Checklist for Capital Management

I. Development and Establishment of Capital Management System by Management

【Checkpoints】

- Capital management refers to implementing measures to maintain sufficient capital, assessing its internal capital adequacy and calculating the capital adequacy ratio.

- It is extremely important for a financial institution to calculate the capital adequacy ratio and secure sufficient capital to cover risks it faces by developing and establishing a capital management system, from the viewpoint of ensuring the soundness and appropriateness of the institution's business. Therefore, the institution's management is charged with and responsible for taking the initiative in developing and establishing such a system.

- There are various capital management methods according to corporate management policies and other factors. In some cases, there may be two or more sets of policies and internal rules with regard to capital management, and the necessary tasks may be divided between two or more divisions because of the diversity of the tasks, including development and implementation of capital plans, assessment of capital adequacy, calculation of the capital adequacy ratio and capital allocation processes. In other cases, the Comprehensive Risk Management Division may concurrently undertake the task of capital management. The purpose of this manual is not to require the establishment of an independent division in charge of capital management, or to seek to bar a financial institution from having two or more divisions conduct capital management operations in accordance with their respective polices and internal rules as mentioned above.

In the case where two or more divisions engage in capital management in coordination with each other, the inspector should review whether the policies and internal rules adopted by the divisions and the tasks undertaken by them are compatible with one another and whether their respective capital management processes are functioning effectively. In the case where the Comprehensive Risk Management Division undertakes the task of internal capital adequacy assessment, review should be conducted by using both the check items concerning internal capital adequacy assessment as part of the capital management system and those concerning the comprehensive risk management system, and any problem with regard to capital adequacy should be examined as the issue of capital management system.

- It is important for the inspector to review whether a financial institution has a capital management system suited to the levels of complexity and sophistication of the internal capital adequacy assessment processes used by the institution. It should be noted that the type and level of the process of internal capital adequacy assessment to be used by a financial institution should be determined according to the institution's corporate management policy, the diversity of its business and the level of complexity of the risks faced by it, and therefore a complex or sophisticated process of internal capital adequacy assessment is not necessarily suited to all financial institutions.

- The inspector should determine whether the capital management system is functioning effectively and whether the roles and responsibilities of the institution's management are being appropriately performed by way of reviewing with the use of check items listed in Chapter I., whether or not the management is appropriately implementing (1) policy development, (2) development of internal rules and organizational frameworks and (3) development of a system for assessment and improvement activities.

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

- If the institution's management fails to recognize weaknesses or problems recognized by the inspector, it is also necessary to explore in particular the possibility that the Internal Control System is not functioning effectively and review findings thereof through dialogue.

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

1. Policy Development

(1) Roles and Responsibilities of Directors

Do directors attach importance to capital management, fully recognizing that the lack of such an approach could seriously hinder attainment of strategic objectives? In particular, does the director in charge of capital management review the policy and specific measures for developing and establishing an adequate capital management system with a full understanding of the assessment, monitoring and control techniques of internal capital adequacy as well as the importance of capital management, and with precise recognition of the current status of capital management based on such understanding? For example, do directors in charge understand the limitations and weaknesses of methods of the internal capital adequacy assessment and consider ways to supplement such shortcomings?

(2) Development and Dissemination of Capital Management Policy

Has the Board of Directors established a policy regarding capital management (hereinafter referred to as the “Capital management Policy”) and disseminated it throughout the institution? Is the appropriateness of the Capital Management Policy being secured by way of, for example, including clear statements on the following matters?[1]

- The roles and responsibilities of the director in charge and the Board of Directors or equivalent organization to the Board of Directors with regard to capital management
- The basic policy for maintaining sufficient capital
- The policy on organizational frameworks, such as establishment of a division concerning capital management (hereinafter referred to as the “Capital Management Division”) and the authority assigned thereto
- The policy on the risk limits in relation to the capital
- The definition of capital and risk as used in the internal capital adequacy assessment
- The policy on the assessment, monitoring and control of internal capital adequacy
- The policy on the calculation of the capital adequacy ratio
- The policy on capital allocation process (in the case where capital allocation process is conducted)

(3) Development and Dissemination of Corporate Management Plans

Has the Board of Directors developed corporate management plans in accordance with the corporate management policy and disseminated them throughout the institution? When developing corporate management plans, does the Board of Directors analyze how much capital the institution needs presently and will need in the future in light of the institution’s strategic objectives and take into consideration the desirable level of capital thus determined, the amount of capital that must be raised to achieve that level and suitable capital-raising methods? With regard to the capital level objectives, does the Board of Directors ensure its consistency with the institution’s risk profile and the situation surrounding its business?

(4) Development of Capital Plans, etc.

Has the Board of Directors, in accordance with the financial institution’s corporate management plans, its strategic objectives, the strategic objectives of various divisions and the

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[1] It is not necessary to develop a unified capital management policy that exhaustively covers all items that must be clearly specified, but it should suffice that all such items are covered by two or more policies established by divisions engaged in capital management and corporate management plans.

Capital Management Policy, developed capital plans, etc. designed to achieve an appropriate level of capital targeted by the institution? In the case where capital allocation process is conducted, do the capital plans, etc. clearly specify the basis for the calculation of capital to be allocated to risk (hereinafter referred to as the "Risk Capital") and the limits on capital to be allocated to each of the risk categories?

(5) Revision of Policy Development Process

Does the Board of Directors revise the policy development process in a timely manner by reviewing its effectiveness based on reports and findings on the status of capital management in a regular and timely manner or on an as needed basis?

2. Development of Internal Rules and Organizational Frameworks

(1) Development and Dissemination of Internal Rules

Does the Board of Directors or equivalent organization to the Board of Directors have the Managers of the Capital Management Division (hereinafter simply referred to as the "Manager" in this checklist) develop internal rules that clearly specify the arrangements concerning capital management（hereinafter referred to as the Capital Management Rules）, and disseminate them to the employees concerned in accordance with the Capital Management Policy? Has the Board of Directors or equivalent organization to the Board of Directors approved the Capital Management Rules after determining if they comply with the Capital Management Policy after legal checks, etc.?

(2) Definition of Capital as Used in Internal Capital Adequacy Assessment

Does the Board of Directors or equivalent organization to the Board of Directors clearly define capital as used in the internal capital adequacy assessment? Does it ensure the consistency of the definition of capital used in the internal capital adequacy assessment and the financial institution's corporate management policy and plans, its strategic objectives, etc. in light of the fact that building up capital means preparing for potential losses? Does the Board of Directors or equivalent organization to the Board of Directors make clear the basis for determining the definition of capital as used in the internal capital adequacy assessment in reference to its relation to capital as defined under regulations concerning capital adequacy ratios, Tier 1 and 2 capital, equity capital, etc?

(3) Establishment of Capital Management Division

(i) Does the Board of Directors or equivalent organization to the Board of Directors have the Capital Management Division established and have the division prepared to undertake appropriate roles in accordance with the Capital Management Policy and the Capital Management Rules?[2]

(ii) Has the Board of Directors allocated to the Capital Management Division a Manager with the necessary knowledge and experience to supervise the division and enabled the Manager to implement management business by assigning him/her the necessary authority therefor?

(iii) Has the Board of Directors or equivalent organization to the Board of Directors allocated to the Capital Management Division an adequate number of staff members with the necessary knowledge and experience to execute the relevant business and assigned such staff the authority necessary for implementing the business?[3]

(iv) Does the Board of Directors or equivalent organization to the Board of Directors keep the Capital Management Division in charge of the internal capital adequacy assessment and the calculation of the capital adequacy ratio independent from the Office (Trading, Banking) Divisions and the Marketing and Sales Division and secure a check-and-balance system?

(4) Disclosure

Does the Board of Directors or equivalent organization to the Board of Directors provide a system to disclose the information concerning capital adequacy as specified by Laws (including but not limited to laws and regulations, etc.; hereinafter referred to "Laws.") in a timely and appropriate manner based on a full understanding of the purpose thereof?

(5) The System for Reporting to Board of Directors and equivalent organizations to Board of Directors and Approval

Has the Board of Directors appropriately specified matters that require reporting and those that require approval and does it have the Manager report the current status to the Board of Directors and the Board of Directors or equivalent organization to the Board of Directors in a regular and timely manner or on an as needed basis or have the Manager seek the approval of the Board of Directors and equivalent organization to the Board of Directors on the relevant matters? For example, do the matters to enable the appropriate assessment and judgment of the matters listed below? In particular, does the Board of Directors ensure that the Manager, without delay, reports to the Board

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

[3] When a department or a post other than the Board of Directors or equivalent organization to the Board of Directors is empowered to allocate staff and assign them authority, the inspector shall review, in light of the nature of such a department or post, whether or not the structure of the Capital Management Division is reasonable in terms of a check-and-balance system and other aspects.

of Directors any matters that would seriously affect corporate management?

- The levels and trends of major risks and their impact on the capital
- Validity of the internal capital adequacy assessment process (including the definition of capital and the methods of determining the range of risks to be covered by capital management and evaluating such risks)
- Status of internal capital adequacy in light of the scale and nature of the financial institution’s business and its risk profile
- Consistency among the capital level objective and the institution’s risk profile and the situation surrounding its business
- Necessity for revising capital plans, etc.

(6) The System for Reporting to Corporate Auditor

In the case where the Board of Directors has specified matters to be directly reported to a corporate auditor, has it specified such matters appropriately and do they provide a system to have the Manager directly report such matters to the auditor? [4]

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

Does the Board of Directors or equivalent organization to the Board of Directors have the Internal Audit Division appropriately identify the matters to be audited with regard to capital management, develop guidelines that specify the matters subject to internal audit and the audit procedure (hereinafter referred to as “Internal Audit Guidelines”) and an internal audit plan, and approve such guidelines and plan?[5] For example, does it have the following matters clearly specified in the Internal Audit Guidelines or the internal audit plan and provide a system to have these matters appropriately audited?

- Status of development of the capital management system
- Eligibility of the institution’s capital under regulations on capital requirements in light of the purposes of “Criteria for Judging Whether A Financial Institution’s Own Capital Is Sufficient in Light of the Assets Held, etc. under the Provision of Article 14-2 of the Banking Law” (Notification No. 19 of 2006, the Financial Services Agency)” (hereinafter referred to as the “Notification”), the Basel agreement, and the “Instruments Eligible for Inclusion in Tier 1 Capital” (issued in 1998 by the Basel Committee on Banking Supervision)
- Status of compliance with the Capital Management Policy and the Capital Management

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

[5] The Board of Directors or equivalent organization to the Board of Directors only needs to have approved the basic matters with regard to an internal audit plan.

Rules, etc.

- Appropriateness of the internal capital adequacy assessment process commensurate with the scale and nature of business and the risk profile
- Appropriateness of the use of the internal capital adequacy assessment method taken in consideration of the limitations and the weaknesses thereof
- Validity of the internal capital adequacy assessment method (technique, assumptions), etc.
- Accuracy and completeness of the data used in the internal capital adequacy assessment
- Validity of scenarios, etc. used in stress tests
- Appropriateness of the process of calculating the capital adequacy ratio
- Status of improvement of matters pointed out in an internal audit or on the occasion of the last inspection

(8) Revision of the Development Process of Internal Rules and Organizational Frameworks

Does the Board of Directors or equivalent organization to the Board of Directors revise the development process of internal rules and organizational frameworks in a timely manner by reviewing their effectiveness based on reports and findings on the status of capital management in a regular and timely manner or on an as needed basis?

3. Assessment and Improvement Activities

1) Analysis and Assessment

(1) Analysis and Assessment of Capital Management

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

(2) Revision of Analysis and Assessment Processes

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

2) Improvement Activities

(1) Implementation of Improvements

Does the Board of Directors or equivalent organization to the Board of Directors provide a system to implement improvements in the areas of the problems and weaknesses in the capital management system identified through the analysis, assessment and review referred to in 3. 1) above in a timely and appropriate manner based on the results obtained by developing and implementing an improvement plan as required or by other appropriate methods?

(2) Progress Status of Improvement Activities

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

(3) Revision of the Improvement Process

Does the Board of Directors or equivalent organization to the Board of Directors revise the improvement process in a timely manner by reviewing its effectiveness based on reports and findings on the status of capital management in a regular and timely manner or on an as needed basis?

II. Development and Establishment of Capital Management System by Manager

【Checkpoints】

- This chapter lists the check items to be used when the inspector reviews the roles and responsibilities that must be performed by the Manager and the Capital Management Division.

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

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

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

1. Roles and Responsibilities of Manager

(1) Development and Dissemination of Capital Management Rules

Has the Manager, in accordance with the corporate management plans, capital plans, etc. and the Capital Management Policy, decided the internal capital adequacy assessment process and the method of monitoring thereof and developed the Capital Management Rules, based on a full understanding of the scale and nature of the financial institution's business and its risk profile as well as the capital management technique? Have the Capital Management Rules been disseminated to all of the relevant employees upon approval by the Board of Directors or equivalent organization to the Board of Directors?

(2) Capital Management Rules

Do the Capital Management Rules exhaustively cover the arrangements necessary for the internal capital adequacy assessment and the calculation of the capital adequacy ratio and specify the arrangements appropriately in a manner befitting the scale and nature of the financial institution's business and its risk profile? Do the rules specify the following items, for example?[6]

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[6] It is not necessary to develop a unified set of capital management rules that exhaustively covers all

- Arrangements on the roles, responsibilities and organizational framework of the Capital Management Division
- Arrangements on the establishment of Risk Capital limits (in the case where capital allocation process is conducted)
- Arrangements on the identification of risks subject to capital management in the internal capital adequacy assessment and the method of risk assessment
- Arrangements on the internal capital adequacy assessment method
- Arrangements on the monitoring method of capital adequacy
- Arrangements on periodic reviews of the internal capital adequacy assessment method
- Arrangements on the process of calculating the capital adequacy ratio
- Arrangements on the allocation of capital with regard to New Products[7] (in the case where capital allocation process is conducted)
- Arrangements on reporting to the Board of Directors or equivalent organization to the Board of Directors

(3) Development of Organizational Frameworks by Manager

(i) Does the Manager, in accordance with corporate management plans, capital plans, the Capital Management Policy and the Capital Management Rules, provide for measures to have the Capital Management Division exercise a check-and-balance system in order to conduct the system of capital management appropriately?

(ii) Has the Manager specified the information necessary for conducting an appropriate capital management befitting the financial institution's risk profile, and does he or she make sure to receive reports from divisions which hold the necessary information in a regular and timely manner or on an as needed basis? Does the Manager receive reports with regard to the following items, for example, in a timely and appropriately manner?

- Status of risks
- Status of compliance with the risk limits and use thereof
- Status of compliance with the Risk Capital limits and use thereof (in the case where capital allocation is conducted)
- Status of profits
- Validity of the risk assessment method (assessment and measurement technique, assumptions, etc.)

(iii) Has the Manager, for the purpose of calculating the capital adequacy ratio accurately, established a manual, etc. that specifies the calculation process, and does he or she provide a

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items that must be clearly specified, but it should suffice that all such items are covered by two or more sets of internal rules established by divisions engaged in capital management.

7 See "Checklist for Business Management (Governance) (for Basic Elements)," I. 3. (4).

system to obtain accurate raw data for calculation?

(iv) Does the Manager have in place computer systems[8] for the internal capital adequacy assessment and the calculation of the capital adequacy ratio with the high reliability suited to the scale and nature of the financial institution's business and its risk profile?

(v) Does the Manager ensure the provision of training and education to enhance the ability of employees to conduct capital management in an effective manner, thus developing human resources with relevant expertise?

(vi) Does the Manager provide a system to ensure that matters specified by the Board of Directors are reported in a regular and timely manner or on an as needed basis? In particular, does the Manager provide a system to ensure that matters that would seriously affect corporate management are reported to the Board of Directors without delay?

(4) Revision of Capital Management Rules and Organizational Frameworks

Does the Manager conduct monitoring on an ongoing basis with regard to the status of the execution of operations at the Capital Management Division? Does the Manager review the effectiveness of the capital management system in a regular and timely manner or on an as needed basis, and, as necessary, revise the Capital Management Rules and the relevant organizational framework, or present the Board of Directors or equivalent organization to the Board of Directors with proposals for improvement?

2. Roles and Responsibilities of Capital Management Division

1) Implementation of Measures for Capital Adequacy

(1) Implementation of Measures and Monitoring for Capital Adequacy

(i) Does the Capital Management Division smoothly implement measures for capital adequacy in accordance with corporate management plans and capital plans, etc.?

(ii) Does the Capital Management Division monitor changes in external environment, including the economic cycle from the viewpoint of smoothly implementing measures for capital adequacy?

(2) Maintenance of Capital Level

(i) Does the Capital Management Division conduct sufficient analysis and deliberations in order to maintain a sufficient level of capital based on the results of monitoring of the status of internal environment (risk profile, status of use of the risk limits, etc.) and external environment

[8] It should be noted that the computer system may be a centralized dataprocessing environment system, distribution processing system, or EUC (end user computing) type.

(economic cycle, market, etc.) as well as the validity of the assumptions?

(ii) Does the Capital Management Division assume the possibility of the institution failing to make a sufficient capital adequacy and examine feasible countermeasures to build up the capital base? Does the division conduct such an examination by taking into consideration the possibility in particular that a reputational risk will make it more difficult for the institution to raise capital than under normal conditions?

2) Internal Capital Adequacy Assessment

(1) Identification of Risks Subject to Capital Management in the Internal Capital Adequacy Assessment

(i) In the case where the Capital Management Division is in charge of risk identification, does the division identify risks faced by the institution exhaustively on a category-by-category basis and specify the risks to be subjected to capital management in the internal capital adequacy assessment in light of the size and nature of the identified risks? Does the Manager ensure that the identification process covers the full extent of business including those of overseas offices, consolidated subsidiaries and consignees, in addition to exhaustively covering the risk categories such as the credit risk, market risk and operational risk?

(ii) Does the Capital Management Division apply capital management to the credit concentration risk and the interest rate risk in the banking book in the internal capital adequacy assessment and is it considering whether to apply capital management to the risks not included in the calculation of the capital adequacy ratio? When there are risks not covered by capital management in the internal capital adequacy assessment, has the Capital Management Division made sure that their impact is negligible?

(2) Risk Assessment Method in Internal Capital Adequacy Assessment

In the case where the Capital Management Division is in charge of risk assessment, does the division assess risks appropriately in internal capital adequacy assessment with a risk assessment method befitting the scale and nature of the financial institution’s business and its risk profile? Does the division review the validity of the risk assessment and measurement techniques and the assumptions thereof, etc.? Does it review the following items, for example?

- Are the treatment of core deposits and the technique of measuring optional risks involved in assets and liabilities (nonlinear risks such as the risks of early termination and early redemption) appropriate when measuring the interest rate risk related to the banking book?
- When the scenario method is used to measure the risk quantity, is the scenario used appropriate?

- When VaR, a uniform yardstick to measure the risk quantity is employed, are the measuring technique, the holding period and the confidence level applied suited to the financial institution’s strategic objectives and risk profile?
- When the comprehensive risk measurement technique is employed, is consistency among various measurement techniques used ensured and is the method of adding up various risks reasonable?

(3) Internal Capital Adequacy Assessment

Does the Capital Management Division assess capital adequacy in a manner befitting the scale and nature of the financial institution’s business and its risk profile? Does it take into consideration the following items, for example?

- Is the quality of capital suited to the internal capital adequacy assessment?
- Are the method of internal capital adequacy assessment and risk assessment valid?
- Are limitations and weaknesses of the risk assessment method taken into consideration?
- Is the internal capital adequacy assessment conducted in light of two or more stress scenarios and based on the analysis of the level of the impact thereof on the capital? Do the stress scenarios give due consideration to all material risks that would seriously affect capital adequacy?
- Is the internal capital adequacy assessment conducted from medium- and long-term perspectives?
- Is a lack or excess of loan loss provisions against expected losses taken into consideration?
- In the case where losses are realized, are they taken into consideration in the internal capital adequacy assessment?
- In the case where a decline in earnings is expected to lead to losses, is the risk of changes in earnings taken into account?

3) Monitoring

(1) Monitoring of Capital Adequacy

Does the Capital Management Division, in accordance with the Capital Management Policy and the Capital Management Rules, conduct monitoring with regard to the status of capital adequacy with an appropriate frequency in light of the financial institution’s internal environment (risk profile, the status of the use of risk limits, etc.) and external environment (economic cycle, markets, etc.)? Does the division also conduct monitoring with regard to the status of internal and external environments and the validity of the assumptions?

(2) Reporting to Board of Directors or equivalent organization to Board of Directors

Does the Capital Management Division, in accordance with the Capital Management Policy and the Capital Management Rules, provide in a regular and timely manner or on an as needed basis information necessary for the Board of Directors or equivalent organization to the Board of Directors to make appropriate assessment and judgment with regard to the status of capital management and capital adequacy?

(3) Feedback to Relevant Divisions

Does the Capital Management Division feed back the results of its assessment, analysis and consideration with regard to the status of capital adequacy to relevant divisions as necessary?

4) Control

(1) Countermeasures to Case Where Unmanageable Risks Exist

In the case where risks not covered by capital management have non-negligible impact from the viewpoint of capital adequacy or where risks subject to capital management cannot be managed appropriately, does the Capital Management Division provide information necessary for the Board of Directors or equivalent organization to the Board of Directors to make decisions as to whether the financial institution should withdraw from or downsize the operations affected by those risks?

(2) Countermeasures to the Case Where Capital Adequacy is Insufficient

In the case where capital adequacy is insufficient, does the Capital Management Division promptly consider feasible countermeasures to build up the capital base and provide information necessary for the Board of Directors or equivalent organization to the Board of Directors to make decisions as to what specific countermeasures should be taken in the future?

5) Review and Revision

(1) Review and Revision of the Internal Capital Adequacy Assessment Method

Does the Capital Management Division grasp the limitations and weaknesses of the internal capital adequacy assessment method as well as changes in the internal and external environments, and regularly review whether the method suits the financial institution’s strategic objectives, the scale and nature of its business, and its risk profile and revise the method, or provide information necessary for the Board of Directors to make appropriate assessment and judgments? Does the division review and revise the following items, for example?

- Consistency of the definition of capital as used in the internal capital adequacy assessment with the corporate management policy, corporate management plans and strategic objectives, etc. and validity of the grounds for determining the definition

- Validity of identification of risks subject to capital adequacy in the internal capital adequacy assessment
- Validity of the risk assessment method used in the internal capital adequacy assessment (assessment and measurement techniques, assumptions, etc.)
- Validity of the internal capital adequacy assessment method
- Appropriateness of the use of the internal capital adequacy assessment method taken in consideration of its limitations and weaknesses

III. Specific Issues

【Checkpoints】

- Criteria for judging whether or not the status of a financial institution's capital adequacy is appropriate are specified in Article 14-2 of the Banking Law to enable judgments with regard to the soundness of the institution's corporate management. The Banking Law also specifies criteria for issuing an order for corrective measures in a prompt and appropriate manner with a view to encouraging financial institutions as necessary to take corrective action quickly.

- This chapter lists the check items to be used when the inspector reviews whether the capital adequacy ratio is calculated accurately in accordance with the Notification and other rules and procedures. It should be noted that relevant Laws should be taken into consideration when specific cases are examined with the use of the check items listed in this checklist.

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

- If the institution's management fails to recognize problems recognized by the inspector, it is also necessary to strictly explore in particular the possibility that the systems and processes listed in Chapter 1. are not functioning and review findings thereof through dialogue.
- The inspector should review the status of improvements with regard to the issues pointed out on the occasion of the last inspection that are not minor and determine whether or not effective improvement measures have been developed and implemented.

1. Accuracy of Calculation of Capital Adequacy Ratio

(1) Calculation Formula for Capital Adequacy Ratio

Is the capital adequacy ratio calculated according to the calculation formula specified in Article 2 (in the case of a consolidated-basis capital adequacy ratio under international standards established by the Basel Committee on Banking Supervision), Article 14 (in the case of a non-consolidated-basis capital adequacy ratio under international standards), Article 25 (in the case of a consolidated-basis capital adequacy ratio under domestic standards) and Article 37 (in the case of a non-consolidated-basis capital adequacy ratio under domestic standards) of the Notification?

(2) Range of Consolidation

Is the range of consolidation in accordance with Article 3 (in the case of a consolidated-basis capital adequacy ratio under international standards) and Article 26 ((in the case of a consolidated-basis capital adequacy ratio under domestic standards) of the Notification?

(3) Capital Amount

(i) Is the amount of Tier 1 (core) capital calculated as specified in Article 5 (in the case of a consolidated-basis capital adequacy ratio under international standards), Article 17 (in the case of a non-consolidated-basis capital adequacy ratio under international standards), Article 28 (in the case of a consolidated-basis capital adequacy ratio under domestic standards) and Article 40 (in the case of a non-consolidated-basis capital adequacy ratio under domestic standards) of the Notification?

(ii) Is the amount of Tier 2 (supplementary) capital calculated as specified in Article 6 (in the case of a consolidated-basis capital adequacy ratio under international standards), Article 18 (in the case of a non-consolidated-basis capital adequacy ratio under international standards), Article 29 (in the case of a consolidated-basis capital adequacy ratio under domestic standards) and Article 41 (in the case of a non-consolidated-basis capital adequacy ratio under domestic standards) of the Notification?

(iii) Is the amount of Tier 3 capital calculated as specified in Article 7 (in the case of a consolidated-basis capital adequacy ratio under international standards), Article 19 (in the case of a non-consolidated-basis capital adequacy ratio under international standards), Article 30 (in the case of a consolidated-basis capital adequacy ratio under domestic standards) and Article 42 (in the case of a non-consolidated-basis capital adequacy ratio under domestic standards) of the Notification?

(iv) Is the amount of items to be deducted from capital calculated as specified in Article 8 (in the case of a consolidated-basis capital adequacy ratio under international standards), Article 20 (in the case of a non-consolidated-basis capital adequacy ratio under international standards), Article 31 (in the case of a consolidated-basis capital adequacy ratio under domestic standards), and Article 43 (in the case of a non-consolidated-basis capital adequacy ratio under domestic standards) of the Notification?

(v) Does the institution pay attention to the following matters when considering the eligibility of its capital amounts?

- Are equity and other capital elements that involve the probability of redemption due to special provisions for step-up interest, etc. eligible as capital under Paragraph 2 of each of Articles 5, 17, 28 and 40 of the Notification?

- In the case where preferred securities are issued through an overseas special-purpose company, are the securities eligible as capital under Paragraphs 3 to 5, Article 5 and Paragraphs 3 to 6, Article 17 of the Notification.
- Is the amount of the tax effect equivalent (amount commensurate with deferred tax assets) included in the capital account amount tax effect equivalent (amount commensurate to deferred tax assets posted appropriately in light of the purposes of "Audit Treatment of Judgments with Regard to Recoverability of Deferred Tax Assets" (Report No. 66, the audit committee of the Japanese Institute of Certified Public Accountants) and other standards and operational guidelines concerning the tax effect accounting? With regard to the inclusion of deferred tax assets in Tier 1 capital, attention should be paid to Paragraph 7, Article 5, Paragraph 8, Article 17, Paragraph 3, Article 28, and Paragraph 3, Article 40 of the Notification.
- Are reserves for retirement allowances booked appropriately in the liabilities column in accordance with "Accounting Standards concerning Retirement Allowance Reserves" (June 16, 1998, Business Accounting Council) and "Operational Guidelines concerning Retirement Allowance Reserve Accounting" (Report No. 13, the accounting system committee of the Japanese Institute of Certified Public Accountants)?
- In the case where a subordinated loan is taken or a subordinated bond is issued, is the loan or the bond eligible as capital under Articles 6, 18, 29 and 41 of the Notification?
- Are "intentionally owned capital-raising instruments of other financial institutions" appropriately posted as a deduction item?

(4) Amounts of Credit Risks and Assets

(i) Are the amounts of credit risks and assets calculated as specified in Article 10 (in the case of a consolidated-basis capital adequacy ratio under international standards), Article 21 (in the case of a non-consolidated-basis capital adequacy ratio under international standards), Article 33 (in the case of a consolidated-basis capital adequacy ratio under domestic standards) and Article 44 (in the case of a non-consolidated-basis capital adequacy ratio under domestic standards) of the Notification?

(ii) In the case where the institution inspected falls under the category of institutions that adopt The Standardized Approach under Item 10, Article 1 of the Notification, the inspector should pay attention to the items included in a checklist for The Standardized Approach attached to the "Checklist for Credit Risk Management."

(iii) In the case where the institution inspected falls under the category of institutions that adopt The

Internal Ratings-Based Approach under Item 3, Article 1 of the Notification, the inspector should pay attention to the items included in a checklist for The Internal Ratings-Based Approach attached to the “Checklist for Credit Risk Management.”

(5) Total Sum of Market Risk Equivalent Amounts

(i) Is the total sum of market risk equivalent amounts calculated as specified in Article 11 (in the case of a consolidated-basis capital adequacy ratio under international standards), Article 22 (in the case of a non-consolidated-basis capital adequacy ratio under international standards), Article 34 (in the case of a consolidated-basis capital adequacy ratio under domestic standards) and Article 45 (in the case of a non-consolidated-basis capital adequacy ratio under domestic standards) of the Notification?

(ii) In the case where the institution inspected uses the Internal Model Approach under Article 272 of the Notification, the inspector should pay attention to the items included in Chapter III. 4. “Market Risk Measurement Technique” of the “Checklist for Market Risk Management.”

(6) Total Sum of Operational Risk Equivalent Amounts

(i) Is the total sum of operational risk equivalent amounts calculated as specified in Article 12 (in the case of a consolidated-basis capital adequacy ratio under international standards), Article 23 (in the case of a non-consolidated-basis capital adequacy ratio under international standards), Article 35 (in the case of a consolidated-basis capital adequacy ratio under domestic standards) and Article 46 (in the case of a non-consolidated-basis capital adequacy ratio under domestic standards) of the Notification?

(ii) In the case where the institution uses The Standardized Approach under Article 305 of the Notification, does it meet the criteria specified in Article 308 of the Notification on a continuous basis?

(iii) In the case where the institution falls under the category of institutions that adopt the Advanced Measurement Approaches as defined in Item 13, Article 1 of the Notification, does it calculate the risk equivalent amount as specified in Article 311 of the Notification? Does it also meet the criteria specified in Article 315 of the Notification on a continuous basis?

(7) Minimum Capital under Rules on Capital Requirements

With regard to institutions that adopt the Internal Ratings-Based Approach as defined in Item 3, Article 1 of the Notification and those that adopt the Advanced Measurement Approaches as defined in Item 13, Article 1 of the Notification, do they calculate the minimum capital allowed as specified in Article 13 (in the case of a consolidated-basis capital adequacy ratio under international standards), Article 24 (in the case of a non-consolidated-basis capital adequacy ratio under international standards), Article 36 (in the case of a consolidated-basis capital adequacy ratio under domestic standards) and Article 47 (in the case of a non-consolidated-basis capital adequacy ratio under domestic standards) of the Notification?