these measures. In doing so, the Bank will focus on, for example, the effects of business alliances with other banks and firms from other industries and measures taken by branches. With regard to regional financial institutions that have been pushing ahead with strengthening business foundations through business integration and enhancement of group-wide business activities, such as in the form of holding companies, the Bank will examine the status of implementing such measures, as well as their effectiveness. Through these examinations, the Bank will continue dialogue with regional financial institutions on the status of implementing measures to support regional economies and strengthen their business foundations, as well as their future policies and challenges in coordination with off-site monitoring.

The Bank will examine the outlook for financial institutions' future profitability and financial soundness through profitability simulations, etc. In doing so, it will ascertain the outlook for future net interest income, etc., based on the interest rates factored in by the market, taking into account financial institutions' repricing schedules of interest payment for assets and liabilities, their setting of loan and deposit interest rates, and the feasibility of expected pass-through of interest rates to loan and deposit interest rates and of the outstanding amount of loan and deposits. Moreover, as for ALM operations with regard to deposits and loans, securities investment, etc., on this basis, the Bank will hold in-depth discussions with financial institutions in coordination with off-site monitoring.

In addition, the Bank will confirm whether financial institutions' profit management is appropriate, relative to risk, in employing the PDCA cycle for business operations. For financial institutions that aim to enhance ROE, etc., in addition to examining their status of risk taking, returns to shareholders, and the capital use of inorganic investment, the Bank will examine whether their company-wide financial goals are consistent with profitability indicators such as RORA for each business division and client firm, as well as whether profit management is effective. In the case of other financial institutions, the Bank will examine whether they have worked on basic matters such as ascertaining the profit outlook with a certain degree of accuracy. In addition, it will examine how these financial institutions make use of efficiency indicators, while taking into account their profitability, financial soundness, and business scope.

B. Understanding of and Response to Risks Related to Business Strategies and Plans

The Bank will examine whether financial institutions accurately identify risks accompanying the implementation of their business strategies and plans, and whether such identification is leading to a review of these items with the respective boards of directors and senior management being involved. The Bank will pay particular attention to whether financial institutions ascertain risks that take into account changes in their business environment and strategies, such as developments in financial markets, including domestic and foreign interest rates, geopolitical risks, and responses to climate change. Moreover, the Bank will examine whether financial institutions have ascertained and managed quantitatively risks acceptable relative to profitability and financial soundness, including the treatment of valuation losses on securities holdings, under the integrated risk management framework.

In doing so, the Bank will examine whether financial institutions have analyzed the possible impact on profitability and financial soundness in the event of significant changes in financial and economic conditions, including through the use of stress testing, and have considered appropriate management actions. With regard to stress testing, the Bank will examine the following: (1) the involvement of the respective boards of directors and senior management and the control functions of the relevant divisions in charge of such activity; (2) the comprehensiveness of scenarios and coverage of the subjects of the stress testing; (3) schemes to develop and verify models and data; and (4) frameworks to utilize test results for the PDCA cycle for business operations. In particular, the Bank will examine the impact of changes in interest rate environment on valuation losses on securities holdings, losses on the redemption of mutual funds, and the amount of risk. Moreover, it will check how financial institutions have placed and managed IRRBB in their risk management framework, and have dialogue on their thinking behind core deposits.

In the case of financial institutions for which there is concern about their future profitability and financial soundness, the Bank will focus its dialogue with the respective boards of directors and senior management on the balance between capital and risk-weighted assets to perform their financial intermediation function in a stable manner into the future, the framework to manage them, and their capital policies including dividend distributions. In off-site monitoring after the completion of on-site examinations, the Bank will maintain dialogue with the top management of such institutions.

Regarding Global Systemically Important Financial Institutions (G-SIFIs) and their equivalents, the Bank will examine the effectiveness of recovery plans and contingency plans.

With regard to climate change responses, the Bank will engage in dialogue with financial institutions on the following issues according to their size and characteristics: (1) the identification and management of climate-related financial risks (including quantitative assessments of transition and physical risks); (2) measures to enhance the quality and quantity of disclosure based on the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD); and (3) engagement with corporate customers in pursuit of decarbonization (including raising awareness among small and medium-sized firms, supporting efforts to measure greenhouse gas emissions, and enhancing products and services such as sustainability-linked loans and green loans). In doing so, mainly through off-site monitoring, the Bank will urge financial institutions to enhance their climate-change scenario analysis according to their size and characteristics, taking into account the climate-change scenario analysis jointly conducted with some major financial institutions based on a common scenario between the FSA and the Bank from fiscal 2024, and also taking into account international discussions regarding regulation, supervision, and risk management of climate-related financial risks.

II. Governance

A. Ensuring the Efficacy of Governance

The Bank, in the case of major financial institutions, will examine whether they have established group-wide global governance frameworks, including business and risk management and internal audits, that are appropriate for their business strategies, such as initiatives to expand activities mainly through inorganic investment, and to strengthen the cross-selling of services on a group-wide basis.

For regional financial institutions, the Bank will review whether management policies are disseminated throughout the organization, whether communication within the organization regarding the assessment of risks is smooth, and whether a governance framework is in place that enables the organization to properly harness its organizational capabilities to achieve its business strategies and plans. The Bank will also review holding companies to which regional financial institutions belong.

In the on-site examinations, the Bank will conduct interviews with external directors and other officers as necessary.

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 scope and risks while understanding their roles within the group. On this basis, it 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 role of Japanese branches and subsidiaries within the recovery and resolution 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 a deterioration in business conditions. If yen funding is managed by bases other than Japanese branches and subsidiaries, (3) the Bank will confirm the state of the management of the bases and their framework of communicating with the Bank in preparation for unexpected contingencies. Moreover, (4) it will conduct examinations, including the collection of information from their headquarters, of the impact on the Japanese financial system in the case of assumed stress events for the group as a whole.

B. Using and Enhancing Internal Audit Functions

With regard to internal audits, the Bank -- depending on financial institutions' business scope, risk taking, and the materialization of risks -- will examine (1) whether the institutions appropriately decide the scope of internal audits and allocate audit resources through risk assessment that takes into account business strategies, risk taking, and the materialization of risks, (2) whether they have verified the appropriateness of their business operations and properly made improvements reflecting the results of the audits, and, in particular, whether headquarters audits examine in depth the effectiveness of risk management and lead to the consideration of effective improvement measures while making use of outside experts' knowledge as necessary, and (3) whether the results and recommendations of such audits are utilized in their business. To improve the effectiveness of on-site examinations, the Bank will conduct hearings with the respective internal audit divisions before on-site examination, if necessary.

C. Information Management Frameworks Necessary for Business Management and Risk Management

Concerning the global and group-wide financial information and risk information required for the respective boards of directors and senior management to make appropriate business decisions, the Bank will examine, particularly for major financial institutions, (1) whether they have appropriately set up a framework for the collection of the necessary information, such as the MIS, (2) whether sufficient management resources are allocated to this end, and (3) whether the completeness, accuracy, and timeliness of information, etc. are appropriate. In doing so, the Bank also will confirm the status of responses with regard to institutional frameworks, such as international financial regulations.

III. Credit Risk Management

A. Credit Screening and Monitoring

For both major and regional financial institutions, it is important to conduct credit risk management that takes into account changes in financial and economic conditions as well as individual borrowers' conditions. Regional financial institutions in particular need to conduct credit risk management in consideration of structural challenges faced by regional economies, such as a declining population.

Given this situation, the Bank will examine whether financial institutions (1) appropriately ascertain borrowers' financial and funding conditions at the individual borrower level as well as changes therein, and analyze their repayment capacity, including resilience to stress from rising interest rates; (2) analyze portfolio characteristics and changes; and (3) properly analyze cases of credit cost incurrence. Moreover, the Bank will also examine whether financial institutions accurately use these analyses in their initial screening and interim management of loans. In particular, it will carefully examine whether financial institutions sufficiently comprehend the business conditions of large borrowers that are low-performing or carry considerable business risks and whether their credit screening and monitoring are appropriate, including the accuracy of self-assessments. In doing so, the Bank will employ "line sheet reviews" (the same applies throughout this section).[2]

B. Responses to Promoted Areas

Among major financial institutions, some have been active in financing for NBFIs, including investment funds, along with M&A financing, real estate-related lending, and sustainable financing, etc. As for regional financial institutions, some are focusing on real estate-related lending, such as for the sale and purchase of real estate and for residential real estate leasing businesses, and structured finance, as well as "cross-border" lending.

Taking this situation into account, as for major financial institutions, the Bank will examine (1) whether they are appropriately managing credit in areas where they have been increasing their efforts, such as financing for NBFIs, including investment funds, and M&A financing, as well as managing operations in other areas they have been focusing on, such as the origination and distribution of loan-related instruments; and (2) whether their headquarters have established global management and reporting rules and are appropriately monitoring them.

Moreover, for both major and regional financial institutions, the Bank will examine their screening and monitoring of real estate-related lending and housing loans as well as the monitoring of loan portfolios. In particular, with regard to real estate-related lending, the Bank will examine (1) whether loans for the sale and purchase of real estate are managed proactively based on an examination of projects and real estate valuations, property sales progress management, and the monitoring of conditions in the real estate market. In addition, with regard to (2) apartment loans and other residential rental real estate loans, the Bank will examine financial institutions' revenue and expenditure plans and the collectability of these loans, including rent and vacancy rates. In addition, the Bank will

[2] A line sheet review consists of (1) interviews with relevant divisions on the basis of documents ("line sheets") containing information on developments in the financial condition, developments in the borrowing and repayment situation, and future prospects of chosen individual borrowers, as well as the financial institution's self-assessment results, lending policy, etc.; and (2) the understanding and assessment of the borrowers' business environment, such as developments in regional economies and industries, as well as its credit management practices, etc.

examine the screening and monitoring frameworks in the event of stress such as rising interest rates and declining real estate prices.

Moreover, regarding regional financial institutions that are focusing on structured finance, etc., the Bank will examine whether their credit screening and monitoring of such lending are appropriate in light of loan structures and borrower characteristics.

C. Support for Firms to Improve Business Conditions

In helping firms to improve their business conditions, it is important for both major and regional financial institutions to provide support that takes into account changes in financial and economic conditions, as well as individual borrowers' conditions. Regional financial institutions in particular need to ensure the effectiveness of this support from the viewpoint of increasing the sustainability of regional economies.

From this standpoint, the Bank will examine (1) whether financial institutions' headquarters and branches are cooperating and accurately identifying borrowers that require support to improve their business conditions, mainly taking account of individual borrowers' financial conditions and the status of loan coverage ratios and loan-loss provision ratios. In addition, the Bank will examine the status and efficacy of financial institutions' support for and management of these borrowers, including the following: (2) whether financial institutions adequately analyze the current business conditions and future prospects of borrowers, and share with them an understanding of the business challenges they face and possible countermeasures; (3) whether these institutions' headquarters and branches are cooperating in terms of offering advice, recommendations, and support to help borrowers overcome challenges; (4) whether these institutions are providing support for business succession and M&A as necessary; and (5) with regard to borrowers with unstable business conditions, whether these institutions are making efforts toward more drastic solutions for business challenges by cooperating with other financial institutions and outside specialists. Regarding large borrowers continuing to have unfavorable business conditions in particular, the Bank will deepen dialogue with financial institutions to examine whether risks have built up; for example, whether they have continued to provide loans without making efforts toward devising more drastic solutions to address management challenges.

D. Outlook for Credit Costs (Write-Offs and Loan-Loss Provisions)

The Bank will examine future credit costs and downside risks -- taking into account financial and economic conditions in Japan and abroad, recent default cases, borrowers' conditions both at the individual borrower level and the portfolio level, and the status of loan coverage ratios and loan-loss provision ratios -- and have dialogue with financial institutions on their accuracy. Moreover, the Bank will deepen its dialogue with financial institutions regarding the appropriate approach to calculating write-offs and loan-loss provisions, and exchange opinions with the accounting auditors of financial institutions as necessary. In particular, the Bank will engage in in-depth dialogue regarding large borrowers with unfavorable business conditions, including on the sufficiency of loan-loss provisions.

IV. Market Risk Management

A. Establishment of Management Frameworks Depending on Financial Institutions' Risk Taking

Some financial institutions have seen increases in valuation losses as a result of insufficient organization-wide consideration of loss limit frameworks, action plans, and risk tolerance. Moreover, there have also been moves to increase the amount outstanding of yen-denominated bond investment to be held to maturity.

Against this background, the Bank will review financial institutions' market risk-taking policies (including hedging policies) based on changes in the interest rate environment, as well as their risk management frameworks with regard to dealing with valuation losses, including the handling of inverse mutual funds and held-to-maturity bonds. Moreover, it will examine whether financial institutions, when formulating investment plans, verify that the amount of risk relative to their profitability and financial soundness remains at acceptable levels if those investment plans are implemented. In doing so, the Bank will examine whether they assess the impact that an increase in valuation losses would have on their distributable profits and net asset values through the implementation, for example, of stress testing. In addition, particularly in the case of financial institutions with broadening securities portfolios, such as PE fund investments and private REIT investments, the Bank will check management frameworks to ascertain whether risk profiles are properly identified and market values, risk amounts, etc., are monitored and measured appropriately.

B. Appropriateness of Various Risk and Loss Limits, and Responses to Market Turmoil

The Bank will examine whether financial institutions set various risk and loss limits at the appropriate levels relative to their financial soundness and profits, whether these are properly reviewed, and whether organization-wide action plans in case of market turmoil are considered. Moreover, the Bank will examine whether loss-cut rules are in place and functioning to allow for timely management action on the appropriateness of continuing to hold securities when a mandatory consultation framework becomes requisite, taking into account the impact on their financial soundness and profits.

V. Liquidity Risk Management

A. Foreign Currency Liquidity Risk Management

Given that internationally active major financial institutions have large amounts of foreign currency funding outstanding, the Bank will examine the following: (1) whether such financial institutions have set their risk appetite (such as in terms of the medium- to long-term funding ratio, indicators based on the results of liquidity stress testing, etc.) in line with their foreign currency balance sheet strategy (such as with regard to whether they are planning to increase or decrease their foreign currency balance sheet and in respect to the gap between loans and deposits, the maturity gap in investment and funding, and profitability); (2) whether such financial institutions have set up a framework for managing their funding gap based on their funding capacity, in terms of different currencies, and have a liquidity buffer to cope with sudden outflows of funds; and (3) whether they have developed and implemented liquidity stress testing and contingency funding plans in a consistent manner on a group-wide basis, based on reasonable capital flow assumptions.

In off-site monitoring, the Bank will also continue to examine major financial institutions' efforts to strengthen foreign currency funding bases and increase the sophistication of their risk management while cooperating with the FSA and overseas regulators that exercise jurisdiction over major financial institutions. The Bank will conduct joint surveys with the FSA on some major financial institutions and avoid overlapping with such surveys in the on-site examinations. In the joint surveys, the Bank will examine the status of individual financial institutions' assumptions regarding the deposit runoff rate in liquidity stress testing, the efficacy of their contingency funding plans, their frameworks for ascertaining and collecting information related to liquidity risks, including the status of their MIS.

Turning to regional financial institutions, particularly with regard to those that are highly dependent on short-term market funding, etc., as well as those that are actively lending or investing in foreign currency-denominated assets, the Bank will examine whether they have secured stable funding means that take into account changes in funding environment and market liquidity of assets and also examine their risk management frameworks, such as the conduct of and the use of stress testing and the effectiveness of emergency measures.

B. Yen Liquidity Risk Management

The Bank will examine, especially at financial institutions for which deposits have been declining as a trend or those whose increases in deposits have been sluggish, whether they are analyzing the underlying reasons for developments in deposits and examining countermeasures on an organization-wide basis. It will also examine whether, given the downsizing of branch networks and staff reductions, they have established and/or reviewed frameworks to quickly secure liquidity reserves and cash in an emergency.

Moreover, the Bank will examine the implementation of analyses of the stickiness of deposits in response to rising interest rates, etc., as well as monitoring frameworks and policies for dealing with the risk of deposit outflows through the internet.

VI. Operational Risk Management

A. IT System Risk Management Frameworks

Regarding whether financial institutions, in large-scale projects such as the move toward open and cloud core banking systems, are managing the various projects and outsourcee companies appropriately, the Bank will examine this while also investigating outsourcee companies, if necessary, and check deliberations for the next system (including joint systems to be used by regional financial institutions). Furthermore, focusing on financial institutions' critical computer systems, the Bank will examine the effectiveness of (1) measures to prevent computer system failures, such as their computer system maintenance and the duplication of critical systems; and (2) recovery frameworks in the event of a failure, including the planning and training for contingencies. The Bank will also examine financial institutions' computer systems from the perspective of whether their management is in line with the use of new technologies and services brought about by advances in DX, including generative AI. Moreover, in light of the growing trend toward financial institutions' business collaborations with third parties, such as the use of cloud computing and API linkages, the Bank will examine whether they appropriately manage third parties, including outsourcee companies, in terms of the management of the development and operation of projects, a collaborative framework at times of system failures, and information security, such as with regard to customer data. In addition, the Bank will examine the effectiveness of financial institutions' IT governance -- their own and that of their group companies, etc. -- from the perspective of whether management resources are allocated to ensure both the efficacy of their overall system management, including cybersecurity, and efficiency with regard to their investment in computer systems.

B. Cybersecurity Management Frameworks

With regard to the status of cybersecurity management frameworks, the Bank, while referring to the FSA's "Guidelines for Cybersecurity in the Financial Sector," will examine whether, given the increase in cybersecurity threats and taking individual financial institutions' business scope (including the use of cloud computing) into account, financial institutions thoroughly implement basic operations to ensure that the management of IT assets, countermeasures against vulnerabilities, the management of access privileges to important data such as customer information, and the management of security product configurations are appropriate and effective. Moreover, given that it is difficult to prevent cyberattacks completely, it will review whether frameworks to recover critical operations in case of cyber incidents are arranged and effective contingency plans are set, and also examine whether drills and the review of management frameworks reflecting the outcomes of such drills are conducted appropriately. It will also examine the appropriateness of financial institutions' management of third parties such as group companies and outsourcee companies.

In the joint surveys with the FSA on some major financial institutions, the Bank will deepen its dialogue on (1) the development of group-wide global risk management frameworks;

(2) cyber resilience ; (3) the management of third parties, considering cyber incidents; and (4) addressing changes in risk profiles, such as increases in API connections. In conducting on-site examinations, the Bank will avoid overlapping with the joint surveys.

In cooperation with the FSA, the Bank will continue to implement a self-assessment survey on cybersecurity management frameworks, such as for regional financial institutions, and encourage them to ascertain their preparedness and strengthen their countermeasures.

C. Compliance Management Framework

The Bank will examine whether financial institutions have taken measures to prevent the occurrence and recurrence of fraud and whether organizational checks and balances as well as internal controls, including internal audits and compliance frameworks, are functioning effectively. In addition, especially for institutions that focus on fee-based business, it will examine the status of compliance frameworks, including with regard to the management of the abuse of dominant bargaining positions and conflicts of interest in relation to sales of financial instruments and advisory services.

D. Anti-Money Laundering and Countering the Financing of Terrorism

Given strong international requests to take measures specific to anti-money laundering and countering the financing of terrorism, it is essential for financial institutions to steadily implement these measures to ensure the proper conduct of their business operations and to maintain their credibility. On this basis, in the on-site examinations, the Bank will continue to examine the frameworks in these areas while sharing its awareness and perspectives with the FSA through the framework of coordination between the FSA's inspections and the Bank's on-site examinations.

E. Administrative Risk Management

Given that financial institutions have actively taken measures such as concentration of business operations and review of branch networks and staff allocations, the Bank will examine (1) whether financial institutions adequately recognize changes in the risk profiles of business procedures associated with recent developments and (2) whether these institutions, including their major group companies and third parties such as their outsourcee companies and partners, have appropriately established and reviewed risk management frameworks in response to changes in risk profiles. It also will examine whether financial institutions identify risk management issues through understanding of the actual situation of operational processing and analysis of accidents, and take effective measures to address such issues.

F. Business Continuity Management

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. Based on this perspective, the Bank will continue to examine whether business continuity management is reviewed appropriately in response to recent natural disasters -- such as earthquakes, typhoons, and floods -- and pandemics and cyber incidents. In doing so, it will take account of individual financial institutions' business scope, as well as these institutions' presence in payment and settlement systems and in their respective business areas.[3]

[3] In the case of major financial institutions, etc., the Bank, given changes in the environment, such as increased dependence on IT systems and third parties, will conduct examinations also from the perspective of their operational resilience (the establishment of early recovery and continuity systems based on the assumptions that business operations may be disrupted even when all preventive measures have been taken) in the event of system failures, terrorism and cyberattacks, pandemics, natural disasters, etc.