

Checklist for Liquidity Risk Management

I. Development and Establishment of Liquidity Risk Management System

【 Checkpoints 】

- Liquidity risk is the risk that a financial institution will incur losses because it finds it difficult to secure the necessary funds or is forced to obtain funds at far higher interest rates than under normal conditions due to a mismatch between the maturities of assets and liabilities or an unexpected outflow of funds (referred to as funding-liquidity risk). It is also the risk that a financial institution will incur losses because it is unable to conduct market transactions or is forced to conduct transactions at far more unfavorable prices than under normal conditions due to a market crisis and the like (referred to as market-liquidity risk).
- The development and establishment of a system for liquidity risks management is extremely important from the viewpoint of ensuring the soundness and appropriateness of a financial institution's business. Therefore, the institution's management is charged with and responsible for taking the initiative in developing and establishing such a system.
- It is important for the inspector to review whether the liquidity risk management system developed is an appropriate one suited to the financial institution's strategic objectives, the scale and nature of its business and its risk profile.
- This checklist is compiled on the assumption that at the institution inspected, the Liquidity Risk Management Division is dedicated to the task of liquidity risk management and the Funds Management Division is dedicated to the task of funds management. The inspector should bear in mind that the scope of the roles and responsibilities of such divisions varies from institution to institution and review whether the liquidity risk management system as a whole is functioning effectively.
- The inspector should determine whether the liquidity risk 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 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 liquidity risk management, fully recognizing that the lack of such an approach could lead directly to bankruptcy in some cases? In particular, does the director in charge of liquidity risk management review the policy and specific measures for developing and establishing an adequate liquidity risk management system with a full understanding of the scope, types and nature of risks, and the techniques of identification, assessment, monitoring and control regarding liquidity risk as well as the importance of liquidity risk management, and with precise recognition of the current status of liquidity risk management within the financial institution based on such an understanding?

(2) Development and Dissemination of Liquidity Strategy

Has the Board of Directors developed a liquidity strategy consistent with the strategic objectives of the financial institution as a whole and disseminated it throughout the institution? When developing the liquidity strategy, does the Board of Directors also ensure its consistency with the strategic objectives of operational divisions, take account of the assets and liabilities structure, marketability and liquidity on a currency-by-currency basis, a product-by-product basis and a term-by-term basis as well as its capital status?

(3) Development and Dissemination of Liquidity Risk Management Policy

Has the Board of Directors established a policy regarding liquidity risk management (hereinafter referred to as the "Liquidity Risk Management Policy") and disseminated it throughout

the institution? Is appropriateness of the Liquidity Risk Management Policy secured by, for example, including clear statements on the following matters?

- 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 liquidity risk management
- The policy on organizational framework, such as establishment of a division concerning liquidity risk management (hereinafter referred to as the “Liquidity Risk Management Division”) and a division concerning funds management (hereinafter referred to as the “Funds Management Division) and the authority assigned thereto
- The policy on setting of liquidity risk limits
- The policy on the allocation of the roles and responsibilities of the Liquidity Risk Management Division and the Funds Management Division
- The policy on identification, assessment, monitoring, control and mitigation of liquidity risks
- The policy on liquidity crisis management

(4) 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 liquidity risk 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 Manager of the Liquidity Risk Management Division develop internal rules that clearly specify the arrangements concerning liquidity risk management (hereinafter referred to as the “Liquidity Risk Management Rules”) and disseminate them throughout the institution in accordance with the Liquidity Risk Management Policy? Has the Board of Directors or equivalent organization to the Board of Directors approved the Liquidity Risk Management Rules after determining if they comply with the Liquidity Risk Management Policy after legal checks, etc.?

(2) Establishing of Appropriate Limits

Does the Board of Directors or equivalent organization to the Board of Directors in accordance with the Liquidity Risk Management Policy and the Liquidity Risk Management Rules, establish appropriate limits suited to the scale and nature of the institution’s business and its risk profile, financial conditions and fund-raising capacity (funding gap limits from the viewpoint of funds risk and position limits from the viewpoint of market liquidity risk)? Does the Board of

Directors or equivalent organization to the Board of Directors revise the method of establishing limits and the limits established in a regular and timely manner or on an as needed basis?

(3) Establishment of Liquidity Risk Management and Funds Management Divisions

- (i) Does the Board of Directors or equivalent organization to the Board of Directors have a Liquidity Risk Management Division and a Funds Management Division established and have the divisions prepared to undertake appropriate roles in accordance with the Liquidity Risk Management Policy and the Liquidity Risk Management Rules?¹
- (ii) Has the Board of Directors allocated to the Liquidity Risk Management Division and the Funds Management Division Managers with the necessary knowledge and experience to supervise these divisions and enabled the Managers to implement management business by assigning them the necessary authority therefor?
- (iii) Has the Board of Directors or equivalent organization to the Board of Directors allocated in the Liquidity Risk Management Division and the Funds Management Division an adequate number of staff members with the necessary knowledge and experience to execute the relevant operations and assigned such staff the authority necessary for implementing the operations?²
- (iv) Does the Board of Directors or equivalent organization to the Board of Directors secure a check-and-balance system of the Liquidity Risk Management Division by ensuring its independence from the Funds Management Division, the Office (Trading, Banking) Divisions, Marketing and Sales Divisions, etc.?

(4) Development of Liquidity Risk Management System in Funds Management Division, Office (Trading, Banking) Divisions, Marketing and Sales Divisions, etc.

- (i) Does the Board of Directors or equivalent organization to the Board of Directors provide arrangements to fully disseminate the relevant internal rules and operational procedures to divisions exposed to liquidity risks subject to risk management (e.g. Funds Management Division, Office (Trading, Banking) Divisions, Marketing and Sales Divisions) and have such divisions observe them? For example, does the Board of Directors or equivalent organization to the Board

¹ When the liquidity risk management division and the funds management division are not established as independent divisions (e.g. when divisions in charge of other business also take charge of liquidity risk management and funds management operations or when Managers, instead of divisions or departments take charge of liquidity risk management and funds management), the inspector shall review whether or not such a system is sufficiently reasonable and provides the same functions as in the case of establishing independent divisions commensurate with the scale and nature of the institution and its risk profile.

² When a department or a person in a post other than those relating to 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 structures of the Liquidity Risk Management Division and the Funds Management Division are reasonable in terms of a check-and-balance system and other aspects.

of Directors instruct the Manager of the Liquidity Risk Management Division to identify the internal rules and operational procedures that should be observed by such divisions and to carry out specific measures for ensuring observance such as providing effective training on a regular basis?

(ii) Does the Board of Directors or equivalent organization to the Board of Directors provide a system to ensure the effectiveness of liquidity risk management in the Funds Management Division, the Office (Trading, Banking) Divisions, Marketing and Sales Divisions, etc. through the Manager or the Liquidity Risk Management Division ?

(5) System for Reporting to Board of Directors or equivalent organization to Board of Directors and Approval

Has the Board of Directors or equivalent organization to the Board of Directors appropriately specified matters that require reporting and those that require approval and does it have the Managers of the liquidity risk management and Funds Management Divisions report the current status to 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 Managers seek the approval of the Board of Directors or equivalent organization to the Board of Directors on the relevant matters? In particular, does it ensure that the Managers report to the Board of Directors or equivalent organization to the Board of Directors without delay any matters that would seriously affect corporate management?

(6) System for Reporting to Corporate Auditor

In the case that 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 of the Liquidity Risk Management Division directly report such matters to the auditor?³

(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 liquidity risk 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?⁴ 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?

³ 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.

⁴ 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.

- Status of development of the liquidity risk management system
- Status of compliance with the Liquidity Risk Management Policy, Liquidity Risk Management Rules, etc.
- Appropriateness of the liquidity risk management computer system⁵
- Appropriateness of the liquidity risk management processes commensurate with the scale and nature of the business and risk profile
- Validity of the methods of liquidity risk analysis and assessment and the underlying assumptions, etc.
- Validity of the method of liquidity risk measurement (technique, assumptions, etc.)(in the case where liquidity risk is measured)
- Effectiveness of the liquidity crisis management
- Status of improvement of matters pointed out in an internal audit or on the occasion of the last inspection

(8) Revision of 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 liquidity risk 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 Liquidity Risk 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 liquidity risk management system and the particulars thereof, and appropriately review their causes by precisely analyzing the status of liquidity risk management and assessing the effectiveness of liquidity risk management, based on all information available regarding the status of liquidity risk 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?

⁵ It should be noted that the computer system may be a centralized dataprocessing environment system, distribution processing system, or EUC (end user computing) type. The same shall apply hereafter.

(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 liquidity risk management in a regular and timely manner or on an a 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 liquidity risk 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 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 liquidity risk management in a regular and timely manner or on an as needed basis?

II. Development and Establishment of Liquidity Risk Management System by Managers

【 Checkpoints 】

- This chapter lists the check items to be used when the inspector reviews the roles and responsibilities that must be performed by the Liquidity Risk Management and Funds Management Divisions as well as their Managers. The inspector should bear in mind that the scope of the roles and responsibilities of such divisions varies according to the scale and nature of businesses of financial institutions and their risk profile, etc. and review whether the liquidity risk management as a whole is functioning effectively.
- 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 1. 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 Managers of the Liquidity Risk Management Division and the Funds Management Division

(1) Development of Liquidity Risk Management Rules

Has the Manager, in accordance with the Liquidity Risk Management Policy, identified risks, decided the methods of assessment and monitoring thereof and developed the Liquidity Risk Management Rules that clearly define the arrangements on risk control and mitigation, based on a full understanding of the scope, types and nature of risk and the relevant liquidity risk management technique?

Have the Liquidity Risk Management Rules been disseminated throughout the institution upon approval by the Board of Directors or equivalent organization to the Board of Directors?

(2) Liquidity Risk Management Rules

Do the Liquidity Risk Management Rules exhaustively cover the arrangements necessary for the liquidity risk management 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:

- Arrangements on the roles, responsibilities, and organizational framework of the Liquidity Risk Management Division and Funds Management Division
- Arrangements on criteria for identifying and reporting factors that may affect liquidity risks
- Arrangements on the methods of liquidity risk analysis and assessment
- Arrangements on the liquidity risk monitoring method
- Arrangements on the establishing of liquidity risk limits
- Arrangements on categorization of the urgency level of funds needs and judgment criteria
- Arrangements on the methods of management, reporting, decision-making and response with regard to the urgency level categorization of funds needs
- Arrangements on response by the financial institution as a whole in the event of a liquidity crisis
- Arrangements on reporting to the Board of Directors or equivalent organization to the Board of Directors

(3) Development of Contingency Plan for Liquidity Crisis

Does the Manager of the Liquidity Risk Management Division develop a contingency plan for a liquidity crisis in accordance with the Liquidity Risk Management Policy and the Liquidity Risk Management Rules? Does the contingency plan clearly specify the definition of a liquidity crisis, the procedures for dissemination and reporting in the event of a liquidity crisis (such as procedures for reporting directly to the representative directors), the method to respond to a liquidity crisis (securing of fund-raising instruments), the decision-making authority/the line of command, etc.? Is the contingency plan disseminated throughout the institution upon approval by the Board of Directors or equivalent organization to the Board of Directors?

(4) Development of Organizational Frameworks by Managers of the Liquidity Risk Management Division and Funds Management Division

- (i) Do the Managers of the Liquidity Risk Management Division, in accordance with the Liquidity Risk Management Policy and the Liquidity Risk Management Rules, provide for measures to have the Liquidity Risk Management Division exercise a check-and-balance system in order to conduct liquidity risk management appropriately?
- (ii) Does the Manager of the Liquidity Risk Management Division provide a system to report

promptly to the Comprehensive Risk Management Division when detecting any weaknesses or problems of the liquidity risk management system that may affect comprehensive risk management?

(iii) Does the Manager of the Liquidity Risk Management Division provide a system to identify the risks inherent in New Products as specified in the Comprehensive Risk Management Policy, etc. in advance and report them to the Comprehensive Risk Management Division when requested to do so by the division?⁶

(iv) Do the Managers of the Liquidity Risk Management and Funds Management Divisions identify information necessary for conducting liquidity risk management in a manner suited to the institution's risk profile, such as information concerning movements in large-lot transactions, and provide a system to obtain such information from the divisions holding it in a regular and timely manner or on an as needed basis?

(v) Do the Managers of the Liquidity Risk Management and Funds Management Divisions have in place a liquidity risk management computer system with the high reliability suited to the scale and nature of the financial institution's business and its risk profile?

(vi) Do the Managers of the Liquidity Risk Management and Funds Management Divisions ensure the provision of training and education to enhance the ability of employees to conduct liquidity risk management in an effective manner, thus developing human resources with relevant expertise?

(vii) Do the Managers of the Liquidity Risk Management and Funds Management Divisions provide a system to ensure that matters specified by the Board of Directors or equivalent organization to the Board of Directors are reported in a regular and timely manner or on an as needed basis? In particular, do the Managers provide a system to ensure that matters that would seriously affect corporate management are reported to the Board of Directors or equivalent organization to the Board of Directors without delay?

(5) Revision of Liquidity Risk Management Rules and Organizational Frameworks

Do the Managers of the Liquidity Risk Management Division conduct monitoring on an ongoing basis with regard to the status of the execution of business operations at the Liquidity Risk Management Division and the Funds Management Division? Do the Managers review the effectiveness of the liquidity risk management system in a regular and timely manner or on an as needed basis, and, as necessary, revise the Liquidity Risk 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?

⁶ See "Checklist for Business Management (Governance) (for Basic Elements)," I. 3. (4).

2. Roles and Responsibilities of Liquidity Risk Management Division

1) Identification and Assessment of Liquidity Risks

(1) Identification of Factors that May Affect Liquidity Risks

- (i) Does the Liquidity Risk Management Division identify endogenous and exogenous factors that may affect liquidity risks? Does the division, based on an understanding that credit, market and operational risks may affect liquidity risks, identify large-lot fund movements, deterioration in the account settlement condition, a sharp market decline, and malfunctioning of the administrative processing computer system, for example, as factors that may affect liquidity risks?
- (ii) Does the Liquidity Risk Management Division identify the focus of liquidity risks and their impacts in advance when the financial institution starts the handling of New Products, purchases new products, introduces a new computer system and begins business at overseas offices and subsidiaries?

(2) Comprehensive Management of Liquidity Risks

Does the Liquidity Risk Management Division, in addition to managing liquidity risks on an office-by-office basis and a currency-by-currency basis, manage liquidity risks in an integrated manner? Does the division have a grasp on the funds status of consolidated subsidiaries that may affect the financial institution's liquidity risks?

(3) Assessment of Liquidity Risks

- (i) Does the Liquidity Risk Management Division conduct analysis and assessment of liquidity risks in a manner befitting the scale and nature of the institution's business and its risk profile? Does its assessment of liquidity risks reflect the analysis of the following items, for example?
- Nature of various currencies handled in and outside Japan
 - Product-by-product liquidity status (market size, depth, etc)
 - Deviation of loan provision and deposit-taking plans from the actual results
 - Overall funds status of the institution as a whole and office-by-office and currency-by-currency funds status
 - Breakdown of funds raised and invested by currency, product and maturity and outstanding amounts thereof
 - Status of market-based fund-raising
 - Balances of the credit received and provided on a contract basis
 - Status of dependency on specific sources for fund procurement (concentration risk)
 - Status of dependency on the Bank of Japan for fund procurement

- Outstanding amount of payment reserve assets
- Status of collateral management

(ii) Does the Liquidity Risk Management Division analyze and assess liquidity risks based on two or more scenarios that take account of both endogenous and exogenous factors commensurate with the status of assets and liabilities management and the capital status?

(4) Judgment of Urgency Level of Funds Needs

Does the Liquidity Risk Management Division, in coordination with the Funds Management Division, collect and analyze information concerning internal environments such as the institution's risk profile and external environments such as the economic and market conditions and appropriately judge the current urgency level category of funds needs that should be applied to the institution?

(5) Method of Liquidity Risk Measurement

In the case where the Liquidity Risk Management Division measures liquidity risks as such and measures liquidity risks within the operational risk category, does it ensure the consistency of the measurement method (technique, assumptions, etc.) with the methods of monitoring various liquidity risks and evaluating capital buildup?

2) Monitoring

(1) Monitoring of Liquidity Risks

Does the Liquidity Risk Management Division, in accordance with the Liquidity Risk Management Policy and the Liquidity Risk Management Rules, obtain reports from the Funds Management Division, collect information concerning the internal environments such as the institution's risk profile and external environments such as the economy and the market, analyze the reports and information and monitor these conditions on an ongoing basis? Is the information examined by the division useful for liquidity risk management?

(2) Monitoring of Status of Compliance with Limits

Does the Liquidity Risk Management Division appropriately monitor the status of compliance with the funds gap limits, limits on market-based fund-raising and position limits established by the institution and the status of the use thereof?

(3) Monitoring of Appropriateness of Judgment of Urgency Level Category of Funds Needs

Does the Liquidity Risk Management Division monitor the status of various indexes used as criteria for judging the urgency level category of funds needs and the appropriateness of the

criteria?

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

Does the Liquidity Risk Management Division, in accordance with the Liquidity Risk Management Policy and the Liquidity Risk 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 an appropriate assessment and judgment with regard to the status of the liquidity risk management and the status of the risks? Does the division report the following items, for example?

- Factors that may seriously affect liquidity risks
- External environment conditions such as the economic and market conditions
- Urgency of funds needs
- Level and trend of liquidity risk
- Status of compliance with limits and use thereof

(5) Feedback to Funds Management and The Office (Trading, Banking) Divisions

Does the Liquidity Risk Management Division feed back the results of its assessment, analysis and examination of the status of liquidity risks to the Funds Management and the Office (Trading, Banking) Divisions, etc.?

3) Control and Mitigation

(1) Response to Breach of Risk Limits

In the case where the financial institution has exceeded the funds gap limits, limits on market-based fund-raising and position limits, etc., does the Liquidity Risk Management Division provide information necessary for the Board of Directors or equivalent organization to the Board of Directors without delay to decide what measures should be taken?

(2) Response to Change in Urgency Level of Funds Needs

In the case where the urgency level category of funds needs applied to the institution changes or is likely to change, does the Liquidity Risk Management Division provide information concerning the urgency of funds needs, future prospects and other matters to the Board of Directors or equivalent organization to the Board of Directors without delay in order to enable the development of countermeasures?

(3) Securing of Funding Instruments in the Event of a Liquidity Crisis

Does the Liquidity Risk Management Division constantly keep track of the outstanding

amount of assets that can be immediately sold or used as collateral in and outside Japan (e.g. government bonds) and the amount of funds that can be raised from yen investments, yen conversions, etc. and the possible timing of such funding? Does the division also secure funding instruments in anticipation of a future liquidity crisis, for example by having the Funds Management Division obtain credit lines from central banks and commercial banks?

4) Verification and Revision

(1) Verification of Validity of Identification of Factors Affecting Liquidity Risks and Revision of Criteria for Reporting Thereof

Does the Liquidity Risk Management Division verify and revise the validity of identification of endogenous and exogenous factors that may affect liquidity risks in a regular and timely manner or on an as needed basis?

Does it review the appropriateness of the criteria for reporting of such factors in a regular and timely manner or on an as needed basis in light of internal environments such as the scale and nature of the institution's business and its risk profile as well as external environments such as market and economic conditions, and revise the criteria?

(2) Revision of Methods of Liquidity Risk Analysis and Assessment

Does the Liquidity Risk Management Division review in a regular and timely manner or on an as needed basis whether the methods of analyzing and assessing liquidity risks are suited to the scale and nature of the institution's business and its risk profile as well as external environments, and revise the methods? In particular, is it ensured that the assumptions used in analysis and assessment remains effective on an ongoing basis?

(3) Revision of Method of Establishing Limits and Limits Established

Does the Liquidity Risk Management Division review in a regular and timely manner or on an as needed basis whether the method of establishing limits and the limits established are suited to the scale and nature of the institution's business and its risk profile, financial conditions and funding capacity by conducting an impact evaluation under two or more stress scenarios and analyzing and assessing endogenous and exogenous factors that may affect liquidity risks?

When a revision is deemed as necessary, does the Liquidity Risk Management Division provide information necessary for the Board of Directors or equivalent organization to the Board of Directors without delay to make appropriate assessment and judgment?

(4) Revision of Urgency Level Category of Funds Needs and Judgment Criteria

Does the Liquidity Risk Management Division review the appropriateness of the urgency

level category of funds needs, the judgment criteria and the methods of management, reporting and decision-making in a regular and timely manner or on an as needed basis by conducting an impact evaluation under two or more stress scenarios and verifying the effectiveness of countermeasures from the following viewpoints, and conduct a revision thereof?

- Is the categorization of the urgency level of funds needs an appropriate one that takes account of specific funds statuses (e.g. “normal” “needs care,” and “crisis”) and the corresponding countermeasures?
- Does the institution ensure that the categorization judgment criteria are sufficiently specific and easy-to-understand to enable appropriate and timely action? For example, does the institution set two or more judgment criteria items such as the ratings assigned to the institution by rating agencies, the institution’s stock price, corporate bond spread, deposit balance trend, and extra interest cost imposed on its market-based funding and the shortening of the maturity of funds raised from the market as a way to determine the urgency level of its funds needs in an appropriate and timely manner or on an as needed basis?
- Are the methods of management, reporting and decision-making effective ones that take account of a broad range of countermeasures in terms of both assets and liabilities and enable responses suited to the urgency level of funds needs?

(5) Revision of Liquidity Crisis Contingency Plan

Does the Liquidity Risk Management Division regularly review the effectiveness of a contingency plan to be implemented in the event of a liquidity crisis by having the Funds Management Division, Marketing and Sales Division, etc. conduct crisis simulation exercises? When a need to revise the contingency plan arises due to a change in the environment surrounding the institution, does the division revise without any delay upon approval by the Board of Directors or equivalent organization to the Board of Directors (by the Board of Directors in the case of an important revision)?

3. Roles and Responsibilities of Funds Management Division

(1) Appropriate Funds Operation and Management

Does the Funds Management Division, in accordance with the liquidity strategy, the Liquidity Risk Management Policy, the Liquidity Risk Management Rules, etc., conduct appropriate funds operation based on the analysis of information collected with regard to internal environment such as the institution’s risk profile and external environment such as the economic and market environments? In its funds operations, does the division conduct liquidity assessment in terms of both assets and liabilities and comprehend the status of securing of liquidity such as the amount of

funds that can be raised and the timing thereof and the value of collateral that can be provided and the timing thereof?

(2) Compilation of Funds Timetable

Does the Funds Management Division compile a timetable of planned funds operations broken down by office and currency on daily, weekly, monthly and quarterly bases?

(3) Grasp of Impact on Funds Management

Does the funds management manage the following items so as to grasp their impact on funds management?

- Centralized control of large-lot fund movements
- Management of procurement of market-based funds
- Management of the structure of funds invested and raised broken down by product, currency and maturity
- Management of collateral
- Management of deposit maturity
- Balances of the credit received and provided on a contract basis
- Management of payment reserve assets
- Cash management (including management of ATMs)
- Currency-by-currency funds management
- Funds management with due consideration for exchanges between different currencies

(4) Grasp of Amounts of Planned Fund Investment and Possible Funding

Does the Funds Management Division, based on information from Marketing and Sales Division, etc., keep track of the amount of funds to be invested (the amount of loans and guarantees to be provided) and the amount of funds that can be raised (funds that can be raised from the interbank and open markets, deposits expected to be taken and cancelled, etc.)? Does the Funds Management Division make sure to obtain necessary reports and information from Marketing and Sales Division in a timely manner so as to accurately grasp the amounts of funds to be invested and funds that can be raised? In order to grasp these amounts, does the division give due consideration to the following items?

- Off-balance sheet transactions
- Commitment lines
- Current account overdrafts
- Grasp of actual investment maturities (e.g. in the case where funds are nominally invested for the short term but actually invested for the long term)

- Status of dependency on specific sources for fund procurement (concentration risk)
- Dependency on the Bank of Japan for fund procurement
- Urgency level of funds needs (e.g. “normal,” “needs care” and “crisis”)
- Reserves for deposit withdrawals (cash on hand, funds deposited at other institutions)

(5) Liquidity Crisis Management

Does the Funds Management Division at all times conduct funds management in light of the trading environment so as to keep the institution ready to liquidate assets smoothly in the event of a liquidity crisis through means such as the sale of securities?

(6) Control and Mitigation of Liquidity Risks

- (i) Does the Funds Management Division control liquidity risks in accordance with the liquidity strategy, the Liquidity Risk Management Policy, the Liquidity Risk Management Rules, etc.?
- (ii) Does the Funds Management Division conduct funds operations in a manner complying with the limits set?

(7) Securing of Funding Instruments in the Event of Liquidity Crisis

Does the Funds Management Division constantly keep track of the outstanding amount of assets that can be immediately sold or used as collateral in and outside Japan (e.g. government bonds) and the amount of funds that can be raised from yen investments, yen conversions, etc. and the possible timing of such funding? Does it also secure funding instruments in anticipation of a possible liquidity crisis by obtaining credit lines from central banks and commercial banks?

(8) Reporting to Liquidity Risk Management Division

Does the Funds Management Division report to the Liquidity Risk Management Division on a regular basis or as necessary according to the level of urgency the results of its analysis of information collected with regard to internal environment such as the institution’s risk profile and external environment such as the economic and market conditions as well as the current status of funds management and future prospects?

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

Does the Funds Management Division report to the representative directors and the director in charge the current status of funds management and future prospects on a regular basis or as necessary according to the level of urgency? Does it also make such a report to the Board of Directors or equivalent organization to the Board of Directors in a regular and timely manner or on an as needed basis? Does the Board of Directors or equivalent organization to the Board of Directors

review whether the findings of such reports are in compliance with the Liquidity Risk Management Policy?

III. Specific Issues

【 Checkpoints 】

- This chapter lists the check items to be used when the inspector reviews specific issues particular to the actual status of liquidity risk management.

- 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 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 The Office (Trading, Banking) Divisions and The Marketing and Sales Divisions

(1) Investment with Due Consideration for Market Liquidity Risk

Do the Office (Trading, Banking) Divisions make investments with due consideration for the size and depth of the market and liquidity for each product? When investing in a long-term investment product for which early redemption of the contract is difficult⁷, for example, do the Office (Trading, Banking) Divisions take account of various risks (credit, market risks, etc) involved in the gap between the maturities of funds invested and raised and consider an extraordinary long-term financing plan?

(2) Reporting of Factors Affecting Liquidity Risks

In the case where a factor affecting liquidity risks and meeting the criteria for reporting arises, do the Office (Trading, Banking) Divisions and The Marketing and Sales Divisions report it

⁷ Including structured bonds and loans which require high fees and penalties in the event of an early redemption

promptly to the Liquidity Risk Management Division and the Funds Management Division in accordance with the relevant internal rules and operational procedures?

2. Roles and Responsibilities of ALM Committee, etc.⁸

(1) Development of Liquidity Strategy

- (i) Is an ALM Committee, etc., as an entity that participates in the development and implementation of the investment strategy, involved in the development of a liquidity strategy?
- (ii) Does the ALM Committee, etc., in accordance with the liquidity strategy, the Liquidity Risk Management Policy and the Liquidity Risk Management Rules, discuss the management of assets and liabilities, including long term investment for business relationships and off-balance sheet assets and liabilities, from the viewpoint of liquidity by making effective use of the findings of the analysis and examination conducted by the relevant divisions? Does the ALM Committee, etc. report its findings to the Board of Directors?

(2) Framework of ALM Committee, etc.

Is there a system to ensure that important information related to the Funds Management Division and the Office (Trading, Banking) Divisions is provided to the ALM Committee, etc. in a timely and appropriate manner? Is the definition of the important information that must be provided to the ALM Committee, etc. specified by the internal rules?

⁸ In the case where an ALM Committee, etc. is not in place, the inspector should review whether an alternative risk management process is performing necessary functions.