



**Senior Vice Minister Tanimoto at the International Monetary Conference (IMC) in Kyoto (June 8)**

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## 【Featured】

### Report by the Financial System Council's Study Group on the Internationalization of Japanese Financial and Capital Markets: Toward stronger corporate governance of publicly listed companies

On June 17, 2009, the Financial System Council's Study Group on the Internationalization of Japanese Financial and Capital Markets (chaired by Kazuhito Ikee, Professor, Faculty of Economics, Keio University) compiled the "Report by the Financial System Council's Study Group on the Internationalization of Japanese Financial and Capital Markets: Toward Stronger Corporate Governance of Publicly Listed Companies."

The study group adopted a perspective that, in considering the desired form of financial and capital markets in Japan, it is important that high quality management interested in shareholders, investors and other stakeholders be attained through the enhancement of the corporate governance of listed companies. With an aim of strengthening corporate governance, the study group convened eight times from October 2008 to discuss a wide range of issues, including:

- Issues relating to listed companies raising additional capital, such as the response to capital increases through third-party share issuances;
- Structural aspects of corporate governance, such as the structure of boards of directors; and
- Issues relating to investors exercising their voting rights, such as effecting governance through the exercise of voting rights.

The "Report by the Financial System Council's Study Group on the Internationalization of Japanese Financial and Capital Markets: Toward Stronger Corporate Governance of Publicly Listed Companies" summarizes the results of the discussions of the study group.

The Financial Services Agency, in cooperation with the stock exchanges and other bodies, will fully consider the details of the report, and will take urgent action, including the development and improvement of relevant systems.

#### < Outline of the report >

##### ○ **Issues relating to listed companies raising additional capital, such as the response to capital increases through third-party share issuances**

One of the reasons why deep concerns have been expressed by domestic and foreign investors alike about the corporate governance of listed companies in Japan is that there appears to be no end to instances where the interests of minority shareholders are severely undermined when companies raise additional capital from the market. The strengthening of governance in connection with the capital policies of listed companies has become a pressing issue, and from the perspective of ensuring fairness and transparency in connection with raising new capital from the market, the following types of measures should be taken:

- With respect to capital increases through third-party share issuances, enhance the disclosure of how the funds will be used and the identity of those third parties; and in cases where it will result in the control of existing shareholders being considerably diluted, ensure due processes are carried out, such as examinations being conducted by the stock exchange and opinions being expressed by persons independent of management;
- With respect to the issuance of moving strike convertible bonds (MSCBs), enhance disclosure related to the reasonableness of their issuance terms and to the exercise of conversion rights following their issuance.

##### ○ **Structural aspects of corporate governance, such as the structure of the board of directors**

In considering the desired form of corporate governance among listed companies in Japan, one very important aspect is the governance structure of directors, auditors and so forth. Strong interest on this issue has been shown by domestic and foreign investors alike. From the perspective that it is important to attain high quality management among listed companies in Japan and to secure the confidence of investors, the following types of measures should be taken:

- Stock exchanges should present the notion of appointing highly independent outside directors and having them cooperate closely with the board of auditors, etc. as a model suitable for the majority of listed companies; and
- Based on this, listed companies should disclose the details of their respective governance systems and the reasons for selecting a particular system.

○ **Issues relating to investors exercising their voting rights, such as effecting governance through the exercise of voting rights**

In order to improve the governance of listed companies through the market, in conjunction with the efforts on the part of companies, it is important that shareholders and investors also actively monitor management. Based on this perspective, the following types of measures should be taken:

- Prepare and publish guidelines relating to the exercise of voting rights by institutional investors; and establish industry rules relating to the disclosure of total voting rights exercised; and
- Listed companies should disclose the ballot results for each proposal at shareholder meetings.

\* For further details, please refer to the [Publication of the “Report by the Financial System Council’s Study Group on the Internationalization of Japanese Financial and Capital Markets” \(June 17, 2009 \)](#) in the “Press Releases” section of the FSA website.

## 【Topics】

### FY2008 financial results of major banks, etc.

Following announcements by major banks, etc. of their financial results for FY2008, the FSA compiled the figures, etc. announced by the respective banks and released this on May 29, 2009. Below is a summary of the financial results of the major banks, etc. for FY 2008.

#### 1. Status of profit

Net core business profits, which represent profits from the core banking operations of the major banks, etc., totaled 2.7 trillion yen in the fiscal year ended March 2009, down 0.6 trillion yen from the fiscal year ended March 2008. Although there were improvements in interest income on the back of increases in outstanding loans, the decrease in total net core business profits appears to have been caused by such factors as declines in fee revenues, such as for the sale of investment trusts, due to the deterioration of market conditions.

The banks’ net profits in the fiscal year ended March 2009 amounted to 1.6 trillion yen in the red, down 3.1 trillion yen from the fiscal year ended March 2008. This decrease appears to have been influenced by such factors as increases in credit-related expenses partly attributable to the deteriorated performance of the corporate sector (0.4 trillion yen →1.9 trillion yen) and increases in the write-down of stock holdings attributable to the sluggish stock market (0.5 trillion yen →1.5 trillion yen).

#### 2. Status of financial soundness

The non-performing loan ratio of major banks, etc. stood at 1.7% in the fiscal year ended March 2009, up 0.3 percentage points from the fiscal year ended March 2008.

Their capital adequacy ratio stood at 12.4%, up 0.1 percentage points from the fiscal year ended March 2008. Despite the banks’ net losses and unrealized losses on securities, the slight increase appears to have been mainly due to the policies implemented by each of the banks to increase their equity capital.

As shown above, although the major banks, etc. recorded a net loss due to the effects of increases in

credit-related expenses and increases in the write-down of stock holdings, we believe that their financial health remains sound given the sufficient level of their capital adequacy ratios.

**Figure 1**

Non-consolidated financial results of major banks, etc. for the year ended March 2009 <based on preliminary announcements>

(Unit: 100 million yen, %)

	Net core business profit	Total losses on disposal of NPLs	Gains (losses) related to stocks, etc.			Ordinary profit	Net profit	Gains (losses) on valuation of other securities		Capital adequacy ratio	Balance of non-performing loans (loans disclosed under the Financial Reconstruction Act)			NPL ratio (ratio to total credit)
			Gains (losses) on sales	Write-offs				Stock	Special attention loans		Doubtful and bankrupt/de facto			
Mizuho Bank, Ltd.	2,566	- 3,149	- 1,668	283	- 1,951	- 2,902	- 2,936	- 1,421	- 1,018	11.78%	8,730	2,389	6,341	2.19%
Mizuho Corporate Bank, Ltd.	2,813	- 1,975	- 2,879	128	- 3,007	- 2,215	- 2,555	- 3,460	- 1,210	11.75% *	4,342	2,277	2,065	1.24%
Mizuho Trust & Banking Co., Ltd.	388	- 269	- 176	8	- 183	- 86	- 278	- 184	94	13.41% *	776	114	662	2.16%
Mizuho Total	5,767	- 5,393	- 4,723	418	- 5,141	- 5,203	- 5,770	- 5,065	- 2,134	11.85%	13,848	4,780	9,068	1.77%
The Bank of Tokyo-Mitsubishi UFJ, Ltd.	7,131	- 4,238	- 4,488	494	- 4,982	- 1,970	- 3,634	- 7,299	- 2,949	12.74% *	11,184	2,784	8,400	1.32%
Mitsubishi UFJ Trust and Banking Corporation	1,315	339	- 674	9	- 683	509	169	- 2,277	- 371	12.49% *	758	147	612	0.69%
MUFG Total	8,447	- 3,899	- 5,162	503	- 5,665	- 1,461	- 3,465	- 9,577	- 3,320	12.71% *	11,943	2,931	9,012	1.25%
Sumitomo Mitsui Banking Corporation	8,234	- 5,501	- 2,204	27	- 2,231	361	- 3,011	- 427	- 165	13.85% *	11,942	1,963	9,979	1.77%
Resona Bank, Ltd.	2,038	- 1,482	- 339	- 121	- 218	231	821	- 184	238	9.87%	4,928	1,258	3,669	2.68%
The Chuo Mitsui Trust and Banking Company, Ltd.	951	- 213	- 1,858	- 1,027	- 831	- 1,422	- 1,010	- 1,015	- 419	11.27%	1,392	168	1,224	1.47%
The Sumitomo Trust & Banking Co., Ltd.	2,010	- 559	- 467	36	- 502	380	389	- 685	- 246	13.03% *	1,164	147	1,017	0.93%
Shinsei Bank, Ltd.	- 654	- 780	- 77	39	- 115	- 1,649	- 1,570	- 294	- 29	10.95%	1,458	69	1,390	2.50%
Aozora Bank, Ltd.	- 196	- 1,288	- 783	- 341	- 442	- 2,359	- 2,453	- 100	- 1	11.73%	1,401	152	1,250	4.33%
<b>Total</b>	<b>26,596</b>	<b>- 19,114</b>	<b>- 15,613</b>	<b>- 467</b>	<b>- 15,146</b>	<b>- 11,122</b>	<b>- 16,069</b>	<b>- 17,347</b>	<b>- 6,075</b>	<b>12.42%</b>	<b>48,076</b>	<b>11,467</b>	<b>36,609</b>	<b>1.66%</b>

(Source) Summaries of accounts, etc.

(Note) Changes in the results of major banks, etc.

Year ended March 2006 (11-bank total)	38,611	2,804	4,536	5,757	- 1,221	32,906	32,194	70,331	77,591	12.52%	46,938	22,745	24,193	1.76%
Year ended March 2007 (11-bank total)	34,666	- 2,729	997	5,289	- 4,292	29,242	25,750	84,286	87,344	13.27%	41,442	17,849	23,592	1.50%
Year ended March 2008 (11-bank total)	32,774	- 4,110	- 413	4,773	- 5,186	22,521	14,527	23,039	33,940	12.30%	38,589	16,971	21,618	1.38%

Notes

1. Yen amounts and the ratios for the 11-bank total have been rounded to the nearest whole number. Ratios for each bank have been rounded down.
2. Asterisks indicate banks that are subject to international standards.
3. For the Bank of Tokyo-Mitsubishi UFJ, Ltd., the figures for net core business profit, total losses on disposal of NPLs, gains (losses) related to stocks, etc., ordinary profit, net profit, and gains (losses) on valuation of other securities include those of its subsidiaries for corporate revitalization; and for the Chuo Mitsui Trust and Banking Company, Ltd., the figures include those of its special stockholding subsidiaries.
4. For the Bank of Tokyo-Mitsubishi UFJ, Ltd., figures for the balance of non-performing loans and the NPL ratio include those of its subsidiaries for corporate revitalization.
5. Positive values for the total losses on disposal of NPLs and for the write-offs related to stocks, etc. indicate gains, while negative values indicate losses.
6. Capital adequacy ratios have been calculated based on Basel II since the year ended March 2007.

\* For further details, please refer to [FY2008 Financial Results of Major Banks, etc. <based on preliminary announcements> \(May 29, 2009\)](#) in the "Press Releases" section of the FSA website.

## Key points of FY2008 financial results of regional banks

Following announcements by regional banks of their financial results for FY2008, the FSA compiled the figures, etc. announced by the respective banks and released this on May 29, 2009. Below is a summary of the financial results of the regional banks for FY 2008.

## Key points of FY2008 financial results of regional banks

### 1. Profit status

- The net core business profits of regional banks decreased 36.5% from FY2007, mainly due to an increase in valuation losses on bonds and investment trusts and a decrease in fee revenues.
- Their net profits were in deficit, in part due to the decrease in net core business

profits, as well as an increase in the disposal of NPLs and valuation losses on shareholdings.

(Unit: ¥ billion)

	FY2006	FY2007	FY2008	Year-on-year change
Gross business profit	5,128.6	4,986.5	4,359.9	- 626.6
Interest income	4,476.8	4,512.5	4,481.2	- 31.3
Fee income	655.0	602.9	482.1	- 120.7
Gains (losses) related to bonds, etc.	- 44.1	- 161.6	- 676.8	- 515.1
Write-off of bonds, etc. (-)	- 2.1	- 129.8	- 519.7	- 389.9
Net core business profit	2,002.8	1,799.4	1,143.2	- 656.1
Disposal of NPLs (-)	- 773.0	- 712.8	- 1,183.4	- 470.5
Gains (losses) related to stocks, etc.	189.1	97.0	- 413.2	- 510.3
Write-off of stocks, etc. (-)	- 37.9	- 122.0	- 500.7	- 378.6
Net profit	805.6	640.1	- 413.8	- 1,053.9

(\*)The amount of net profits in FY2008 excludes the monetary grant of ¥256.6 billion that was provided by the Deposit Insurance Corporation to Ashikaga Bank.

(Reference)

	FY2006	FY2007	FY2008
Loans (¥ trillion)	192.5	197.6	204.9

## 2. Status of non-performing loans

- The amount of non-performing loans (NPLs) held by regional banks decreased from FY2007, and the NPL ratio also declined.

	FY2006	FY2007	FY2008
NPL amount (¥ trillion)	7.8	7.5	7.1
NPL ratio (%)	4.0	3.7	3.4

(Note) The NPL amount and the NPL ratio peaked at ¥15 trillion and 8.3% respectively in the first half of FY2002.

## 3. Status of capital adequacy ratio

- The average capital adequacy ratio of regional banks (excluding Ashikaga Bank) declined slightly compared to FY2007.

	FY2006	FY2007	FY2008
Average capital adequacy ratio (%)	10.4 (10.8)	10.3 (10.7)	10.5 (10.6)

(\*)The figures in the parentheses exclude those for Ashikaga Bank, which was under special public management.

(Note 1) The number of banks included in the figures for FY2006 stood at 111 (comprised of 64 regional banks, 46 second-tier regional banks and Saitama Resona Bank).

The number of banks included in the figures for FY2007 stood at 110 (comprised of 64 regional banks, 45 second-tier regional banks and Saitama Resona Bank).

The number of banks included in the figures for FY2008 stood at 109 (comprised of 64 regional banks, 44 second-tier regional banks and Saitama Resona Bank).

(Note 2) The above figures were calculated on a non-consolidated basis. However, the figures for non-performing loans include those of subsidiaries for corporate revitalization.

(Note 3) Figures for FY2006 and FY2007 may differ from those published by the FSA in the past, as some banks have revised their results.

## Exposures of Japanese deposit-taking institutions to subprime-related products and securitized products

On June 2, 2009, the Financial Services Agency (FSA) summarized and published the exposures of Japanese deposit-taking institutions to subprime-related products and to securitized products based on the leading practices summarized in the FSF report.

As of March 31, 2009, subprime-related products held by all Japanese deposit-taking institutions totaled 449 billion yen (down 116 billion yen compared to December 31, 2008), and the cumulative total of their valuation losses and realized losses amounted to 1,094 billion yen (1,053 billion yen as of December 31, 2008).

Meanwhile, as of March 31, 2009, their total exposure to securitized products stood at 18,483 billion yen (down 925 billion yen compared to December 31, 2008), and the cumulative total of their valuation losses and realized losses amounted to 3,302 billion yen (1,053 billion yen as of December 31, 2008). Since the end of December 2008, the cumulative total of the valuation losses and realized losses on all securitized products increased by approximately 64 billion yen.

While there appear to be a range of overlapping factors underlying why overall losses on securitized products remained generally constant, it seems that one of the main drivers was the fact that some financial institutions have changed the way they measure fair value as a result of last year's revisions to the accounting standards pertaining to securities.

Since September 2007, the FSA has used a uniform set of standards to publish the exposures of Japanese deposit-taking institutions to subprime-related products and securitized products.\*

We believe that efforts like this help promote a precise understanding of how the turmoil in the global financial markets (triggered by the subprime mortgage problem) is impacting on Japan's financial system through securitized products.

The FSA will continue its efforts to publish information, and we will continue to make environmental improvements so that the public can more easily access the current state of the Japanese financial system and the approaches to financial administration.

\* As for exposures to securitized products based on the leading practices summarized in the FSF report, the FSA started survey and publication with the exposures as of the end of March 2008.

\* For further details, please refer to [Exposures of Japanese deposit-taking institutions to subprime-related products and securitized products based on the leading practices summarized in the FSF report \(June 2, 2009\)](#) in the "Press Releases" section of the FSA website.

## 【International Affairs】

### Fifth High-Level Bilateral Dialogue on Securities Markets

The Fifth High-Level Bilateral Dialogue on Securities Markets was held on June 15 at the Financial Services Agency (FSA).

The High-Level Bilateral Dialogue on Securities Markets is a policy dialogue held regularly to conduct high-level discussions on issues common to the global securities markets. Dialogues have been held once a year since 2005, with the venue alternating between Japan and the United States.

The High-Level Bilateral Dialogue on Securities Markets was attended by high-level officials from the FSA and from the United States Securities and Exchange Commission (SEC), led respectively by Mr. Junichi Maruyama, Deputy Commissioner for International Affairs, and by Commissioner Kathleen Casey. At the meeting, participants discussed a wide range of policy issues, including regulatory issues such as credit rating agencies, short selling and credit default swaps, accounting standards, disclosure, and enforcement issues.

During the 12 months since last year's dialogue, we have witnessed turmoil in the global financial and capital markets. It is believed that we are in an age where, in order to respond to the global financial crisis, the regulatory authorities of each country must conduct serious discussions.

Amid ongoing globalization, it is important that Japan and the United States also join hands in boosting the cooperation of their supervisory authorities more than ever before. And as the turmoil of the world financial markets continues, it is considered extremely important that the SEC and the FSA also cooperate and collaborate closely in the area of enforcement.

Given these circumstances, officials from the two organizations deepened their mutual understanding through the dialogue and enhanced their cooperative relationship.

\* For further details, please refer to [FSA and U.S. SEC hold the fifth meeting of the High-Level Dialogue \(June 15, 2009\)](#) in the "Press Releases" section of the FSA website.

## 【Explanations of Laws and Regulations】

### Partial revision of the inspection manuals pertaining to the development of conflict of interest management systems

#### 1. Introduction

On May 20, the Financial Services Agency (FSA) partially revised the Financial Inspection Manual, the Insurance Inspection Manual and the Inspection Manual for Financial Holding Companies, including establishing checkpoints relating to the development of conflict of interest management systems.

#### 2. Background to the revisions

Under the Act for the Amendment of the Financial Instruments and Exchange Act, which was passed in June 2008, firewall regulations were reformed and requirements were introduced for the establishment of systems for managing conflicts of interest.

The aim of the amendment is to enable financial groups to provide a diverse range of high-quality services by relaxing the firewall regulations pertaining to the reciprocal entry of firms into other types of business, and by requiring firms to establish conflict of interest management systems in order to prevent their customers' interests from being unfairly harmed in association with trading by the firm itself or by a group company.

In response to the amendment, a decision was made to revise each of the inspection manuals from the perspective of customer protection, including establishing new checkpoints related to the development of conflict of interest management systems. The proposed revisions were referred to public comment between March 31 and April 30, 2009. On May 20, the FSA published their response to the comments received, and released the revised manuals incorporating consideration of these comments. The

revisions will come into force on June 1, 2009, and shall apply to inspections conducted on or after this date.

### 3. Financial Inspection Manual

Below, we examine the outline and main checkpoints of the Financial Inspection Manual which were subject to revision.

#### 1) Outline of revision

Regulations contained in the Financial Instruments and Exchange Act relating to conflict of interest management are not controls on conduct that prohibit “transactions involving conflicts of interest”; instead, from the perspective of protecting customers’ interests, they require financial institutions to have arrangements and procedures for appropriately managing conflicts of interest.

Thus, in the revised Financial Inspection Manual, it was decided to include a conflict of interest management system alongside the customer explanation management system and customer support management system as an inspection point of the customer protection management system.

The Financial Inspection Manual states that, with regard to customer protection management, it is important for a financial institution to review its own business operations from the customer’s viewpoint and to constantly review and improve the business operations. This means that this kind of approach is also important when managing conflicts of interest.

#### 2) Main checkpoints

##### (1) What is conflict of interest management?

What specifically does “conflict of interest management” mean?

The Financial Inspection Manual describes it as:

**Managing conflicts of interest in a way that prevents customers’ interests from being unfairly harmed as a consequence of transactions conducted by a financial institution or an affiliated group company**

With respect to the term “a financial institution or an affiliated group company,” in addition to the Bank, a bank agent for which the Bank serves as a principal bank, and a parent or subsidiary financial institution, etc. of the Bank (as prescribed in Article 13-3-2 (1) of the Banking Act<sup>1</sup>), the manual goes further to include:

- Any company for which the said financial institution has deemed conflict of interest management necessary for the protection of its customers.

Furthermore, the manual broadly states “customers” as the target of protection, unlike the Banking Act which limits protection to those “customers connected to banking-related business.”

Although inspecting thus whether a firm is managing conflicts of interest may be seen as going beyond the scope of the law, this checkpoint has not been included with that objective in mind.

The checkpoint has been included in keeping with the spirit that, in developing a conflict of interest management system regarding which transactions are at risk of harming the interests of which customers, because circumstances differ greatly between different financial groups, each financial institution should determine itself the scope of its applicable transactions and the scope of its customers to be protected based on laws and regulations and in accordance with such factors as the scale and characteristics of its own business.

##### (2) Organizational frameworks

With respect to conflict of interest management systems, the Financial Inspection Manual stipulates

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<sup>1</sup> Banks shall, pursuant to the provisions of a Cabinet Office Ordinance, appropriately manage information pertaining to the business conducted by the Bank, a bank agent for which the Bank serves as a principal bank, or a subsidiary financial institution, etc. of the Bank (limited to banking business, bank agency service and other business specified by a Cabinet Office Ordinance), and shall develop systems and implement other necessary measures for appropriately monitoring how the said business is being conducted, so that customers’ interests pertaining to the said business are not unfairly harmed as a consequence of transactions conducted by the Bank, a bank agent for which the Bank serves as a principal bank, or a parent financial institution, etc. or subsidiary financial institution, etc. of the Bank.

the designation of a Conflict of Interest Manager as a checkpoint:

**Has a manager in charge of the overall control of conflicts of interest (Conflict of Interest Manager) been established for the development and establishment of an appropriate system for controlling conflicts of interest? Has a system been provided that stipulates the responsibilities and authority and allocates appropriate roles to the Conflict of Interest Manager?**

With respect to the development of a specific organizational framework in such cases as where a conflict of interest management division is established, this is left to the discretion of the financial institution. As long as conflict of interest management is effectively assured, the manual does not preclude an officer or employee of the compliance management division or another division from concurrently engaging in other duties including the management of conflicts of interest.

Furthermore, although a financial institution may of course designate more than one Conflict of Interest Manager to provide more detailed management, in such instances, it would need to clearly specify where responsibility lies, such as by designating the individual responsible for overall management.

### **(3) Ensuring independence from the sales division**

The Financial Inspection Manual lists, as points to note when developing systems relating to conflicts of interest, having the Conflict of Interest Manager ensure independence from the sales division and developing a system under which a check-and-balance function can be performed over the sales division.

The aim of this is to prevent such instances as being unable to take necessary measures to manage conflicts of interest as a result of officers or employees from the sales division having interfered in the decisions related to conflict of interest management.

In the real business world, situations can be readily envisaged where “the sales division makes standard decisions in accordance with an operations manual prescribed by the Conflict of Interest Manager,” and as such, the Financial Inspection Manual does not entirely preclude sales division officers or employees from being involved in the conflict of interest management process.

Of course, since managing conflicts of interest does have a certain quality requiring decisions to be made that are contrary to the pursuit of commercial profit, consideration needs to be given so that a distinction is made between the scope within which decisions should be strictly made from a perspective of managing conflicts of interest and the scope within which the sales division can be involved.

### **(4) Implementation of conflict of interest management, and assessment and improvement activities**

The Financial Inspection Manual also lists other checkpoints regarding measures implemented by individual financial institutions for the purpose of managing conflicts of interest, and checkpoints regarding activities for assessing and improving their conflict of interest management systems (corresponding to the “C” and “A” phases of the PDCA cycle), including:

- Is a system in place to properly specify transactions that have potential conflicts of interest?
- Is a system in place to select appropriate methods for managing conflicts of interest?
- Are records of conflict of interest management being compiled and kept?

## **4. Insurance Inspection Manual**

Similar to the Financial Inspection Manual, new checkpoints regarding conflict of interest management systems were established in the checklist for customer protection management systems contained in the Insurance Inspection Manual.

Descriptions based on the PDCA cycle, like those in the Financial Inspection Manual, have not been fully clarified in the Insurance Inspection Manual, and although some terminology usage is also different to the Financial Inspection Manual, it is fair to regard the basic idea as being the same as the Financial Inspection Manual.

## 5. Inspection Manual for Financial Holding Companies

Checkpoints regarding conflict of interest management have been established in the Inspection Manual for Financial Holding Companies in both the checklists for bank holding companies and the checklists for insurance holding companies, as specific issues of particular note within the checklist for group business management (governance) systems.

The checkpoints here include: Do the directors of the financial holding company fully recognize the need for managing conflicts of interest for the group as a whole? Have the directors developed a system for centrally managing these conflicts of interest?

\* For further details, please refer to [Partial revision of the inspection manuals pertaining to the development of conflict of interest management systems \(May 20, 2009\)](#) in the "Press Releases" section of the FSA website.

## Partial revision of the Comprehensive Guidelines for Supervision of Insurance Companies

The Financial Services Agency (FSA) invited opinions from the public regarding the draft partial revision of the Comprehensive Guidelines for Supervision of Insurance Companies from April 23 to May 25, 2009. On June 8, the FSA published the results of the public comment procedure and revised the guidelines accordingly. The revised guidelines have been applicable since this date.

The aim and the key points of the revision are as follows:

### 1. Aim

In part based on the report of the Financial Stability Forum (FSF) and the G20 action plan, revisions were made regarding viewpoints relating to risk management in the guidelines for the supervision of insurance companies.

### 2. Key points of the revisions

#### 1) Integrated risk management 【II-2-6-1】

Given that insurance companies generally face complex and large-scale risks, the revisions required them to establish systems for managing the various risks by integrating them. Specifically, the following supervisory viewpoints were prescribed:

- (1) Has the insurance company established an integrated risk management policy in line with its overall management policy?
- (2) Has the insurance company clearly defined the division to comprehensively manage risks?
- (3) Has the insurance company quantified the risks using common standards, and is it applying those results to the execution of its business?

#### 2) Stress tests 【II-2-6-2】

Although the existing guidelines do mention stress tests, important points regarding the setting of stress scenarios, etc. were added so that the stress tests could be used in making specific decisions on risk management even in circumstances where the market is fluctuating widely. Specifically, the following supervisory viewpoints were added:

- (1) Does the insurance company conduct analyses based not only on historical scenarios (using past major crises and maximum past losses) but also on simulated scenarios where multiple factors (stock prices, interest rates, exchange rates, etc.) fluctuate simultaneously?
- (2) At such times, does the insurance company include in its examination situations where there is a break down in the price correlations between asset holdings that were anticipated in normal times?
- (3) When setting the stress scenarios, does the insurance company include considerations from the perspective that they are faced with risks that cannot be identified using the quantification techniques of integrated risk management?

### **3) Risk management for credit investments such as securitized products [II-2-6-6-2(3) ]**

The following supervisory viewpoints were added with regard to risk management relating to credit investments such as securitized products:

- (1) Does the insurance company strive to understand the nature of products, etc., such as the details of collateral assets, senior-subordinated structures and the status of credit enhancement, and the details of credit events?
- (2) When appraising values, in cases where there is frequent trading, does the insurance company use the market prices; and in other cases, does the insurance company make reasonable appraisals being mindful of the frequency of transactions and the differences in seller and buyer prices? And does it reflect these in its accounting treatment?
- (3) Does the insurance company have in place systems for responding in a timely manner in cases where concerns over market liquidity have been recognized?

### **4) Risk management relating to financial guarantee insurance and CDS transactions [II-2-6-6-2(3), II-2-6-7-2 (2) ⑦ ]**

The following supervisory viewpoints were added with regard to risk management relating to financial guarantee insurance and CDS transactions:

- (1) Does the insurance company strive to understand the nature of products, etc., such as the details of obligations covered by financial guarantee insurance and reference obligations of CDSs, and the details of credit events?
- (2) With respect to financial guarantee insurance, does the insurance company appropriately appraise the value of the associated liabilities, and where necessary, does it place additional funds into the policy reserves?

With respect to CDS transactions, when appraising values, in cases where there is frequent trading, does the insurance company use the market prices; and in other cases, does the insurance company make reasonable appraisals being mindful of the frequency of transactions and the differences in seller and buyer prices? And does it reflect these in its accounting treatment?

- (3) With financial guarantee insurance and CDS transactions, etc., in cases where one of the terms is a requirement for collateral based on such factors as the rating of the insurance company and the degree of credit of the guarantee obligations or reference obligations, does the insurance company manage liquidity assuming the provision of the collateral?
- (4) In conducting CDS transactions, from the perspective of improving the security of transactions, does the insurance company adopt appropriate trading practices while bearing in mind the efforts of relevant parties, such as the standardization of transactions and the use of a central settlement provider?

### **5) Treatment of policy reserves when insurance contracts are reinsured [II-2-1-4(8) ① ]**

In cases where an insurance contract is reinsured, although the guidelines allow the insurance company not to place an amount equivalent to the reinsured portion into the policy reserves, the guidelines made it clear that attention should be paid to the following points when deciding on this treatment:

- (1) Is the reinsurance contract of the sort where risks will definitely be transferred in the future?
- (2) Is there a high probability that the reinsurance amount pertaining to the reinsurance contract will be recovered?

\* For further details, please refer to [Results of the public comments on the proposed partial revision of the Comprehensive Guidelines for Supervision of Insurance Companies \(June 8, 2009\)](#) in the “Press Releases” section of the FSA website.

