

(Attachment)

Inspection of solvency margin ratios

I. Inspection of the accuracy of solvency margin ratios

When inspecting the solvency margin ratio of the insurance company under inspection, verify that calculations of the portions relevant to margin and various risks are accurate and in conformity with “Standards for Insurance Company Capital, Funds, Reserves, etc. and Methods for Calculating the Amount Equivalent to the Risk Exceeding Normal Estimates Pursuant to Articles 86, 87, 161, 162, and 190 of the Enforcement Regulation of the Insurance Business Law” (Ministry of Finance Notice No. 50; hereinafter “the Notice”).

In particular, verify whether solvency margin ratios are calculated appropriately in light of the Notice, the Guidelines, and corporate accounting principles.

1. Verify that the tax effect equivalent (amount of deferred tax assets) used in the capital account is calculated appropriately in light of the intentions of practical policies on tax effect accounting, such as “Auditing Treatment Concerning Judgment of the Recoverability of Deferred Tax Assets” (Auditing Committee Report No. 66) published by the Japanese Institute of Certified Public Accountants.

Also verify that the tax effect equivalent as stipulated in Article 1-3-5 of the Notice is calculated appropriately in light of the intentions of the Notice.

2. If the insurance company has borrowed subordinated loans or issued subordinated bonds, verify that the subordinated borrowings are eligible for use for the enhancement of the company’s claims-paying ability.
3. If the insurance company has utilized debt-based methods to raise capital that include special clauses to add on “step-up interest rates” or the like, verify that the step-up interest rates, etc. are not excessive.
4. Verify that the insurance company raised capital lend the resource of subordinated loans to the issuers of such loans in a roundabout way for use.
5. With regard to “intentional holdings” which the Article 1-2 of the Notice stipulates have to be deducted as “deduction item” from the total of solvency margins, verify that they are deducted as “deduction item” in line with the intentions of the Guidelines.
6. Verify that the asset liquidation is substantial transfer as it has been completely transferred its risk to the transferee , even when it falls into “transfer” in law.
7. Verify that credits recognized as risk management credits are not intentionally excluded from the risk management credits in order to reduce credit risks for the calculation of solvency margin ratios.

8. In the case in which the insurance company has a huge amount of unrealized loss as a result of once selling real estate and buying it back at the same price or around the same price as the selling price when the market value of the real estate is declining, verify that the company is not using the recourse price as the assessment value.
9. With regard to off-balance-sheet transactions with negative risk factor (example: forward trading in foreign currency (short position)), in the case in which, for example, the transactions balance at the end of a business year far exceeds the average transactions balance at the end of each month of the year, or the ratio of transactions balance to the cash assets held as of the end of a business year (hereinafter to be called cover ratio) far exceeds the average cover ratio at the end of each month of the year, check if it falls into “transactions judged as being conducted intentionally” as stipulated in Article 2-6-1~2 of the Note and, if it does, verify that it is appropriately deducted.
10. If the insurance company has issued guarantees, etc. for assets held and these guarantees, etc. extend across settlement terms or are issued on the last day of the settlement term, verify that it has not reduced its credit risks for the calculation of solvency margin ratios even if the time to maturity for the guarantee is less than one year.
However, this excludes cases in which there are justifiable reasons for the guarantee and continuing reductions of credit risks can be expected.
11. Verify that there are no solvency-margin padding or any other reductions of risks contrary to the intentions of the solvency margin standards.

II. Verification of the effect of write-off, allowances, responsibility reserve fund and liability reserves inspection results on solvency margin ratios

If the results of inspections of write-off, allowances, responsibility reserve fund and liability reserves indicate insufficient write-off, allowances, responsibility reserve fund and liability reserves levels, endeavor to calculate additional required write-off, allowances, responsibility reserve fund and liability reserves values and the degree of impact this will have on the solvency margin ratio. In other words, verify the degree to which the solvency margin ratio will be reduced if additional required write-off, allowances, responsibility reserve fund and liability reserves are made.

Specifically, handle these situations as described below, taking care to bring the recognition into line among the chief inspector, the insurance company under inspection, and the external auditors.

1. Study of write-off and allowances levels

Write-off and allowances levels shall be deemed inadequate in the following cases.

- (1) Verifications of self-assessment standards and self-assessment results indicate inappropriate self-assessment standards or inaccurate self-assessment results, so that changes in debtor classifications etc. result in an increase in classified amounts (assigned to Category II, Category III, or Category IV), and therefore predict an increase in write-off and allowances values.

(2) Verifications of write-off and allowances standards and write-off and allowances results indicate inappropriate write-off and allowances standards or inappropriate calculations of write-off and allowances values so that an increase in the write-off and allowances values if forecast.

2. Calculation of additionally required write-off and allowances values

Pay close attention to the following in calculating additionally required write-off and allowances values, and endeavor to fully exchange opinions with the insurance company under inspection and accounting auditors.

(1) For the case in 1 (1)

If the write-off and allowances standards of the insurance company under inspection are deemed appropriate, calculate additionally required write-off and allowances values based on the write-off and allowances standards.

If the write-off and allowances standards of the insurance company under inspection are deemed inappropriate, calculate additionally required write-off and allowances values based on write-off and allowances standards found as described in (2) below.

(2) For the case in 1 (2)

If the write-off and allowances standards of the insurance company under inspection are deemed inappropriate, fully exchange opinions with the insurance company under inspection and accounting auditors regarding the parts deemed inappropriate, determine how to improve write-off and allowances standards, and calculate additionally required write-off and allowances values based on the corrected write-off and allowances standards.

If the write-off and allowances results of the insurance company under inspection are deemed inappropriate, calculate the write-off and allowances values assuming appropriate write-off and allowances had been provided based on the write-off and allowances standards of the insurance company under inspection, and calculate the additional write-off and allowances required.

3. Study of accumulation levels of responsibility reserve fund and liability reserves, and calculation of additionally required responsibility reserve fund and liability reserves values

The accumulation levels of responsibility reserve fund and liability reserves shall be deemed inadequate, if verifications by using the insurance risk checklist indicate inadequate calculations of responsibility reserve fund and liability reserves so that an increase in accumulation of responsibility reserve fund and liability reserves is forecast. In this case, calculate the accumulation values of responsibility reserve fund and liability reserves assuming appropriate responsibility reserve fund and liability reserves had been provided, and calculate the additional responsibility reserve fund and liability reserves required.

III. Monitoring of the insurance company's response to declines in the solvency margin ratio

To monitor the insurance company's response to declines in the solvency margin ration, calculate the solvency margin ratio assuming that additionally required write-off, allowances, accumulations of responsibility reserve fund and liability reserves had been provided during the settlement term, provide the results of these calculations to the insurance company under inspection, and confirm them with the company.

Inspectors should accurately monitor the responses being considered by the insurance company under inspection in providing for additionally required write-off and allowances and accumulations of responsibility reserve fund and liability reserves in the future. Specifically, inspectors should accurately monitor the response of the insurance company under inspection regarding write-off resources (profit forecasts, asset sales etc.), capital increase plans, and various risk-reduction measures.

Study the appropriateness of this response, verify what the solvency margin ratio will be in the next settlement term as a result of provisions of additionally required write-off and allowances and accumulations of responsibility reserve fund and liability reserves as called for in appropriate response plans, and endeavor to bring the recognition into line among the chief inspector, the insurance company under inspection and the accounting auditors.

In addition, verify whether the solvency margin ratio this settlement term and next settlement term could be at levels that would invoke Prompt Corrective Actions as set forth in Article 88, etc. of the Concomitant Orders to the Insurance Business Law (1996 Ministry of Finance Ordinance).

In doing this, verify whether the insurance company falls under the provision of Article 88-2:2 or 3 of the Concomitant Orders.