

FSA FINANCIAL INSPECTIONS FINDINGS CASEBOOK
PROGRAM YEAR 2008

SAMPLE ONLY

July 2009
Inspection Bureau, Financial Services Agency

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The International Bankers Association prepared this translation with the intention of having the content represent the areas of the Japanese original selected for translation as accurately as possible. However, certain text has been excluded and there are differences in layout and pagination from the Japanese original.

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*(Note) Only that text which pertains to foreign bank branches has been translated.
Sections highlighted in gray above were purposely and fully excluded from this translation.
The original text, in Japanese, is available at: <http://www.fsa.go.jp/news/21/20090703-6/01.pdf>*

Introduction

The Financial Inspections Findings Casebook has been prepared and published with the aim of further improving the transparency and predictability of financial administration and encouraging financial institutions to strengthen their internal control systems in accordance with the principle of self-responsibility.

In its basic inspection policy for Program Year 2008 (July 2008 to June 2009), the Inspection Bureau of the Financial Services Agency established the following four areas of emphasis for inspections:

- 1) Establishment of risk management systems appropriate to each lending and financial instrument environment
- 2) Development of management systems by financial institutions engaged in international business expansion
- 3) Measures aimed at promoting user protection and improving user friendliness
- 4) Measures for smooth SME and regional financing

These were based on the five items listed in the preface of the Inspection Manual:

- 1) Verification focused on significant risk (a “risk-focused, forward-looking” approach)
- 2) In-depth causal analysis and clarifications leading to a substantial amelioration of problems
- 3) Identification of problem areas and evaluation of appropriate initiatives, static and dynamic verification of actual conditions
- 4) Clear indication of reasons for findings and ratings, clarification of matters that should be investigated for remediation
- 5) Thorough understanding of verification results (“sense of acceptance”)

This edition has been prepared with cases occurring in inspections concluded (with an inspection result notice) in Program Year 2008 (July 2008 to June 2009) on the basis of the above policy.

This edition has the following characteristics:

- 1) It strives to improve the number of cases introduced in order to continue the “enrichment of dialogue with financial institutions and the strengthening of information transmission” in “Initiatives for Better Regulation in Financial Inspections (Action Plan II)” (*1).
- 2) In continuation from the edition of the previous program year, this edition also introduces “Grade A” cases and “Grade B” cases to promote better regulation and to offer incentives to financial institutions to make voluntary and ongoing management improvements. “Grade B” cases are classified into three levels for comparison purposes: “Grade B close to A,” “Grade B average” and “Grade B close to C” (*2).

- 3) In light of the strong expectation that financial institutions should, in addition to engaging in appropriate and active risk-taking, actively demonstrate their financial intermediary function in regions through the provision of appropriate risk management systems, inspections in this program year have been conducted with an emphasis on “measures for smooth SME and regional financing” in the basic inspection policy. Therefore, it presents a large number of findings for “measures for smooth SME and regional financing”. As a result, since it is considered that the publication of as many such cases as possible will also serve as a reference for other financial institutions and contribute to the voluntary enhancement of risk management systems, this edition strives for improvement by publishing the examples as an independent category.
 - a. It introduces eight new “ratable cases” for “initiatives to provide smooth financing to SMEs” and five “cases where problems are acknowledged”.
 - b. It introduces six new “cases where problems are acknowledged” in initiatives to prevent “credit squeezes or credit withdrawal”.
 - c. If refusal of financing is done inappropriately, it could bring about issues similar to a so-called “credit squeeze or credit withdrawal”. This edition therefore extracts and reprints eleven cases of problems in systems because problems have been verified not only in the system of customer disclosure management but also in the initiatives to prevent so-called “credit squeezes or credit withdrawal”.
 - d. In continuation from the edition of the previous program year, this edition introduces eight “ratable cases” (seven in the edition of the previous program year) for “business restructuring initiatives” and two new “cases where problems are acknowledged”.

Since findings tend to vary with the size and characteristics of the financial institution, the Financial Inspections Findings Casebook groups cases under three categories for deposit-taking financial institutions: “major banks and foreign bank branches”; “regional banks”; and “credit unions and credit cooperatives”. It also groups cases under two categories for insurance companies: “life insurance companies” and “nonlife insurance companies”. Note, however, that in order to link this to voluntary and sustained improvement in the management of financial institutions it is beneficial to refer to cases without being confined to each category (although there may be differences in identification and evaluation depending on the size or characteristics of the financial institution, for cases of a similar type the case is rated/identified one way or another).

With rated cases, it is therefore essential to note that, even when the same events have occurred, rating and evaluation may vary given differences in the effects on management.

*1 The number of cases introduced has increased significantly from the previous year to 69 rated cases (65 in the previous program year) and 364 cases of identified problems (341 in the previous program year).

*2 Grade B classifications have been assigned to make the levels within Grade B easy to understand. This does not mean that the evaluation grades have changed.

<Deposit-taking financial institutions>

I. Management (governance) system: basic elements◆ **Rated cases**

- (1) **Although minor problems are acknowledged such as inadequate involvement by the management in the ALM committee and the failure to conduct regular reviews of matters such as the measurement and analysis of risk, the management system required for the size and characteristics has been established. 【Grade B close to A】**

Category, etc.

- Major banks and foreign bank branches
- Risky products account for a small percentage of the portfolio.

【Inspection results】

In the management system, the management committee, which is the highest decision-making body in Japan, formulates management policies and management plans. As well as approving personnel, budgets, and internal regulations for internal control systems, risk management systems, and organizational management, the management committee receives reports from relevant departments on important matters regarding the management of the branch concerned, including the execution and operational status of these matters, and discusses countermeasures.

In light of the finding in the previous inspection that “the efforts by top management in the Japan branch management to achieve compliance are unsatisfactory – besides the fact that there are no internal rules setting up the compliance committee, no members have been appointed, and the compliance officer has also not provided the leadership required,” an organizational structure has been provided through the establishment of internal rules setting up a compliance committee, the establishment of a compliance control division, and the appointment of a new compliance officer.

In addition, for the internal audit system, the internal audit division, which reports directly to the head office, implements internal audits according to an audit program drawn up every business year on instruction from head office. As well as reporting and notifying those audit results to the head office, branch management, and the division audited, the internal audit division has been following up the status of improvements made by the audited division in response to the findings.

In this case, the management committee’s inadequate monitoring of the ALM committee, which is a subcommittee of the management committee, resulted in a failure to regularly review the measurement and analysis of risk in changes in the external environment and in the current status of operations, which are supposed to be discussed and investigated according to internal rules. Nevertheless, there are no problem areas that have a significant impact, and the management system required for the size and characteristics has been established.