

Annual Supervisory Policies for Insurance Companies for Program Year 2007

I. Basic Approach

1. Role of Annual Supervisory Policies-in the FSA's supervisory framework

In August 2005, the Financial Services Agency (FSA) compiled the *Comprehensive Guidelines for the Supervision of Insurance Companies*, which summarized the basic approach of its supervision processes for insurance companies in a structured manner. In March 2006, the FSA compiled the *Supervisory Guidelines for Small-claims and Short-term Insurance Businesses*, addressing the system of small-sum, short-term insurance business created following the revision of the Insurance Business Act in April 2005.

In consideration of these supervisory guidelines, the FSA has decided to compile and publish its *Policies for the Supervision of Insurance Companies for Program Year 2007* for the purpose of clearly defining the high-priority areas in the supervision of insurance companies and small-claims and short-term insurance businesses (hereinafter referred to as "insurance companies") for program year 2007.

2. Qualitative Improvements in Supervision

The FSA has been making efforts to improve customer protection and customer convenience, such as promoting the diversification of insurance products, improving the flexibility of their pricing, developing sales and solicitation rules for insurance products, and encouraging insurance companies to improve and develop claims payment management systems by tackling problems like payment leakage and non-payment. The FSA's policy has been accompanied by efforts made by insurance companies, such as rendering the terms and conditions of insurance policies simpler and easier to understand, strictly enforcing their obligations to provide an explanation when signing insurance policies, and seriously reviewing payment management systems. Such efforts need to become more commonplace and refined in the future.

It is also a high-priority issue in terms of policy to stimulate the Japanese financial and capital markets and boost their international competitiveness, based on the view that the quality of financial regulation and supervision would affect the competitiveness of financial and capital markets.

The FSA will intensively work on the following four areas to improve the quality of supervision of

insurance companies in consideration of the current conditions in the domain of financial regulation and supervision. In doing so, the FSA will strive to ensure the effectiveness of supervision by: (1) enhanced dialogue with financial institutions and other relevant parties; (2) effective dissemination of information; (3) further cooperation with fellow authorities abroad; (4) enhanced research functions for prompt recognition of market developments; and (5) human resource development.

(1) Optimal Combination of Rules-based Supervision and Principles-based Supervision

The FSA will ensure the effectiveness of supervision in its entirety by optimizing the combination of rules-based and principles-based supervision approaches. By performing this task, the FSA will clearly define the policies for the application of laws and regulations in the form of supervisory guidelines as necessary, and endeavor to share its understanding of the concepts and principles behind the rules.

(2) Responding to High-priority Issues through the Effective Use of Regulatory Resources

The FSA will accurately identify and analyze information on the management status of insurance companies and market trends through continuous monitoring. By doing so, the FSA will determine, as quickly as possible, fields in which risks at the business operation level are deemed to have a high probability of materializing in the future, and allocate its supervision resources to such fields on a preferential basis.

(3) Placing Greater Emphasis on Incentives for Insurance Companies and Respecting Self-help Efforts

The FSA will give due consideration to respecting voluntary business improvement efforts implemented by insurance companies. In conjunction with this, the FSA's stance on supervision will place importance on encouraging insurance companies to proactively implement business improvement efforts of their own accord to the greatest extent possible.

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

In order to further improve the transparency and predictability of regulatory actions, the FSA will continue to publish various guidelines, policies and strive to conduct sufficient communication with insurance companies

II. Key Areas

An observation of the circumstances surrounding insurance companies shows that various changes are taking place, as exemplified by the diversification and sophistication of customers' needs, the

diversification of insurance solicitation styles, the progress in conglomeration and international trends in the solvency rating and the evaluation of insurance liabilities.

Taking this into account, the FSA will treat the following four fields as the key areas for program year 2007: (1) encouraging insurance companies to make a unified effort at the organization level to make further business improvements; (2) taking a supervisory stance in accordance with the business scale and style of insurance companies; (3) promoting the sophistication of risk management; and (4) ensuring sufficient communication with stakeholders in the insurance market. The FSA will strive to efficiently execute supervisory administration in a strict and effective manner, while seeking to improve the quality of supervision. In the area of supervision, the FSA will continue to enhance collaboration with inspection departments/bureaus.

1. Encouraging Insurance Companies to make a Unified Effort at the Organization Level to Implement Further Business Improvements

For insurance companies to independently ensure the appropriateness of their operations, it is important that they continue to make voluntary business improvement efforts on an organization level in a unified matter based on proper governance.

Taking this into account, the FSA, as supervisory authority, will examine whether they have built appropriate and autonomous business improvement processes, including detection of problems, analysis of causes and formulation of improvement measures, and encourage them to make improvements as necessary, while respecting their voluntary and continuous business improvement efforts.

In doing so, the FSA's stance will be to focus on incentives aimed at business improvement: for example, in cases where an insurance company to which the FSA has issued a business improvement order, is deemed to have taken sufficient improvement measures against the problem that led to the issue of the order, the insurance company will not be required to submit a report based on that order or will only be required to submit a simplified version of said report.

(1) Building Appropriate Claims Payment Management Systems

The timely and appropriate payment of insurance claims is the most important and fundamental duty of insurance companies that policyholders have placed trust in. However, since 2005, problems such as the inappropriate payment and non-payment at insurance companies have come to light. As supervisory authority, the FSA has issued business improvement suspension orders to insurance companies where non-payment of claims had been uncovered, demanded that they formulate and implement various measures to prevent such problems from recurring, including the development of a claims payment management system, and requested that they promptly deal with customers in an

appropriate manner. In this process, insurance companies have been implementing radical business improvements.

Based on such progress, the FSA, as the supervisory authority, will examine whether insurance companies have established appropriate business improvement processes from the following perspectives and encourage them to make improvements as necessary, while respecting their voluntary and autonomous efforts to prevent the recurrence of non-payment of claims

1) The FSA will examine whether the board of directors has established policies for building an appropriate claims payment management system and identified the effectiveness thereof, and whether management resources are being allocated to the proper execution of business operations in relation to the payment of insurance claims. The FSA will also examine the development status of frameworks capable of managing claims payments in an integral manner.

2) The FSA will examine whether insurance companies have developed a system to enable policyholders to properly make insurance claims, such as through explanation of method for making insurance claims at the time of solicitation and the provision of appropriate guidance when insurance claims are made from the standpoint of policyholders. Especially in regards to requests made in February 2007 to life insurance companies reporting the number of cases in which additional payments were required and other such problems, the FSA will examine the measures taken by companies in order to prevent such problems from recurring based on sufficient analysis of the causes, and look into how they are dealing with the situation according to their recurrence prevention measures.

3) The FSA will examine whether collaboration between divisions, including the product development division and the claims payment division, is functioning effectively, and whether ex-post-facto verification and internal audits are being conducted properly with respect to the payment of claims. Especially in regards to non-life insurance companies, the FSA will examine the implementation status of companies' business improvement plans that have been put together based on administrative action against the non-payment of fringe claims, inappropriate payment associated with third-sector products and other such problems.

(2) Establishing Appropriate Insurance Solicitation Systems

As insurance solicitation is the starting point of insurance contracts, establishing an appropriate insurance solicitation system so that policyholders can accurately understand the features of insurance policies and properly receive payment is indispensable, and constitutes the goal of insurance policies. Accordingly, as supervisory authority, the FSA has been making efforts such as establishing clearly defined rules for insurance sales and solicitation. Based on the Financial Instruments and Exchange Act enforced in September 2007, the FSA has sought to further develop insurance sales and solicitation rules in view of the customer suitability rule and the basic principle

of unsolicited calls with respect to insurance products with strong investment characteristics such as variable annuity insurance.

In consideration of these circumstances, the FSA will examine the status of observance of insurance solicitation rules and voluntary efforts made by insurance companies, and continue to encourage them to build appropriate insurance solicitation systems from the following perspectives.

1) Status of Observance of Sales and Solicitation Rules for Insurance Products

The FSA will examine the status of observance of sales and solicitation rules for insurance products by making use of reports from insurance companies, results of inspections conducted by inspection departments/bureaus, information from the Counseling Office for Financial Services Users. In particular, the FSA will examine the extent to which policyholders are provided with explanations of a “policy overview” and “alerting information”, the extent to which “intention confirmation forms” are utilized so that prospective policyholders can select insurance products that meet their needs, and the extent to which insurance companies observe precautions upon providing comparison information. The FSA will also examine their observance of sales and solicitation rules for insurance products with strong investment characteristics subject to the Financial Instruments and Exchange Act.

Moreover, the FSA will examine whether insurance companies are making voluntary efforts with respect to their policy leaflets, websites, such as providing prospective policyholders with easy-to-understand explanations of the coverage and the terms and conditions of their insurance policies by utilizing the buyers’ guide.

2) Stance on Excessive Collection of Fire Insurance Premiums

With respect to the misapplication of fire insurance premium rates and the excessive collection of fire insurance premiums, the FSA has requested that non-life insurance companies dealing in fire insurance, the General Insurance Association of Japan (GIAJ) and the Foreign Non-Life Insurance Association of Japan (FNLIA) conduct checks as to whether appropriate premiums are being applied. Currently, investigations are underway at both companies. Furthermore, the GIAJ has announced to the public that its member companies would voluntarily investigate not just fire insurance but also insurance products in general. As the supervisory authority, the FSA will keep a close eye on the progress of the investigations at both companies and examine the situation at the companies as necessary upon the completion of the investigations, including the rectification of the application of insurance premium rates.

3) Stance on Sales of Insurance Products through Banks and other depository institutions

With respect to sales of insurance products through banks and other deposit-taking institutions, the FSA will examine the implementation status of measures aimed at preventing detrimental effects thereof, and examine the status of observance of insurance solicitation rules by these institutions,

such as providing an appropriate explanation of the features of insurance policies to prospective policyholders.

(3) Enhancing Queries and Complaints Handling Systems

In order for insurance companies to improve their businesses voluntarily, it is important that they accurately identify queries and complaints from policyholders at the organizational level and deal with them in an appropriate manner, in addition to analyzing the nature of such queries and complaints as well as their causes. With this in mind, the FSA will examine the status of efforts being made by insurance companies from the following perspectives, and encourage them to build appropriate query and complaint-handling systems.

- 1) The FSA will examine whether a system has been built for the purpose of dealing with policyholders in a sincere and fair manner by accurately identifying and analyzing the nature of their queries and complaints.
- 2) The FSA will examine whether an adequate system has been built for compliance-related divisions to monitor branches and for audit divisions to conduct verification in order to ensure the effectiveness of the query and complaint-handling system.
- 3) The FSA will examine whether a system has been built for the purpose of analyzing and identifying the causes of queries and complaints and implementing company-wide business improvement efforts, including efforts at the management level.

(4) Developing a System to Properly handle Personal Information of Policyholders

It is an important duty for insurance companies to properly handle personal information, which is the basis of insurance policy transactions. However, accidents involving the leakage of personal information are still taking place, at times caused by agencies and outsourced.

With this in mind, the FSA will examine the development status of appropriate systems for handling personal information of policyholders, including the extent to which management teams are involved in the handle of personal information of policyholders, and the management status of agencies and outsourced contractors.

2. Taking a Supervisory Stance in accordance with the Business Scale and Style of Insurance Companies

Insurance companies vary widely in terms of business scale, ranging from large ones that constitute financial conglomerates to those that are generally small such as small-claims and short-term insurance businesses. Insurance solicitation styles also vary widely, ranging from those focusing on insurance agent/agency-oriented solicitations to those focusing on advertisement on TV and the

Internet. Insurance companies have their distinctive characteristics in terms of the solicitation styles they emphasize.

As the supervisory authority, the FSA needs to sufficiently identify the current state of such insurance companies as well as their issues through dialogue, and take a supervisory stance in accordance with their differences in business scale and style.

(1) Stance on Specific Insurance Businesses

The FSA's stance on specific insurance businesses will be as follows, pursuant to the *Supervisory Stance on Specific Insurance Businesses* (November 8, 2006)

1) Fact-finding in Relation to Specific Insurance Businesses

The FSA will examine the compliance status of specific insurance businesses required under the Insurance Business Act, such as measures concerning business operations, prohibited conduct in solicitation, personal information management and outsourcing by referring to the content of business reports, and to whether or not there are any problems in their financial position and the nature of their insurance policies. After examining the business reports, the FSA will make fact-finding efforts with respect to business operations as necessary, including interviewing specific insurance businesses.

2) Smooth Transition to Small-claims and Short-term Insurance Businesses

The FSA will properly deal with specific insurance businesses aiming to be registered as small-claims and short-term insurance businesses in order to facilitate their transition into small-claims and short-term insurance businesses ahead of the transition deadline (March 31, 2008), such as responding to their queries in accordance with their actual circumstances. Businesses that have opted not to be registered as small-claims and short-term insurance businesses are required to file an application for the approval of closure of business in advance; the FSA will process their approvals in view of the protection of policyholders in a thoroughgoing manner.

3) Stance on Businesses Not Filing a Notice as Specific Insurance Businesses

The FSA will make fact-finding efforts with respect to businesses that have not filed a notice as specific insurance businesses even though they correspond to- or are deemed to correspond to specific insurance businesses, including investigating the nature of their operations. If they are found to have been conducting insurance business without giving notice thereof, the FSA will issue a written warning, directly contact them and demand that the situation be rectified. The FSA will also collaborate with law enforcement authorities and other relevant authorities as necessary.

If a business underwrites new insurance policies after the expiry of the interim measure period

(March 31, 2008) without taking the necessary procedures set forth in the Insurance Business Act, the business will be operating without a license under the Insurance Business Act. The FSA will undertake fact-finding efforts with respect to such practices.

(2) Stance on Small-claims and Short-term Insurance Businesses

The FSA will examine governance systems, financial soundness, appropriateness of operations in view of the protection of policyholders. Bearing in mind that small-claims and short-term insurance businesses are particularly diverse in terms of the insurance products they provide, company size, the FSA will deal with such businesses in accordance with their actual circumstances rather than applying all supervisory evaluation items in a mechanical and undistinguishing manner.

(3) Stance on Insurance Holding Companies and Conglomerates

An insurance company group in the form of a conglomerate is claimed to be structurally facing spillover, uneven distribution, concentration of risks within the group, including the risk of conflict of interest, the risk of increased temptation of bundled sales, and reputational risk. As the supervisory authority, the FSA will seek collaboration within supervisory departments/bureaus and examine the appropriateness of operations of insurance companies/groups as a whole, in accordance with the *Guidelines for the Supervision of Financial Conglomerates*. If a company takes the form of an insurance holding company group, the FSA will examine the insurance holding company's governance system targeted at the group as a whole.

(4) Stance based on Characteristics of Insurance Solicitation Styles

The FSA will examine insurance companies with distinctive insurance solicitation styles such as those focusing on advertising on TV, internet as to whether solicitation is being performed appropriately based on the characteristics of their solicitation style, such as whether the solicitation advertisement is exposed to the risk of misleading prospective policyholders about the features of the insurance policy.

3. Promoting the Sophistication of Risk Management

Due to the increasingly diversified and complex needs of consumers and changes in the market environment, insurance companies are required to maintain financial soundness with the sophisticated risk management and disclose their financial information appropriately to policyholders based with voluntary and continuous efforts by their management team, in order to properly identify various risks and fulfill their responsibility to policyholders in an appropriate

manner.

The FSA will carry out supervision with a view that each company will adopt risk management practices that recognize the valuation of assets and liabilities consistently based on their economic values, in consideration of international trends. During the process, the FSA will sufficiently identify the current state and issues of the each insurers' risk management through dialogues.

With the aim of improving the quality of financial supervision methods, the FSA will collaborate further with the International Association of Insurance Supervisors (IAIS) and enhance its dialogue with the Institute of Actuaries of Japan, the Non-Life Insurance Rating Organization of Japan, and other organizations.

(1) Sophistication of Asset-Liability Management and Risk Management

1) In consideration of the *Standard on Asset Liability Management* published by IAIS in October 2006 and the report published by the study team on solvency margin ratio calculation standards in April 2007, the FSA will examine the current state, as well as future policies, of asset-liability management and risk management of all insurance companies.

2) With respect to economic value-based solvency assessment (i.e., evaluation method for insurance liabilities and interest rate risks based on the methods which are consistent with financial markets), the FSA will examine the efforts by all insurance companies with regards to management practices and efforts made by the Institute of Actuaries of Japan.

The FSA will make efforts with the aim to achieving a solvency regime that recognizes changes in net asset value, (i.e. the difference between asset value and liability value based on economic value) as risk volume, and manages such changes properly. In doing so, the FSA will consider a regime which will provide incentive to insurance companies to further sophisticate their risk measurement and risk management.

3) The FSA will examine the evaluation method of catastrophic risks—i.e., risks of earthquakes and risks of windstorms and floods—in each non-life insurance company.

4) The FSA will examine the development status of investment risk managements, in consideration of the increasing diversity and complexity of the invested assets.

(2) Enhancing Disclosure of Financial Information

1) The FSA will examine whether the meaning of solvency margin ratio, the total amount and breakdown of solvency margins, the significance, total amounts and breakdowns of risks in the solvency margin ratio are shown properly in an easy-to-understand format in the information disclosed about the enhancement of the ability to pay insurance claims. In doing so, the FSA will also examine whether changes in the total amounts of solvency margins are shown, whether the revenue sources for solvency margins are declared in the balance sheet, whether their features

are described such as being permanent, whether solvency margins are properly compared with risks, and whether the numerical values of solvency margins ratio itself are overemphasized.

2) The FSA will examine whether the characteristics of risks faced by insurance companies are shown properly in an easy-to-understand format in the disclosed information pertaining to their risk management frameworks, including whether or not internal risk management and asset-liability management have become more sophisticated than the identification of risks under regulations on the solvency margin ratio.

3) The FSA will examine whether the results of the stress tests, liability adequacy tests on third-sector liability reserves are properly disclosed.

(3) Ensuring Adequate Level of Liability Reserves

1) The FSA will focus on examining the adequate level of liability reserves in terms of governance by focusing primarily on whether they are fulfilling their functions, such as whether chief actuaries are sufficiently involved in managing the level of liability reserves, in consideration of the appraisal of insurance liabilities based on economic value.

2) The FSA will examine whether stress tests and liability adequacy tests on third-sector liability reserves are being properly conducted.

3) The FSA will examine whether the Institute of Actuaries of Japan properly analyze and study the appropriateness of the level of the standard mortality rate in the standard mortality table of life insurance companies.

(4) Examining the Reference Loss Cost Rates and Loading Premiums

1) The FSA will examine whether the Non-Life Insurance Rating Organization of Japan properly perform its task of verifying the reference loss cost rates and the pure premium rate portion of standard full rates for earthquake insurance.

2) The FSA will examine whether reasonableness, fairness are ensured in the calculation of loading premiums at each insurance company through monitoring.

4. Ensuring Sufficient Communication with Stakeholders in the Insurance Market

It is important that the FSA and insurance companies, insurance agents, insurance agencies, insurance brokers, consumers and their related organizations adequately share their experiences and knowledge with each other, in order to ensure the sound and appropriate operation of insurance businesses and ensure fairness in insurance solicitation and protection of insurance policyholders.

To this end, as the supervisory authority, the FSA will proactively exchange opinions on a regular basis with stakeholders in the insurance market, including the aforementioned insurance companies,

related organizations, and endeavor to share with- and communicate to them its experience and knowledge. The FSA will also implement proper follow-ups to efforts made by related organizations so as to develop voluntary rules and cooperate with them as necessary.