

(Provisional translation)

September 5, 2008

Financial Services Agency

## **Annual Supervisory Policies for Insurance Companies, etc. for Program Year 2008**

The Financial Services Agency (FSA) has established the “Comprehensive Guidelines for the Supervision of Insurance Companies” which show basic approaches for the supervisory processes aimed at insurance companies. The FSA has also established the “Supervisory Guidelines for Small-amount and Short-term Insurance Providers,” addressing the system of small-amount and short-term insurance business created in April 2006.

The FSA publishes its supervisory policies for each program year so as to clarify the supervisory priorities of insurance companies, etc.<sup>1</sup> in consideration of these supervisory guidelines.

At the time of establishing the Annual Supervisory Policies for Insurance Companies, etc. for Program Year 2008, global financial markets remain tense, triggered by the subprime mortgage problem. Furthermore, the economy is weakening, and is exposed to further downside risks depending on movements in crude oil prices and other factors<sup>2</sup>.

In such an environment, insurance companies, etc. are expected to run their businesses with the view of further improving security and convenience for policyholders in consideration of the public nature of insurance business, and to contribute to greater stability of daily lives of the citizens and other such benefits. They are also expected to meet users’ needs, including medical care and the nursing of elderly people, as Japan enters into an aging society with a declining birthrate. In order for insurance companies, etc. to fulfill their functions in this regard and their responsibilities appropriately to policyholders, it is important that they maintain financial soundness, and it is necessary that they execute high-quality risk management and further improve its quality.

### **1. Promoting Efforts to Improve Security and Convenience for Policyholders**

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<sup>1</sup> “Insurance companies, etc.” refers to insurance companies and small-amount and short-term insurance providers.

<sup>2</sup> Cabinet Office (August 7, 2008): “Monthly Economic Report”

(<http://www5.cao.go.jp/keizai3/getsurei.html>)

Since 2005, problems such as the payment leakage and non-payment of insurance claims have come to light at insurance companies. In order for insurance companies, etc. to ensure the appropriateness of their operations and improve security and convenience for policyholders voluntarily, it is important that they make voluntary business improvement efforts at the organization level, in a unified manner based on proper governance.

As the supervisory authority, the FSA will examine whether they have established and instilled business improvement processes—including those for detecting problems, analyzing the causes and formulating improvement measures—and will encourage them to make further efforts as necessary, while respecting their voluntary business improvement efforts.

### **(1) Building Appropriate Claims Payment Management Systems**

- 1) The FSA will examine whether a system has been developed for making the management team proactively engage in building an appropriate claims payment management system, and whether a system has been developed for managing claims payment. in an integral manner.
- 2) The FSA will examine whether verification and internal audits are being conducted properly with respect to the payment of claims, and whether collaboration between divisions—including the product development division and the and the claims payment division—is functioning effectively.
- 3) With respect to measures to prevent the non-payment of claims and other such problems from recurring, the FSA will not only examine the preparedness of each company’s system to prevent operational mistakes, but also look into whether each company has developed an environment in which policyholders can make necessary insurance claims themselves without omission (i.e. an environment in which the principle of self-responsibility can be functioning well). For example, the FSA will examine whether the procedures for making insurance claims is based on a framework that enables policyholders to identify all eligible insurance claims without omission, and easily and proactively make necessary insurance claims by themselves.

### **(2) Establishing Appropriate Insurance Solicitation Systems**

- 1) The FSA will examine the status of observance of sales and solicitation rules for insurance products, by making use of reports from insurance companies, etc., results of inspections conducted by inspection bureaus, information from the Counseling Office for Financial Services Users (such as the extent to which customers are provided with explanations of a “policy overview” and “alerting information,” and the extent to which sales and solicitation rules for insurance products with strong investment characteristics subject to the Financial Instruments and Exchange Act are observed).
- 2) The FSA will examine whether a system has been built for providing an explanation to enable

customers to gain a full understanding in the insurance solicitation stage, including an explanation of the procedures for making insurance claims when an insured event arises.

3) With respect to the problem of excessive insurance premiums collected by non-life insurance companies, non-life insurance companies continue to conduct voluntary inspection and take necessary improvement measures, based on the investigation methods and plans set forth of their own accord. As the supervisory authority, the FSA will properly follow up on the progress of efforts made by non-life insurance companies.

### **(3) Enhancing Queries and Complaints Handling Systems**

1) The FSA will examine whether insurance companies, etc. have built systems to deal with policyholders in a sincere and fair manner, by accurately identifying the nature of queries and complaints received by them.

2) The FSA will examine whether a system has been built for identifying and analyzing the causes of queries and complaints and whether insurance companies including the management team are making use of the findings to make business improvement on a company-wide scale.

## **2. Promoting the Sophistication of Risk Management**

In the midst of the increasingly diversified needs of financial services users and the volatility in financial markets, insurance companies need to ensure financial soundness through the sophistication of risk management, and disclose their financial information appropriately, in order to properly identify various risks and fulfill their responsibility to policyholders in an appropriate manner.

### **(1) Sophistication of Risk Management by Using a Lesson Learned from the Subprime Mortgage Problem**

1) Considering that the assets invested by insurance companies are becoming increasingly diversified and complex, as reflected in their investments in securitized products, structured bonds and other such financial instruments, the FSA will examine whether they have built appropriate asset management and risk management systems for their financial instruments, proportionate to their risk characteristics.

2) The FSA will examine whether risks are managed properly, in cases where insurance companies provide guarantees for securitized products and offer other services that are similar to overseas mono-line insurance companies, such as whether they are properly accounting for future losses based on a proper understanding of their actual positions.

3) The FSA will encourage efforts to ensure market confidence, by enhancing the disclosure of

information on risks to which financial instruments are exposed, in consideration of international best practices.

4) The FSA will work closely with overseas authorities for the supervision of internationally-active insurance companies, by actively participating in discussions held in the International Association of Insurance Supervisors (IAIS) and other international institutions, and through bilateral discussion and day-to-day liaison efforts.

## **(2) Reform of Solvency Assessment**

1) With respect to the solvency margin ratio, the FSA will make improvements to assess the risk more accurately under the current framework in the short run. The FSA will also continue to make efforts at a reform aimed at introducing economic value-based solvency assessment in the medium run, while cooperating with the Institute of Actuaries of Japan and other interested parties.

2) When making efforts to introduce economic value-based solvency assessment, the FSA will encourage insurance companies to develop systems to recognize changes in the difference between the asset value and the liability value (net asset value) based on economic value as risk volume, and manage such changes properly.

## **(3) Promoting Enterprise Risk Management**

In the midst of the volatility in financial markets, it is becoming increasingly important for insurance companies to manage various risks such as insurance underwriting risks, market risks and liquidity risks in an integrated manner, according to their size, risk characteristics, etc., from the viewpoint of ensuring financial soundness.

Therefore, the FSA will encourage insurance companies to develop enterprise risk management framework according to clearly defined policies, based on voluntary and continuous efforts made by their respective management teams.

## **3. Taking a Supervisory Response Proportionate to the Nature of Insurance Companies, etc.**

Insurance companies, etc. vary widely in terms of business scale, ranging from massive companies to those that are generally small, such as small-amount and short-term insurance providers. Insurance solicitation styles are also diversifying, ranging from those focusing on insurance agent/agency-oriented solicitations to those focusing on correspondence sales. In consideration of these circumstances, the FSA will take a supervisory response according to the business scale, style and other such nature of insurance companies, etc.

### **(1) Stance on Insurance Groups, etc.**

The FSA will seek collaboration within supervisory bureaus, and examine the appropriateness of operations of insurance groups as a whole, in accordance with the Guidelines for Financial Conglomerates Supervision. The FSA will also work to properly and smoothly implement the expansion of the scope of businesses of insurance groups and the review of firewall regulations performed as part of the initiatives according to the Better Market Initiative (*Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets*)<sup>3</sup>, announced by the FSA in December 2007.

Furthermore, the FSA will examine insurance companies operating overseas, as to whether they have developed systems to oversee and manage the operational status of their respective overseas business establishments across the board.

### **(2) Stance on Small-amount and Short-term Insurance Providers**

Bearing in mind that the system of small-amount and short-term insurance providers was launched only a short while ago, the FSA will provide guidance and execute supervision carefully with respect to governance systems, financial soundness, appropriateness of operations and other aspects of small-amount and short-term insurance providers.

### **(3) Stance on Specified Insurers**

1) In principle, specified insurers are required to transform into (licensed) insurance businesses or (registered) small-amount and short-term insurance businesses or close their business by March 31, 2009. As the supervisory authority, the FSA will carefully deal with requests for advice from specified insurers, in order to facilitate the transfer of contracts and other changes associated with this, in view of protecting policyholders.

2) When doing so, the FSA will provide guidance and execute supervision as required to protect policyholders, by properly identifying the features of insurance policies, the actual financial position and other aspects of each specified insurers.

3) Existing public-interest corporations are due to be transformed into new corporations, within five years of the enforcement of the laws related to the reform of the public-interest corporations system on December 1, 2008. Given that public-interest corporations engaged in insurance business will be fully subject to regulation under the Insurance Business Act after being transformed into new corporations, the FSA will make fact-finding efforts with respect to such corporations and endeavor to facilitate their transformation.

### **(4) Stance based on Characteristics of Insurance Solicitation Styles**

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<sup>3</sup> <http://www.fsa.go.jp/policy/bmi/index.html>

1) In cases where insurance companies, etc. are engaged in non-face-to-face solicitation as exemplified by correspondence sales using advertisements on TV, internet and other such media, the FSA will examine whether they are engaged in appropriate insurance solicitation according to the characteristics of their respective solicitation styles, including checking whether the solicitation advertisement has the risk of misleading customers about the features of the insurance policy.

2) Given that the restrictions on the sales of insurance products through banks was fully lifted on December 22, 2007, the FSA will continue to examine the implementation status of measures aimed at preventing the detrimental effects of such sales, and examine the extent to which insurance solicitation rules are being observed by banks, such as providing an appropriate explanation of the features of insurance policies to customers.

#### **4. Materializing “Better Regulation”**

Improving the quality of financial regulation is important in order to make Japan’s financial markets more competitive. Also, financial regulation should place a greater emphasis on voluntary efforts and innovative ideas by financial firms, in light of the current phase of Japan’s financial sector where it should continue and further refine its efforts to stabilize the financial system, protect customers, and establish and maintain fair and transparent financial market.

Under these circumstances, the FSA will continue to be engaged in the efforts to solve supervisory issues in program year 2008, based on “better regulation” which centers on the following four pillars. The agency will have all its supervisory staff appreciate the concept and materialize it by the following efforts.

##### **(1) Optimal Combination of Rules-based and Principles-based Supervisory Approaches**

The FSA will utilize “The Principles in the Financial Services Industry,”<sup>4</sup> compiled in April 2008, in its financial administration, and interpret and implement the rules as they were originally intended.

##### **(2) Timely Recognition of Priority Issues and Effective Response**

The newly-established Office for Market Analysis and Office for Supervisory Policy, Financial Market and Risk Analysis will gather and analyze information on market trends and risks related to the financial system, and promptly reflect such information in supervising insurance companies, etc. The FSA will also perform effective supervision by encouraging to cooperate more

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<sup>4</sup> <http://www.fsa.go.jp/news/19/20080418-2.html>

closely between supervisory divisions and inspection divisions. Furthermore, the FSA will strive to collaborate closely with foreign supervisors, and to recognize priority international issues and respond to them effectively, in a manner consistent with the international community.

**(3) Encouraging Voluntary Efforts by Financial Firms and Placing Greater Emphasis on Providing Them with Incentives**

In order to share the same recognition about rectifying problems with insurance companies, etc., the FSA will endeavor to analyze and unravel the causes extensively through two-way dialogues.

**(4) Improving the Transparency and Predictability of Regulatory Actions**

The FSA will strive to improve the transparency and predictability of its regulatory actions by enriching dialogues with insurance companies, related organizations, etc., and distributing more information to them. The agency will also properly provide feedback on the results of its fact-finding to them.

For the purpose of enhancing the effectiveness of such efforts, the FSA will endeavor to improve the skills of its staff by such means as cultivating and hiring experts, and enhancing training programs.