

## **Annual Supervisory Policies for Insurance Companies, etc.<sup>1</sup> for Program Year 2009**

The Comprehensive Guidelines for Supervision of Insurance Companies and the Supervisory Guidelines for Small-Amount and Short-Term Insurance Providers systematically set out the basic approaches for the supervisory processes aimed at insurance companies and small-amount and short-term insurance providers, respectively. The Financial Services Agency (FSA) formulates and publishes supervisory policies for each program year so as to clarify the priority matters in supervision.

In this Program Year, in accordance with “Basic Concepts on Supervision of Financial Institutions for the Future” as shown below, the FSA will place priority on the three areas 1) Promoting the Sophistication of Risk Management, 2) improving customer protection and convenience for users, and 3) Taking a Supervisory Response in Proportion to the Feature of Insurance Companies, etc. Based on this, the FSA will undertake supervision of insurance companies, etc. while striving to engage them in frank and in-depth dialogue.

It should be noted that these supervisory policies were drawn up in light of the circumstances that surrounded financial institutions as of August 2009, and may be subject to review as necessary.

### **1. Experience of Financial Crisis and Basic Concepts of Future Supervision**

Last program year, international financial markets turmoil was triggered by the subprime mortgage problem and pushed to a state of crisis by the bankruptcy of major financial institutions in the US. It was a year in which the economic crisis affected not only financial markets, but also the global economy as a whole including Japan’s real economy.

In the insurance sector as well, losses on securities and other factors led the Yamato Life Insurance Company to forecast that it would become insolvent as of September 31, 2008. On October 10, it filed a petition for reorganization proceedings. Cases were also observed overseas, where international insurance groups received public bailouts having suffered deteriorated business conditions.

In response to these incidents and to a slump in the stock markets, the FSA encouraged individual insurance companies to strengthen their risk management, such as by conducting appropriate stress testing; and it engaged in information collection and

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

impact analysis, etc. in cooperation with overseas authorities.

At the time these supervisory policies were being formulated, despite the economy being in a severe situation, signs of a recovery could be seen. However, as can be seen in the financial results for the year ended March 31, 2009, the turmoil in domestic and overseas financial markets and the deterioration in the real economy are having an impact on the management of insurance companies, etc., in the form of increased losses and loss margins relating to securities and in particular those relating to stocks.

Amid these circumstances, while considering the concepts of better regulation in the last program year, we have been making efforts to deal with the financial crisis. Among those efforts, we reconfirmed the importance of “Better Regulation”.

Accordingly, the FSA is placing “Better Regulation” as a key component (engaging in frank and deep discussions with financial institutions, disseminating information to the outside, sharing and linking information on the economic and financial situations in Japan and overseas, and improving the transparency and predictability of regulatory actions) and striving to further have it become embedded and enhanced. In doing so, the FSA will pay attention to the following points in particular.

- 1) Financial institutions are expected to be aware of long-term managerial issues, conduct positive managerial reforms and make appropriate and responsible business judgments under the appropriate leadership of management personnel. The FSA more than ever will strive to (i) conduct financial administration with a high risk sensitivity that can detect at an early stage any risks that exist in each financial institution or financial system (ii) conduct financial administration that further improves customer protection and convenience for users by looking at things from a citizen’s and user’s point of view (iii) conduct financial administration that does not stop at short-term responses but that also thoroughly determines the progression of international discussions and considers environmental changes, while at the same time implementing long-term responses with an eye on the future, and (iv) help financial institutions autonomously improve management and make better business judgments via frank and deep discussions and the distribution of information.
- 2) In addition to encouraging closer cooperation among inspection divisions and other departments, such as by conducting joint hearings with inspection departments, the FSA will also continue to put efforts into alliances with overseas authorities and into making active contributions to international standard-setting bodies;
- 3) Through the thorough fostering, securing and training of specialized human resources, the FSA will redouble efforts for human resource development and permeating financial knowledge.

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

Amid the recent financial crisis, considerable impacts on financial affairs have also

been observed in the insurance sector. In such circumstances, 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) Promoting the Sophistication of Risk Management in View of a Financial Crisis

- 1) Given that the risks involved in underwriting financial guarantee insurance and credit-related investments, such as securitized products, CDS transactions and so forth, are becoming increasingly diverse and complex for insurance companies, the FSA will examine individual insurance companies to check whether appropriate risk management systems have been built proportionate to their risk characteristics.
- 2) Taking into account the recent fluctuations in financial markets, rather than just individually managing the various types of increasingly diverse and complex risks, it is also becoming increasingly important for insurance companies to develop systems which manage entire risks in an integrated manner. From this perspective, the FSA will examine individual insurance companies to check whether appropriate integrated risk management systems have been built proportionate to the size of the company and risk characteristics, etc. under the leadership and strong commitment of the management team.
- 3) The FSA will promote efforts for securing market confidence, including the enhancement of quarterly disclosure of important financial information such as solvency margin ratios, and, based on international best practices, the disclosure of risk information relating to holdings of financial instruments, etc.

(2) Review of Solvency Assessment, etc.

- 1) With regard to solvency margin ratios, in view of the recent fluctuations in financial markets, the FSA will first work on improvements such as the refinement of risk assessments under the framework of the existing system.
- 2) Given that the International Association of Insurance Supervisors (IAIS) is examining a regulatory framework detailing solvency assessments on a basis of economic value, and given that the EU is also planning to introduce Solvency II in 2012, the FSA will examine the introduction of solvency assessments based on economic value while continuing to carefully ascertain the actual conditions of insurance companies.
- 3) In examining the introduction of solvency assessments based on economic value, the FSA will encourage individual insurance companies to undertake efforts aimed at developing risk management systems based on economic-value assessments, which are a prerequisite for the introduction of such solvency assessments.
- 4) In view of the revision to the international accounting standards on insurance

contracts by the International Accounting Standards Board (IASB) (standard scheduled to be finalized in 2011), the FSA will also advance considerations on how the supervision and accounting of insurance should be in Japan in the medium term. Furthermore, prior to the standard being finalized, the FSA will promote examination for any necessary convergence with the current international accounting standards.

### **3. Improving Customer Protection and Convenience for Users**

Improving customer protection and user convenience at financial institutions not only contributes to the sound development of the national economy, but it also contributes to the stability of Japan's financial system via an increased public confidence in financial institutions. In order for insurance companies, etc. to improve customer protection and user convenience, and to conduct business from a customer perspective, it is important for each insurance company, etc. to engage in voluntary business improvements in a united manner under appropriate governance. Furthermore, in June 2008, the Insurance Act was enacted from the perspective of protecting policyholders. Thus, revisions of operations based on the spirit of this law are also required.

In financial institutions, when implementing strict management of customer information and preventing people from abusing their position of power, and managing conflicts of interest, and also when implementing thorough customer protection based on a sense of security and trust, it is important to make use of originality and ingenuity from the customer's viewpoint and increase competitiveness by providing financial products and services.

Accordingly, in this program year the FSA will conduct investigations while placing priority on the following points, aiming to have improved customer protection and better convenience for users in financial institutions.

In doing so, the FSA will respect the autonomous efforts of insurance companies, etc. and proceed with supervision that places importance on incentives. Accompanying this, the FSA will also pay attention to ensure there are no warped incentives that may arise because financial institutions are pursuing quick profits or because they have conflicts of interest.

Furthermore, as the need arises the FSA will cooperate with the Consumer Affairs Agency, an institution for which there is high hopes with regards to its fulfillment of roles in the area of integrated promotion of consumer administration.

#### **(1) Promotion of Preparedness ahead of the Insurance Act Coming into Force**

- 1) Prior to the enforcement of the Insurance Act (April 1, 2010), insurance companies, etc. are required to make revisions and so forth to policy conditions in accordance with the Insurance Act. In view of the spirit of the Insurance Act, namely the protection of policyholders, and in view of the supervision guidelines, etc. amended to reflect the enactment of the Insurance Act, the FSA will deal with applications for

approval of revisions, etc. to policy conditions in a prompt and appropriate manner.

- 2) In the lead-up to the Insurance Act coming into force, while being mindful of the supervision guidelines, the FSA will examine whether necessary preparations have been made, not only in product development divisions, but also in insurance solicitation divisions and benefits payment divisions.

(2) Thorough management of information security

Customer information forms the basis of financial transactions and it is important to strictly manage it also from the viewpoint of protecting personal information. Furthermore, it is important to strictly manage corporate information in order to increase trust in market transparency and fairness. From these viewpoints, the FSA will firmly encourage the appropriate maintenance of internal control systems for information security, and the enhancement of rules of professional conduct to prevent inappropriate actions of officers (such as information leaks or insider trading).

In addition, in June this year the firewall regulations were revised and a framework was created for a principal base to encourage financial institutions to have an autonomous management system to deal with conflicts of interest. With regards to these, the FSA will conduct investigations as to whether insurance companies, etc. have made accurate responses with regards to improved customer convenience and the prevention of conflicts of interest.

(3) Construction of Appropriate Systems for Managing the Payment of Insurance Benefits

- 1) The FSA will examine whether effective systems have been developed, which carefully instill into the insurance solicitation and benefit payment areas (which come into direct contact with policyholders, etc.) the recognition that the payment of benefits is the most important obligation of insurance companies, etc., and which prevent the inappropriate non-payment of insurance benefits, etc., and allow insurance benefits to be paid in a timely and appropriate manner.

- 2) The FSA will examine whether systems have been developed, by which, in the event a cause for payment of insurance benefits occurs, procedures for claiming insurance are explained, documents for insurance claims are issued, damages are investigated, facts are confirmed, and customers (including accident victims) are addressed, swiftly and appropriately from a viewpoint of customer protection and user convenience.

(4) Establishment of Appropriate Insurance Solicitation Systems

- 1) The FSA will examine how sales and solicitation rules for insurance products are being observed, by making use of reports from insurance companies, etc., results of inspections conducted by inspection departments, and information from the Counseling Office for Financial Services Users.

- 2) The “Interim Summary of Issues” (June 2009) was published by the Working Group

on the Basic Problems of Insurance, which is part of the Second Subcommittee, Sectional Committee on Financial System in the Financial System Council. In the summary, it was determined to conduct practical verifications for the following issues: use of solicitation documents, enforcement of advertising regulations, and efforts for enhancing the qualifications of insurance agents. The FSA will promptly examine these issues.

(5) Enhancing Systems for Processing Consultations and Complaints from Customers

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

The FSA will also examine whether insurance companies, etc. have built systems for identifying and analyzing the causes of queries and complaints, and whether they are utilizing the findings to make business improvements on a company-wide scale.

2) The revised Insurance Business Act, which was enacted in June 2009, incorporates a financial ADR system. The FSA will encourage insurance companies, etc. to make necessary arrangements ahead of the system's launch. Even though the system is yet to be launched, in connection with the voluntary ADR frameworks currently operated by industry organizations, the FSA will examine whether systems for processing inquiries and complaints, etc. have been appropriately developed.

#### **4. Taking a Supervisory Response in Proportion to the Feature of Insurance Companies, etc.**

Insurance companies, etc. vary widely in terms of the size of their operations, ranging from large-scale companies, to small-scale firms like many small-amount and short-term insurance providers. The mode of insurance solicitation is also becoming more diverse, including businesses that are focused on solicitations via insurance agents and agencies, and businesses that are focused on mail-order sales. In consideration of these circumstances, the FSA will take a supervisory response according to the business scale, style and other such attributes of insurance companies, etc.

(1) Measures for Insurance Groups, etc.

With regard to insurance groups, etc., in light of cases where losses recorded by a financing subsidiary within a group have led to deteriorated business conditions for the entire group, the FSA will examine the operational appropriateness and financial soundness of groups as a whole in accordance with the *Guideline for Financial Conglomerates Supervision* and other policies. In doing so, the FSA will work closely with overseas authorities, especially in cases where an insurance group has its head office or a base located in a foreign country.

Furthermore, in view of the fact that, in June 2009, the IAIS commenced research into the design of a common assessment framework for insurance group supervision, the FSA will also actively participate in international discussions on insurance group supervision.

The FSA will also endeavor to efficiently ascertain the actual conditions for small and medium-sized insurance companies.

(2) Measures for Small-Amount and Short-Term Insurance Providers, etc.

1) Given that most small-amount and short-term insurance providers only started their businesses a short while ago, the FSA will provide careful guidance and exercise rigorous supervision for each provider with respect to such aspects as their business management systems, their financial soundness and their operational appropriateness.

2) The laws relating to the reform of the public interest corporation system came into force in December 2008. According to these laws, public interest corporations would become special incorporated foundations or associations, and would then switch to new corporations by November 30, 2013. Given that the regulations under the Insurance Business Act will be fully applied to any special incorporated foundations and associations engaged in insurance business once they become a new corporation, the FSA will carefully respond to requests for advice from these corporations.

(3) Measures Corresponding to Different Modes of Insurance Solicitation

1) In cases where an insurance company, etc. is engaged in non-face-to-face solicitation, as exemplified by mail-order sales using advertisements on TV, internet or other such media, the FSA will examine whether they are engaged in insurance solicitation that is appropriate for their respective solicitation style, including checking whether there is any risk that the solicitation advertisement may mislead customers about the features of the insurance policy.

2) Given that the restrictions on over-the-counter sales of insurance products at banks, etc. were 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 customers with an appropriate explanation of the features of insurance policies.