

Annual Supervisory Policies for Insurance Companies, etc. for Program Year 2010

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, and in full consideration to the role which insurance companies should play in the people’s lives and economic activities, the FSA will place priority on three areas: Promoting the Sophistication of Risk Management, Improving Customer Protection and Convenience for Users, and Taking a Supervisory Response Corresponding to the Characteristics of Insurance Companies, etc. Based on this, the FSA will undertake the supervision of insurance companies, etc.

It should be noted that these supervisory policies were drawn up in light of the circumstances that surrounded financial institutions as of August 2010, and may be subject to review as necessary.

1. Environment Surrounding Financial and Capital Markets, and Basic Concepts on Supervision of Financial Institutions for the Future

(1) Environment Surrounding Financial and Capital Markets

Japan’s economy is now solidly recovering, but still faces harsh conditions, with risk factors stemming from global economic recession concerns, fluctuations in financial and capital markets, the effects of deflation, etc. In particular, large growth in fund inflows was seen in emerging economies, supported by their fast growth, while in Europe, fiscal problems sparked by Greece became more serious, and in the U.S., there was stronger sentiment that the economic outlook is unclear. In response, uncertainty in financial and capital markets has increased along with larger price fluctuations. Under these conditions, global movements are having even greater effects on Japan than before.

In the year ended March 31, 2010, final profit levels in general greatly improved at insurance companies due to improved securities related gain/loss, reduced operating costs, etc. However, conditions require continued observation of risks faced by insurance companies.

In the “New Growth Strategy” approved by the Cabinet in June this year, the financial sector is expected to back up and support the real economy and enterprises. Insurance companies are also expected to support the risk management of enterprises, by underwriting insurance, etc.

In addition to the domestic market, insurance companies are actively expanding into Asia and other overseas markets. To do this, they must practice risk management and make sure they are financially sound as financial institutions.

(2) Approach Taken by Supervisory Authority

Under these conditions, in the financial supervision for this Program Year, the basic policy is to further solidify and make progress in “Better Regulation” (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). In particular, in accurately managing various risks, customer protection, etc., financial institutions are strongly expected to be aware of long-term managerial issues. They are also expected to conduct positive managerial reforms, and make appropriate, swift and responsible business judgments under the appropriate leadership of management personnel.

To this end, the FSA will take the following approaches as the supervisory authority.

1) Supervisory Response based on High Risk Sensitivity

In order to accurately respond to currently conceivable risks, the FSA will gain a deeper understanding of the macroeconomy and financial and capital markets, deepen awareness of how these affect the soundness of financial institutions, and identify and understand from a forward-looking perspective the risks which accumulate in each financial institution and in the financial system. It will also promote integrated on-site and off-site monitoring in an effort at early identification of risks.

2) Supervisory Response from a Citizen’s and User’s Point of View

The FSA will strive to take regulatory actions so as to further improve customer protection and convenience for users, by looking at things from a citizen’s and user’s point of view.

3) Supervisory Response with a Future Outlook

The FSA will strive to take regulatory actions that, rather than stopping at short-term responses, seize the trend of international discussions in a sufficient manner and predict environmental changes, while at the same time implementing long-term responses with an eye on the future.

4) Supervisory Response which Contributes to Financial Institutions Autonomously Improving Management and Making Better Business Judgments

The FSA will help financial institutions autonomously improve management and make better business judgments, via frank and deep discussions and the distribution of information with financial institutions.

In performing supervision, in addition to these approaches, the FSA will also bear the following points in mind.

- In addition to performing joint interviews with inspection divisions and encouraging other forms of closer cooperation with inspection divisions, the FSA will also cooperate with overseas authorities via supervisory colleges, and positively contribute to international standards setting bodies.
- The necessity of reports and submitted documents will be periodically reviewed once per year, as part of consideration for reducing the burdens on financial institutions.

- Through the thorough fostering, securing and training of specialized human resources, the FSA will redouble efforts for human resource development.

2. Promoting the Sophistication of Risk Management

Amid the financial crises of recent years, 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 the 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 overall 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 by insurance companies to gain 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.

4) For insurance company groups and groups headed by insurance holding companies which are subject to the consolidated financial regulations to be introduced, the FSA will strive for timely and accurate understanding of the business status of the entire group, and conduct investigations while placing priority on the status of development of the entire group's comprehensive risk management system.

5) In cases of management integration, the FSA will verify the holding company governance, and progress on information system integration.

(2) Review of Solvency Assessment, etc.

1) The FSA will promote preparations for the smooth introduction of risk measurement by more stringent solvency margin ratios (disclose reference indices starting March 31, 2011, and come into force from March 31, 2012). This review will work on informing insurance policyholders and market participants.

2) Given that the International Association of Insurance Supervisors (IAIS) is examining a regulatory framework detailing solvency assessments on the 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.

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.

3) 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 increased public confidence in financial institutions. In financial institutions, when implementing strict administration 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 as a result of financial institutions' pursuit of short-term profits or their conflicts of interest.

Furthermore, as the need arises the FSA will cooperate with the Consumer Affairs Agency, an institution expected to promote integrated consumer administration.

(1) 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, last year the firewall regulations were revised and a principles-based framework was created to encourage financial institutions to have an autonomous management system to deal with conflicts of interest. With regard to these, the FSA will conduct investigations as to whether insurance companies, etc. have made accurate responses with regard to improved customer convenience and the prevention of conflicts of interest.

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

1) Under the recognition that the payment of benefits is the most important obligation of insurance companies, etc., the FSA will conduct investigations while placing priority on whether effective systems have been developed which allow insurance benefits to be paid in a timely and appropriate manner, including bringing to light the possibility that insurance benefits are not properly paid, and whether relevant organizational and continual efforts are being made. The FSA will also verify whether there are systems to properly investigate the possibility of additional insurance benefit payments, even after insurance benefits have been paid.

2) The FSA will conduct investigations while placing priority on whether systems have been developed to provide each customer with swift and appropriate claims guidance administration, etc. from the viewpoint of customer protection and user convenience 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 are addressed, swiftly and appropriately, from the viewpoint of customer protection and user convenience).

(3) Establishment of Appropriate Distribution System of Insurance Products

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. The FSA will also verify that proper distribution control systems are created in insurance distributors.

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

1) It is extremely important to ensure customer trust in financial products and services, and carry out independent, timely and appropriate consultations and complaint handling, after implementing business management that actively makes good use of customer needs. From this viewpoint, the FSA will verify whether internal control systems are developed so that the top management is involved in properly executing such actions as the development of suitable contact points, analyzing the causes of consultations and

complaints, sharing information internally, and taking measures and providing notifications to prevent the recurrence of complaints, and conducting follow-ups on the implementation status of such actions.

2) The FSA will also verify whether required systems have been prepared for the start of the financial ADR system to be introduced this October.!!

4. Taking a Supervisory Response Corresponding to the Characteristics 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 distribution channels of insurance products are also becoming more diverse, and now include those focusing on distributors or agencies, or on mail-order sales. In consideration of these circumstances, the FSA will take a supervisory response according to the business scale, style and such other attributes of insurance companies, etc.

In order to efficiently ascertain the actual practices, focused off-site interviews will be conducted in cooperation with inspection divisions, based upon the type of operations of the insurance company.

(1) Measures for Insurance Groups

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.

(2) Measures for Small and Medium-sized Insurance Companies

The FSA will also endeavor to efficiently ascertain the actual conditions for small and medium-sized insurance companies, while working on closer cooperation with inspection divisions.

(3) 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 internal control systems, their financial soundness and their operational appropriateness. In doing so, the FSA will focus careful monitoring on small-amount and short-term insurance providers which have problems with financial soundness, etc.

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 will become special incorporated foundations or associations, and will then switch to new corporations

by November 30, 2013. Given that the regulations under the Insurance Business Act will be fully applied to all 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.

(4) Measures Corresponding to Different Distribution Channels

- 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 appropriate solicitation for their respective channels, including checking whether there is any risk that the advertisement may mislead customers about the features of the insurance policy.
- 2) Regarding over-the-counter sales of insurance products at banks, etc., 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.

(5) Ensure Effective Product Examinations

The FSA will work on effective product examinations, while also boosting speed and efficiency, while maintaining the perspective of policyholder protection.