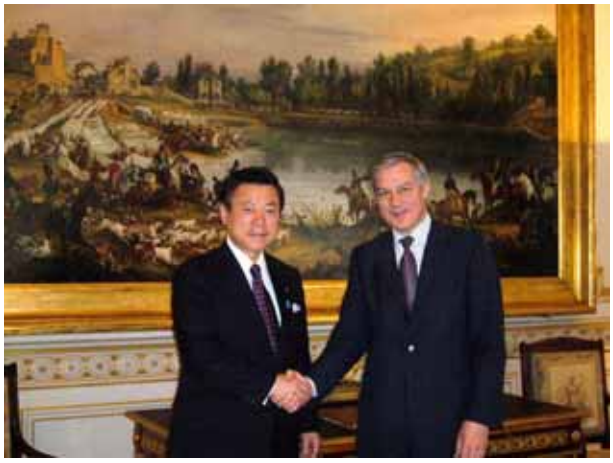
FSA Newsletter June 2006



Yoshitaka Sakurada (Senior Vice Minister for Financial Services) meets with Christian Noyer, (Governor of the Banque de France) on May 22nd.

FSA launched a for kids website on May 11th. (available in Japanese only)

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【Topics】

Working Group on Information Technology Innovations and Financial System, Sectional Committee on Financial System of Financial System Council: "Issues facing the Development of New Electronic Payment Services (Memorandum of Chairman)"

The Working Group on Information Technology Innovations and Financial System (hereinafter referred to as the "Working Group", Chairman: Professor Shuya Nomura, Chuo Law School) under the Sectional Committee on Financial System of the Financial System Council has conducted a fact-finding survey on new prepaid-type electronic payment services exemplified by so-called electronic money based on interviews with service providers and summarized the issues on seven occasions in total since October 2005, as part of its studies aimed at compiling legislation to enable users to actively enjoy the benefits of innovations in information technology (IT) and to improve the convenience, etc. of the financial infrastructure based on the Program for Further Financial Reform announced in December 2004.

A summary of the discussions which took place in the Working Group was released to the public in the form of the Chairman's memo entitled "Issues facing the Development of New Electronic Payment Services" on April 26.

In consideration of the Working Group's discussions so far, the Memorandum of Chairman is primarily a summary of: (1) matters to be considered by service providers; and (2) issues to be studied by the government in the future.

This article provides an overview of the Chairman's memo.

I. Overview of Issues facing the Development of New Electronic Payment Services (Memorandum of Chairman)

1. Description of Recent Electronic Payment Services

Electronic payment services are wide-ranging. The Working Group interviewed providers of prepaid-type electronic payment services which are becoming increasingly widespread nowadays. The Memorandum of Chairman summarizes and categorizes the services into "electronic payment services using IC chips" and "electronic payment services over the Internet", based on the interview results.

Among the two, "electronic payment services using IC chips" continue to expand rapidly in line with the sophistication of traffic cards and IC cards *per se* and affiliations with convenience stores, mileage programs, point-based rewards programs, etc. As of March 2006, the number of issued IC cards, etc. exceeded 28 million. Moreover, services have been diversifying recently, as exemplified by the provision of services using not only IC cards but also IC-chip-embedded mobile phones and the launch of services which enable electronic value to be transferred between users.

"Electronic payment services over the Internet" are characterized by the administration of electronic value with respect to each user solely on the service provider's server, without issuing cards, etc. which carry electronic value.

2. Matters Deemed to Require Consideration by Electronic Payment Service Providers

A wide range of electronic payment services are expected to be developed and disseminated in the future, but there is currently no legislation, etc. which regulates such electronic payment services across the board. For this reason, the Working Group has indicated that the following five matters should at least be considered by providers of electronic payment services, in order to improve the reliability of services by ensuring the protection of users and stability in settlement.

(1) Clarification of contractual relationships, etc.

- Service providers should clearly state, for example, the point in time at which the user's obligation to make a payment disappears, the responsibilities of the user and the service provider and other such matters in an easy-to-understand manner for users in the terms and conditions of use.

(2) Handling of loss, impairment, etc. of electronic value data

- Service providers should clearly state how electronic value data on IC chips and servers will be handled in

the event that it is lost, impaired, etc. in the terms and conditions of use, etc., especially the conditions of re-issuance, etc.

(3) Information security and ensuring reliability of system operation

- In particular, services in which electronic value data is centrally managed solely on the service provider's server are deemed to be exposed to higher risks of hacking, unauthorized use and other illicit acts. Therefore, countermeasures should be taken, such as devising an authorization mechanism.

(4) Proper management of advances received

- In the case of electronic payment services which involve receiving a certain amount of money from users in advance, a service provider should have a mechanism to refund as much money as possible even if it goes bankrupt.

(5) Protection of personal information

- While this is not limited to electronic payment services, due caution needs to be exercised especially when using the usage log in other operations, etc. in order to protect personal information.

3. Issues Relating to Electronic Payment Services to be Studied in the Future

In the Working Group's discussions, members have pointed out that the dissemination of electronic payment services has the potential to affect the future profile of Japan's financial settlement system and that problems are arising with which are difficult to be dealt legally within the existing legislative framework in providing diverse services according to users' needs. With this in mind, it is deemed necessary to properly develop an environment in which users can receive highly convenient services from private service providers with a sense of security, and private service providers can evolve diverse services according to user needs based on their creativity.

From this perspective, it is deemed necessary for the government to continue conducting studies especially on how to deal with the following three issues in the future, by taking trends in other countries into account, while making sure the development of services in line with IT innovations will not be hindered, in light of the future trends in electronic payment services, etc.

(1) User protection in the event that the service provider goes bankrupt

- Currently, the Law for Prepaid Cards does not apply to services in which electronic value data is managed solely on the service provider's server. It is deemed necessary to work out an appropriate user protection method to deal with cases in which such a service provider goes bankrupt.

(2) How responsibility should be shared between parties to electronic payment services, etc.

- It is deemed necessary to look into how responsibility should be shared between the service provider and the user, etc. in cases where some kind of problem arises in the electronic payment services (e.g., cases where electronic value data is lost or impaired or the settlement is not completed or delayed due to system failure, etc.) in order to protect users and ensure confidence in electronic payment services.

(3) Modality of electronic payment services

- In light of user convenience, some members pointed out during the Working Group's discussions that user convenience would improve if services that transfer electronic value between users and services that convert electronic value into cash are provided.
- On the other hand, it is necessary to clearly define the relationship between these services with the existing legislative framework and business practices regarding "exchange transactions" under the Banking Law and "deposits" under the Law Concerning the Regulation of Receiving of Capital Subscription, Deposits and Interest on Deposits. In relation to this, for example, some members said that sufficient user protection should be sought when looking into the modality of regulations, etc., and that if the electronic value is small and the services are provided to the extent that they are deemed unlikely to seriously affect the stability of the financial settlement system, one way is to establish certain rules for handling them with other settlement services.
- Accordingly, the Working Group expects the government to continue actively conducting studies in the future on the ideal form of electronic payment services to enable the provision of diverse and stable settlement services and properly protect users in consideration of the above.

II. Future Actions

The Financial Services Agency (FSA) expects service providers to continue making efforts in providing

services in consideration of user protection, etc., by heeding the matters pointed out in the Memorandum of Chairman. Furthermore, the FSA will continue examining the matters pointed out in the Memorandum of Chairman as issues that need to be studied by the government in the future, in order to enable diverse and stable settlement services and to properly protect users, while making sure that the development of services in line with IT innovations will not be hindered.

Convocation of 5th Meeting of Subcommittee on Certified Public Accountants System of Financial System Council

The 5th meeting of the Subcommittee on Certified Public Accountants System of the Financial System Council was held on Wednesday April 26.

The Subcommittee had engaged in deliberations and made recommendations to improve the certified public accountants (CPAs) system throughout fiscal 2001 and 2002, which led to the revision of the Certified Public Accountant Law in 2003. After an extended recess, the Subcommittee decided to resume deliberations in consideration of the circumstances subsequently faced by the system of CPAs and auditing firms.

Audits conducted by CPAs and auditing firms constitute an extremely important system for ensuring the reliability of financial statements, and their enhancement and reinforcement are pressing challenges. Under these circumstances, the Subcommittee plans to conduct comprehensive studies on how auditing firms, etc. should operate.

As the issues regarding how auditing firms, etc. should operate are deemed to be wide-ranging, the Subcommittee intends to narrow down the specific issues in the course of having discussions with members from a broad perspective in the months ahead.

At the 5th meeting, the Executive Bureau first explained the circumstances faced by the system of auditing firms, etc. This was followed by a free discussion, in which members expressed their opinions from a broad perspective.

In the next meeting, the Subcommittee plans to summarize the system of auditing firms, etc. in other countries and hold discussions based on the summary.

Results on "Small- and Medium-Sized Enterprise Financing Monitoring" Conducted in February 2006

"Small- and Medium-Sized Enterprise (SME) Financing Monitoring" is performed on a quarterly basis by employees of the Local Finance Bureaus and Offices with the cooperation of the Japan Chamber of Commerce and Industry (JCCI), etc. for the purpose of accurately identifying the actual status, etc. of SME financing from the viewpoint of SMEs in the respective regions, as part of efforts to facilitate SME financing.

The Financial Services Agency (FSA) recently summarized and published the following results of SME Financing Monitoring conducted in February 2006.

An overview of the latest survey results reveals that:

(1) While lending trends in SME financing over the most recent three months varied from region to region, the majority of interviewees answered "Turned positive" or "Turned somewhat more positive" in nine out of eleven regions. Those who responded "Turned negative" or "Turned somewhat more negative" accounted for less than 20% in all regions.

(2) Judging from the comments on the actual status of SME financing, a positive trend seems to be spreading steadily among financial institutions in general, exemplified by financing without excessive reliance on collateral and guarantees, as negative comments (e.g., "stance to lending varies with the borrower's financial position") received were limited in number.

The FSA will continue to make efforts in facilitating SME financing, including actively identifying the local sentiment towards SME financing through Monitoring and making use of the findings as important information when inspecting and supervising financial institutions.

1. 1. Subjects of Monitoring

We conducted interviews with a total of 397 individuals (from 206 organizations) in 47 prefectures nationwide who are involved in management consulting in such organizations as JCCI, Central Federation of Societies of Commerce and Industry, Societies of Commerce and Industry, National Federation of Small Business Associations, Federations of Chambers of Commerce and Industry and Small and Medium Entrepreneurs Associations.

Organization	Number of Interviewees (Number of Organizations)
JCCI	198 (86)
Societies of Commerce and Industry	97 (79)
Central Federation of Societies of Commerce and Industry	61 (21)
National Federation of Small Business Associations	31 (14)
Federation of Chamber Commerce and Industry	5 (3)
Small and Medium Entrepreneurs Associations	5 (3)
Total	397 (206)

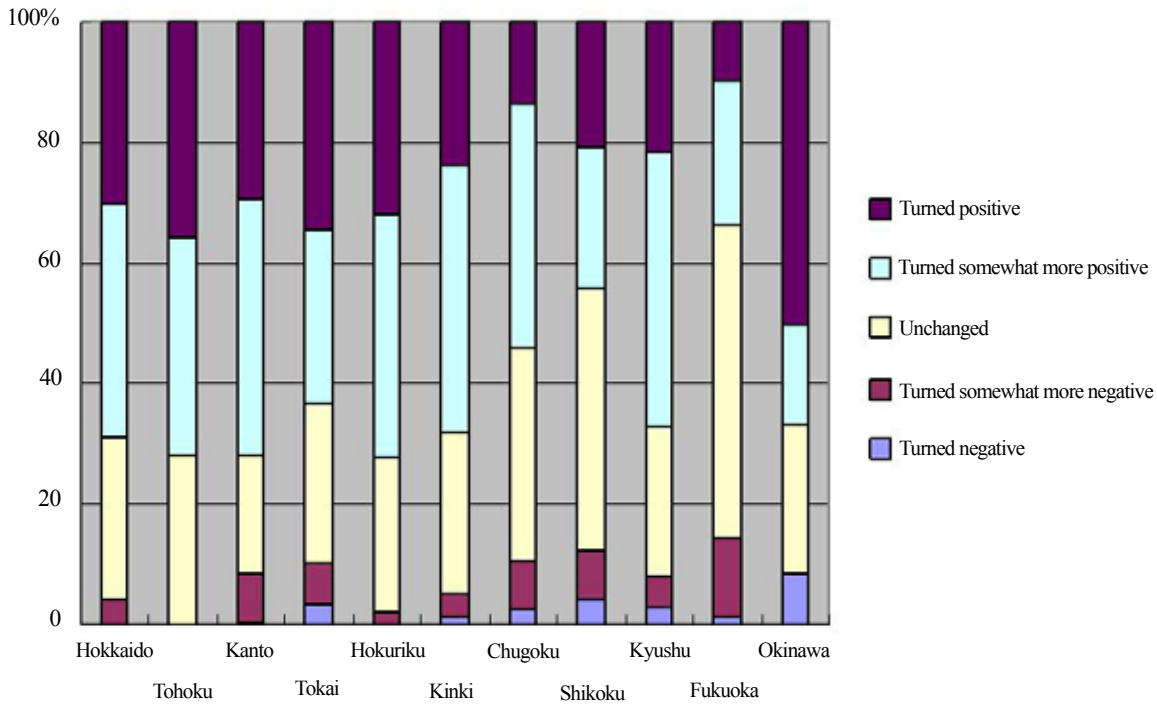
(Note) As SME Financing Monitoring is not a fixed-point survey in which the survey is conducted with the same interviewees every time, the number and identity of interviewees may vary between surveys.

2. Overview of Interview Results

(1) Overview of interview results: "Lending trends in SME financing over the most recent three months"

[By Region]

While the results varied between regions, the majority of interviewees answered "Turned positive" or "Turned somewhat more positive" in the Hokkaido, Tohoku, Kanto, Tokai, Hokuriku, Kinki, Chugoku, Kyushu and Okinawa regions. Those who responded "Turned negative" or "Turned somewhat more negative" accounted for less than 20% in all regions.



[By Type of Financial Institution]

Trend over Most Recent 3 Months	Major Banks		Regional Banks, Second-tier Regional Banks		Shinkin Banks, Credit Unions		Government-affiliated Financial Institutions		Total	
1. Turned positive	56	25.7%	67	18.0%	86	24.0%	137	35.7%	346	26.0%
2. Turned somewhat more positive	85	39.0%	159	42.6%	151	42.2%	120	31.3%	515	38.6%
3. Unchanged	61	28.0%	119	31.9%	101	28.2%	93	24.2%	374	28.1%
4. Turned somewhat more negative	12	5.5%	25	6.7%	12	3.4%	30	7.8%	79	5.9%
5. Turned negative	4	1.8%	5	0.8%	8	2.2%	4	1.0%	19	1.4%
Total	218	100.0%	373	100.0%	358	100.0%	384	100.0%	1333	100.0%

(Note 1) SME Financing Monitoring is not a fixed-point survey in which the survey is conducted with the same interviewees every time.

(Note 2) The table above shows the breakdown of valid responses and does NOT include non-responses and unclear responses. For this reason, the number of interviewees is not consistent with the total number of responses.

- Reasons given by respondents who selected "4. Turned somewhat more negative" or "5. Turned negative" in the table above

Reasons given for Answer 4 or 5 above	Major Banks		Regional Banks, Second-tier Regional Banks		Shinkin Banks, Credit Unions		Government-affiliated Financial Institutions		Total	
Refusal of new loan requests	1	4.8%	7	17.9%	8	30.8%	8	19.5%	24	18.9%
Collateral & guarantee	3	14.3%	14	35.9%	8	30.8%	5	12.2%	30	23.6%
Interest rates	1	4.8%	3	7.7%	2	7.7%	1	2.4%	7	5.5%
Lending terms	5	23.8%	9	23.1%	5	19.2%	14	34.1%	33	26.0%
Loan assessment procedures	5	23.8%	5	12.8%	3	11.5%	10	24.4%	23	18.1%
Other	6	28.6%	1	2.6%	0	0.0%	3	7.3%	10	7.9%
Total	21	100.0%	39	100.0%	26	100.0%	41	100.0%	127	100.0%

(Note) As a single interviewee may give multiple answers, the total number of answers 4 and 5 above (98) is not consistent with the total number of the responses in the table above (127).

(2) Overview of interview results: "Actual status, etc. of SME financing in the respective regions from the viewpoint of SMEs"

> Interviews were conducted on the following eight topics regarding the actual status, etc. of SME financing in the respective regions from the viewpoint of SMEs:

(a) Stance to lending
(b) Collateral and guarantee
(c) Management guidance and business startup or revival assistance
(d) System of providing explanation when lending
(e) Quality and ability of financial institutions
(f) Period of loan assessment
(g) Interest rates
(h) Others

> Main comments received with respect to each topic are as follows:

(a) Comments on actual status of stance to lending

- There have been no reports on credit crunch and oppressive debt collection. Financial institutions are generally inclined to actively tap new borrowers. (Hokkaido, Tohoku, Kanto, Tokai, Hokuriku, Kinki,

Chugoku, Shikoku, Kyushu, Fukuoka and Okinawa)
- Staff of financial institutions come to places of business for solicitation and respond promptly to changes in lending terms. (Hokkaido, Kanto, Tokai, Hokuriku, Kinki, Kyushu, Fukuoka and Okinawa)
- Can acknowledge the branch manager's positive stance from regular visits to the Chamber of Commerce and Industry, etc. to collect information on regional affairs and request mediation for financing, etc. (Hokkaido, Kanto, Tokai, Hokuriku, Kinki, Kyushu, Fukuoka and Okinawa)
- Financial institutions' stance to lending varies and is becoming polarized due to their cherry-picking of borrowing companies. (Hokkaido, Kanto, Kinki, Shikoku, Kyushu, Fukuoka and Okinawa)

(b) Comments on actual status of collateral and guarantee

- It is becoming easier to borrow partly due to the commercialization of affiliated loans targeted at JCCI members, etc. which do not require any collateral/third-party guarantee. (Hokkaido, Tohoku, Kanto, Tokai, Hokuriku, Kinki, Chugoku, Shikoku, Fukuoka and Okinawa)
- Financial institutions are providing loans without relying on collateral and guarantees after properly assessing the business performance of the company itself. (Hokkaido, Tohoku, Kanto, Kinki, Chugoku, Kyushu and Fukuoka)
- Additional collateral is no longer requested upon refinancing. (Hokkaido, Tohoku, Tokai, Kinki and Shikoku)
- The valuation of collateral is reasonable and financial institutions are lending actively. (Tohoku, Kanto, Hokuriku and Shikoku)
- Financial institutions do not rely on collateral and guarantees as excessively as they used to. (Hokkaido, Tohoku, Tokai, Kinki, Chugoku, Shikoku, Kyushu and Fukuoka)
- Financial institutions might be focusing on collateral and guarantees because considerable skill is required for non-collateral valuations. (Tokai and Kyushu)
- Financial institutions' stance to lending still appears to be dependent on collateral and guarantees. (Hokkaido, Tohoku, Kanto, Tokai, Hokuriku, Kinki, Chugoku, Shikoku, Kyushu, Fukuoka and Okinawa)
- Financial institutions are shifting their focus from physical collateral to human resources collateral. (Tohoku, Kyushu and Fukuoka.)

(c) Comments on actual status of management guidance and business startup or revival assistance

- Financial institutions are making efforts aggressively at the organization level, such as establishing management consulting divisions. (Hokkaido, Tohoku, Kanto, Tokai, Kinki, Chugoku and Fukuoka)
- Financial institutions are appointing experts and making efforts in human resources development. (Hokkaido, Tohoku, Kanto, Tokai, Chugoku and Fukuoka)
- Financial institutions are preparing aggressive revival plans by digging deep into management affairs. (Hokkaido, Tohoku, Kanto, Tokai, Kinki, Chugoku, Kyushu and Fukuoka)
- Financial institutions are actively providing consulting and business-matching services while training SME management consultants. (Kanto, Tokai, Hokuriku, Kinki and Okinawa)
- Financial institutions are making aggressive efforts in holding management seminars, collaborating with SME Revitalization Support Councils and investing in funds. (Hokkaido, Kanto, Tokai, Hokuriku, Kinki, Chugoku, Shikoku, Kyushu and Okinawa)
- Financial institutions are making progress in joint industry-academic-government initiatives. (Hokkaido, Kanto, Hokuriku and Shikoku)
- Financial institutions do not have the structure to venture into management guidance and business startup/revival assistance. (Hokkaido, Kanto, Tokai, Hokuriku, Kinki, Chugoku, Shikoku, Kyushu, Fukuoka and Okinawa)
- Financial institutions are not actively engaged in management guidance and business startup/revival assistance. (Hokkaido, Tohoku, Kinki, Chugoku, Shikoku and Kyushu)

(d) Comments on system of providing explanation when lending

- The explanations provided by financial institutions seem sufficient, as there are opportunities for the

company, financial institution, and the Society of Commerce and Industry, etc. to have tripartite meetings. (Hokkaido, Kanto, Tokai, Hokuriku, Kinki, Chugoku, Fukuoka and Okinawa)
- Financial institutions are providing sufficient explanation upon financing with respect to the purpose of funds, cash flows, cash planning, borrowing limit, etc. (Hokkaido, Kanto, Tokai, Hokuriku, Kinki, Kyushu, Fukuoka and Okinawa)
- Financial institutions appear to be improving their system of providing an explanation at the organization level. (Hokkaido, Tohoku, Kanto, Hokuriku, Kinki, Chugoku, Shikoku and Fukuoka)
- Financial institutions are making sure that a careful explanation is provided even in cases where a request for a loan is rejected. (Hokkaido, Tohoku, Kanto, Hokuriku, Chugoku, Shikoku and Kyushu)
- Explanation of risks and matters that are disadvantageous to financial institutions is insufficient. (Hokkaido, Tohoku, Kyushu and Fukuoka)
- Financial institutions lack the ability to provide an explanation, including the staff's lack of knowledge. (Kanto, Kinki, Chugoku, Fukuoka and Okinawa)
- Explanation is insufficient in cases where a loan request is rejected. (Hokkaido, Tohoku, Kinki, Chugoku, Shikoku and Kyushu)

(e) Comments on actual status of quality and ability of financial institutions

- Financial institutions are making aggressive efforts at the organization level, including encouraging staff to acquire qualifications. (Hokkaido, Tohoku, Kanto, Tokai, Hokuriku, Kinki, Shikoku, Kyushu and Fukuoka)
- Financial institutions are actively conducting training to improve their discerning eyes, and are gaining the ability to determine the future potential of companies. (Hokkaido, Tohoku, Kanto, Hokuriku, Chugoku, Kyushu and Fukuoka)
- The qualities and abilities of financial institutions are sufficient in terms of analysis of financial statements, analysis of cash flows, etc. (Hokkaido, Kanto, Tokai, Hokuriku, Kinki, Kyushu and Fukuoka)
- Financial institutions are not making enough efforts to improve the qualities and abilities of staff at the organization level. (Hokkaido, Kanto, Hokuriku, Kinki, Chugoku, Shikoku, Kyushu and Fukuoka)
- Financial institutions are attaching importance to past performance, while ignoring the qualities of the top management and the future potential of companies. (Hokkaido, Tohoku, Kanto, Tokai, Hokuriku, Kinki, Chugoku, Shikoku, Kyushu, Fukuoka and Okinawa)

(f) Comments on period of loan assessment

- The assessment period is becoming shorter. (Hokkaido, Tohoku, Kanto, Tokai, Hokuriku, Kinki, Chugoku, Shikoku, Kyushu, Fukuoka and Okinawa)
- Financial instruments with shorter assessment periods are being developed, as exemplified by "speedy loans". (Hokkaido, Tohoku, Kanto, Tokai, Kinki, Shikoku, Kyushu and Fukuoka)
- The assessment process is becoming simpler—for example, less documentation is required for application. (Kanto, Hokuriku, Kinki and Shikoku)
- The assessment period is still long for some loans. (Hokkaido, Tohoku, Kanto, Kinki, Chugoku, Fukuoka and Okinawa)
- The assessment period is becoming shorter (some as short as two to three business days) based on the utilization of SME credit risk database (CRD), unique scoring sheets, etc. However, the assessment period is long (approx. one month) for some publicly-backed loans. (Kanto, Kinki and Chugoku)

(g) Comments on actual status of interest rates

- There have been no particular complaints about interest rates. (Hokkaido, Tohoku, Kanto, Tokai, Hokuriku, Kinki, Chugoku, Shikoku, Kyushu, Fukuoka and Okinawa)
- Interest rates are on the decline. In some cases, financial institutions offer lower interest rates due to competition with other banks. (Hokkaido, Tohoku, Kanto, Tokai, Hokuriku, Kinki, Chugoku, Shikoku and Okinawa)
- Interest rates are being set properly according to the credit risks. (Hokkaido, Tohoku, Kanto, Tokai,

Hokuriku, Kinki, Chugoku, Shikoku and Kyushu)

- There have been no reports lately about financial institutions demanding that interest rates be raised one-sidedly. (Shikoku)
- While financial institutions have the right to decide interest rates, negotiations with the loan applicant are inadequate in some cases. (Kanto and Kinki)
- In some cases, high interest rates are offered even to applicants with a good financial position unless they negotiate with financial institutions. (Tohoku, Kanto, Tokai, Hokuriku, Kinki, Chugoku, Kyushu, Fukuoka, Okinawa)

(h) Other Comments

- JCCI and other commerce/industry-related groups should be provided with information on all monetary policies, not just on SME financing. (Tohoku)
- While it goes without saying that financial institutions should be supervised properly, "debt" still tends to be considered a taboo in Japan, resulting in the lack of proper education both at home and at school. Deregulation seems to have taken precedence in that users appear to be at the mercy of service providers due to having virtually no knowledge. For this reason, users should be educated properly on matters that they should at least be aware of. (Kanto)
- In some cases, companies apply for loans without making business efforts, as a wide range of publicly-backed loans are available. In a way, it hinders the growth of young entrepreneurs. (Hokuriku)
- There are cases in which the loan applicant agrees to everything the financial institution says in negotiations over the discount rate of bills and the lending rate. Part of the problem is the lack of learning efforts on the borrower's side. (Kinki)
- A system that enables businesses to revive even after failing once (bankruptcy, etc.) should be established. Direct financing should also be realized in rural districts. Otherwise, it would be difficult to start new businesses and revive existing businesses. (Kyushu)

(3) Overview of interview results: "Case examples showing the penetration of measures for facilitating SME financing"

- In SME Financing Monitoring, a specific theme relating to inspection and supervision is set each time, and a survey is conducted accordingly with respect to cases showing the penetration of measures for facilitating SME financing.
- The theme for the latest Monitoring was as follows.

Degree of SMEs' awareness of the Supplementary Issue to the Financial Inspection

[Main Comments Received]

- Although the Supplementary Issue to the Financial Inspection Manual seems to have penetrated enough related institutions, it does not appear to have penetrated borrowers (SMEs).
- Now that financial institutions' lending stance is positive, the Supplementary Issue might not be as necessary as before.
- Public sentiment has improved since the production of the Supplementary Issue. The Supplementary Issue is hardly discussed nowadays.
- Why not utilize PR campaigns using the Internet, TV commercials and other media?

3. How the "SME Financing Monitoring" Results Are Utilized

(1) Interviews

We conducted interviews with individual financial institutions in regards to their action policies, systems, etc. by making effective use of the information on those financial institutions obtained from SME Financing Monitoring.

(2) Requests at Discussion Meetings (Utilized by FSA)

We present cases acquired from SME Financing Monitoring at monthly discussion meetings held between top

officials of the FSA and representatives of business associations and on other occasions. More specifically, we request participants to: further facilitate the supply of funds to sound SMEs, including loans focusing on cash flows from business activities without excessively relying on collateral and guarantees; provide a sufficient explanation that could gain customers' understanding and convince them, in consideration of the past business relationship and the customers' knowledge, experience and asset positions; make the Supplementary Issue to the Financial Inspection Manual common knowledge; and so on.

(3) Utilization at Conference for Regional Financing Facilitation (Utilized by Local Finance Bureaus, etc.)

On various occasions including the semiannual Conference for Regional Financing Facilitation in each prefecture (consisting of financial authorities, small- and medium-sized and regional financial institutions and relevant business associations) and meetings between top officials of Local Finance Bureaus and representatives of financial institutions, we urge participants to develop a system to provide an explanation to customers and enhance consultation and complaint-handling functions, and request them to make efforts to facilitate SME financing.

Consultation Requests Received by Counseling Office for Financial Services Users

1. Background

On July 19, 2005, the Financial Services Agency (FSA) launched consultation services with the opening of the Counseling Office for Financial Services Users (hereinafter referred to as "Counseling Office") assigned to serve as a one-stop center to handle users' inquiries, consultation requests, opinions, etc. on financial services, etc. (hereinafter referred to as "consultation requests, etc."), with the aim of improving the user convenience of financial services and putting the received information to effective use in financial administration.

The number of consultation requests received by the Counseling Office from users, the gist of major consultation cases and other such information are released to the public on a quarterly basis. The consultation requests, etc. received, their characteristics and other related information for the quarter commencing January 1, 2006 and ending March 31, 2006 are as follows.

2. Outline of Public Release

(1) We received a total of 9,668 consultation requests, etc. between January 1, 2006 and March 31, 2006. The average number of consultation requests, etc. received per day was 158, more or less the same as the level in the previous period from October 1, 2005 to December 31, 2005 (159 requests).

(2) By subject, the number of consultation requests, etc. related to depositing, financing, etc. totaled 2,444 (25%), insurance products, etc. totaled 2,593 (27%), investment products, etc. totaled 3,649 (38%), cash loans, etc. totaled 837 (9%) and financial administration in general and other issues totaled 145 (1%).

(3) The following characteristics, etc. were identified with respect to each subject area.

a. Depositing, financing, etc.: With respect to financing services, we received consultation requests concerning the execution and repayment of loans, etc. With respect to depositing services, we received consultation requests relating to the deposit-making structure, such as personal identification procedures.

b. Insurance products, etc: We received consultation requests, etc. concerning insurance payments, insurance companies' responses to insurance claims, etc.

c. Investment products, etc.: We received consultation requests, etc. relating to unlisted shares, securities companies, foreign exchange margin trading businesses, stock exchanges, how to use Electronic Disclosure for Investors' NETwork (EDINET), etc.

d. Cash loans, etc.: We received consultation requests, etc. relating to inquiries about the existence of moneylender registration, individual transactions, contract results, etc.

(4) Consultation requests, etc. received by the Counseling Office included information that would be useful for inspection and supervision purposes. For the purpose of protecting users in general and improving user convenience, we make use of such valuable information in financial administration, when conducting verification as part of an inspection, conducting interviews for supervision, issuing reporting orders and taking administrative action with respect to the financial institution concerned:

a. Information on credit crunch and oppressive debt collection;

b. Information on the sale of financial products to a borrower by a financial institution exploiting its

dominant position;

c. Information on improper conduct by salespersons, etc. of an insurance company (such as abetting non-disclosure, paying insurance premiums on behalf of the policyholder, producing a contract without authorization and borrowing someone else's name); and
d. Information on improper conduct by foreign exchange margin trading businesses (such as making unsolicited calls to general customers, making assertive judgments, trading without authorization, and delaying refund of balance, etc.).

Compared to the previous quarter (from October 1, 2005 to December 31, 2005), the number of consultation requests relating to unlisted shares substantially increased from 447 to 985.

3. Approach to Future Actions

The Counseling Office was established as part of measures designed to *enhance the framework for providing information and dealing with consultation requests, etc. in order to protect users* under the Program for Further Financial Reform. The FSA will continue to run the Counseling Office in an appropriate fashion, including summarizing and publishing the number of consultation requests, etc. received and the gist of major consultation cases on a quarterly basis, in order to realize the ideal financial system pursued under the Program for Further Financial Reform, that is, *a financial system with high user satisfaction*.

[Amendments to Laws and Regulations relating to Insurance Business Law]

Revision of Enforcement Regulation of Insurance Business Law, etc. (Draft): Development of Funding Rules, etc. for Policy Reserves for Third-Sector Products

The Financial Services Agency (FSA) established new funding rules, etc. for policy reserves for third-sector insurance products, and amended the Enforcement Regulation of the Insurance Business Law, related official notifications and the Comprehensive Guideline for Supervision of Insurance Companies accordingly.

1. Characteristics and Trends of Third-sector Products

"Third sector" refers to a sector in which claims and medical treatment benefits are paid in the event of illness or injury, as exemplified by medical insurance, cancer insurance and nursing care insurance.

There used to be entry restrictions on third-sector products in that major Japanese life insurance companies were not allowed to sell such products alone. As the restrictions have gradually been relaxed since January 2001, sales of third-sector products are rapidly increasing in line with the shift in demand among policyholders, mainly from life insurance against death to medical, nursing and other such insurances which provide security while the policyholder is alive. In fiscal 2004, annual premiums exceeded ¥3.5 trillion, accounting for more than 20% of policies of life insurance companies.

2. Whereabouts of the Problem and the Solution

As Japan's population ages and the birth rate falls, policyholders' demand is growing for products such as medical insurance and nursing care insurance. However, such products are claimed to be exposed to long-term uncertainties, due to being susceptible to external factors such as public healthcare policies and unexpected behavior on the part of policyholders, in addition to many products in Japan offering lifetime coverage.

Despite these circumstances, third-sector products are rich in variety. However, there are no standard indicators such as the standard fatality rate and reference loss cost rate due to insufficient data, and in reality, there is no option but to estimate the incidence of each situation in which benefits are payable based on public data, past records of each company, etc.

Therefore, each insurance company deals with uncertainties over the incidence of an insured event under third-sector products by setting aside standard policy reserves and by carrying out ex-post-facto performance monitoring of the incidence. The reality is that the performance monitoring method and actions taken after performance monitoring are at the discretion of each insurance company. On the other hand, for contingency reserves, the problem is that the risks of each product are not properly reflected in contingency reserves because risk coefficients are defined in a uniform and mechanical manner.

Having such a critical awareness, the FSA decided to develop the following funding rules based on the results of the study conducted by the Study Team on Funding Rules for Policy Reserves and Performance Monitoring, etc. for Third-Sector Products, in order to enable insurance companies to execute risk management properly and set aside funds to fulfill its future obligations.

3. Overview of Funding Rules, etc.

(1) Implementation of Stress Test and Liability Adequacy Test

- The FSA decided to introduce a new performance monitoring framework to ensure that a sufficient level of policy reserves is set aside, by conducting a "stress test" and a "liability adequacy test" focusing on the uncertainties over the incidence of insured events under third-sector insurance.

(i) Stress Test

- This test aims to confirm, at the end of each fiscal year, whether or not risks are sufficiently covered by the predetermined expected incidence of an event with respect to each product. It involves forecasting the incidence at which 99% of the risks relating to the incidence during the test period (10 years) are covered based on the actual incidence of an insured event, etc. (incidence of risk A) **(Figure 1),** comparing the amount of claims payable in the future **(Figure 2-A)** with the amount of claims based on the expected incidence **(Figure 2-P),** and determining that the premium reserves are sufficient if the amount of claims based on the expected incidence is large **(Figure 2: Case I).**
- As the scope of coverage and risks of third-sector products is broad and varies from product to product,

insurance companies are required to rationally set the model for forecasting the future incidence of an insured event.

Figure 1: Forecasting the Future Incidence of an Insured Event
(Case in which expected incidence is sufficient)

* Age, number of years elapsed and other such factors need to be taken into account when estimating the future incidence.

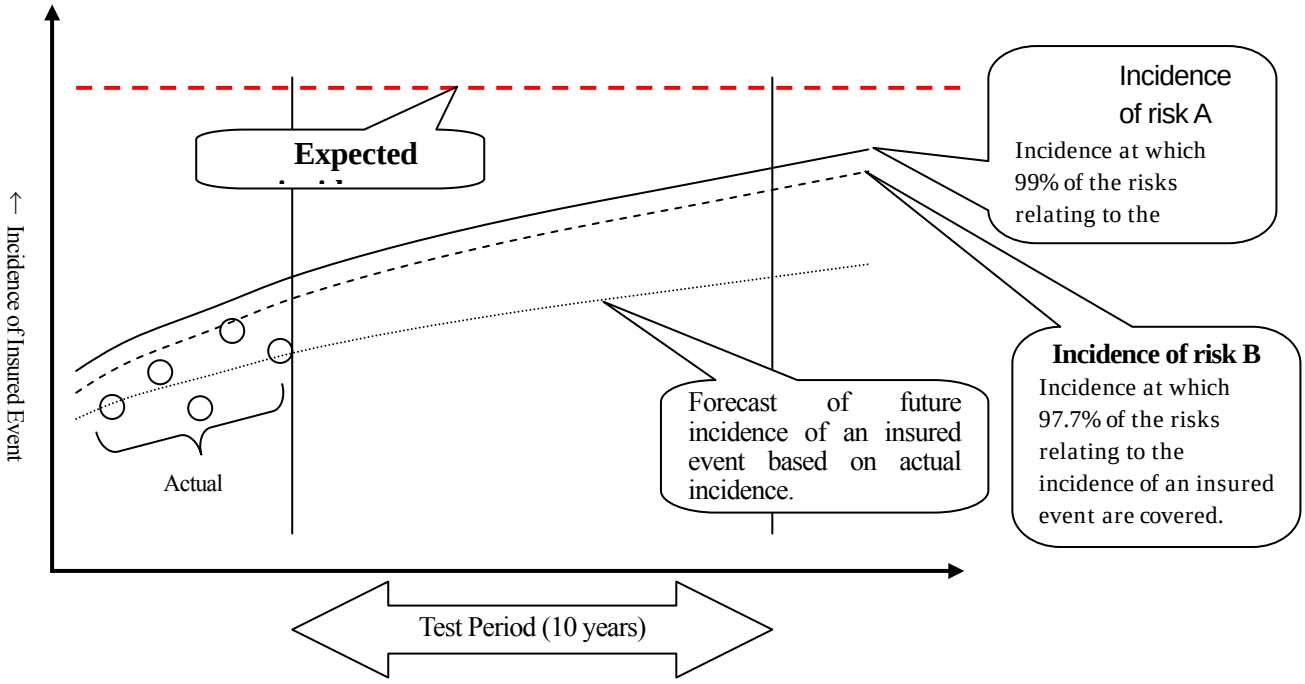
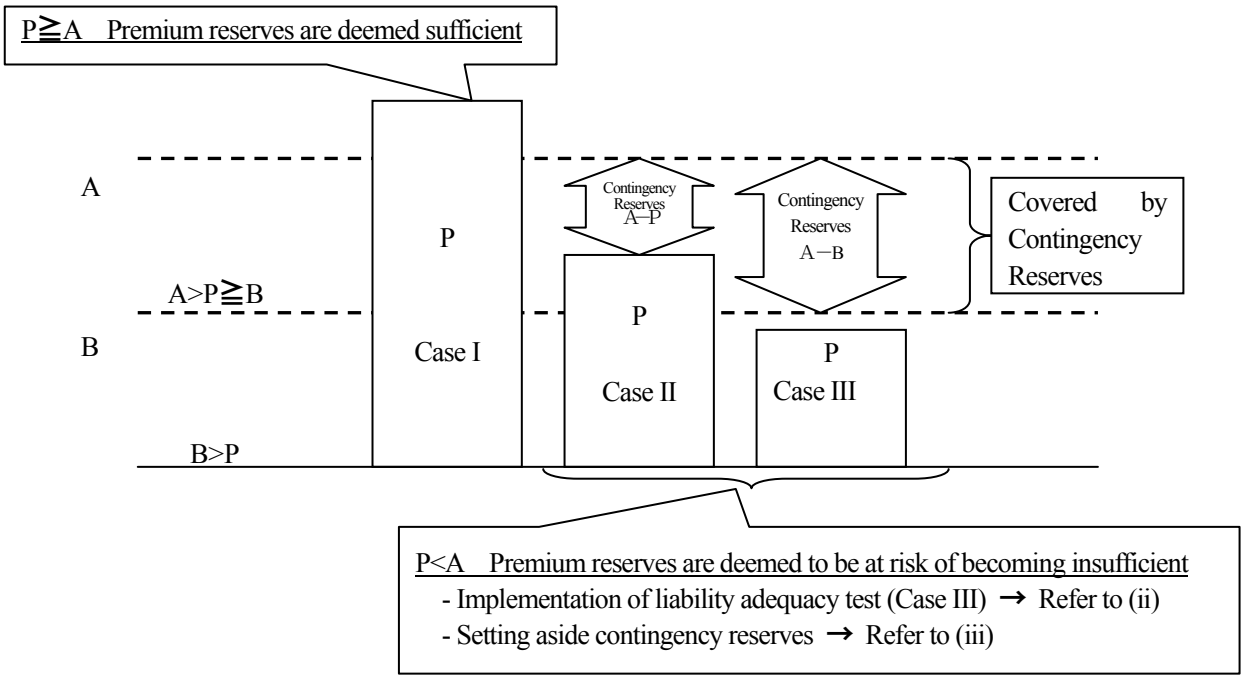


Figure 2: Stress Test and Setting Aside Contingency Reserves



(Note) P: Amount of benefits paid during test period (10 years) based on expected incidence
A: Amount of benefits paid during test period (10 years) based on incidence of risk A
B: Amount of benefits paid during test period (10 years) based on incidence of risk B

(ii) Liability Adequacy Test

- If there is a possibility that the predetermined expected incidence of an insured event cannot cover "normally foreseeable risks" (97.7% of risks under the new rules) which should be covered by premium reserves according to the results of the stress test, performance monitoring is conducted based on a liability adequacy test **(Figure 2: Case III).**
- As the sufficiency of premium reserves needs to be determined in terms of whether they are materially deficient in consideration of the trends in overall income and expenditure, verification is conducted based on future cash flow analysis (liability adequacy test) **(Figure 3).**

* Contingency reserves are determined by comparing the future amount of benefits (whether or not the amount of claims accruing in the future exceeds the expected amount) solely in consideration of the risks attributable to the increase in incidence to prepare against risks relating to the incidence of an insured event.

Figure 3: Liability Adequacy Test

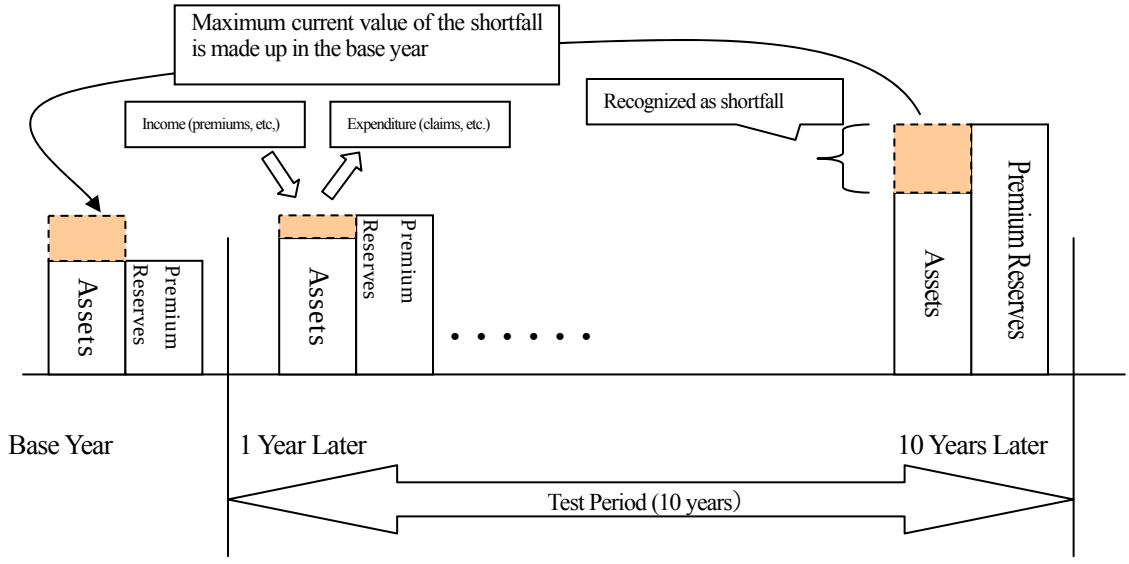
● Estimate income and expenditure in the future (10 years) based on past records, etc. and confirm whether or not assets fall short of premium reserves (i.e., liabilities).

- In the base year, assets = premium reserves.
- Premium reserves (liabilities) are calculated at the expected base rate.
- Assets are calculated by using the income and expenditure in each year estimated from past records, etc.

* Payment of claims, etc. is set at a level at which 97.7% of risks relating to the incidence of an insured event are covered.

- Premium reserves are deemed deficient if assets fall short of premium reserves.

* The maximum current value of the shortfall needs to be made up in the base year.



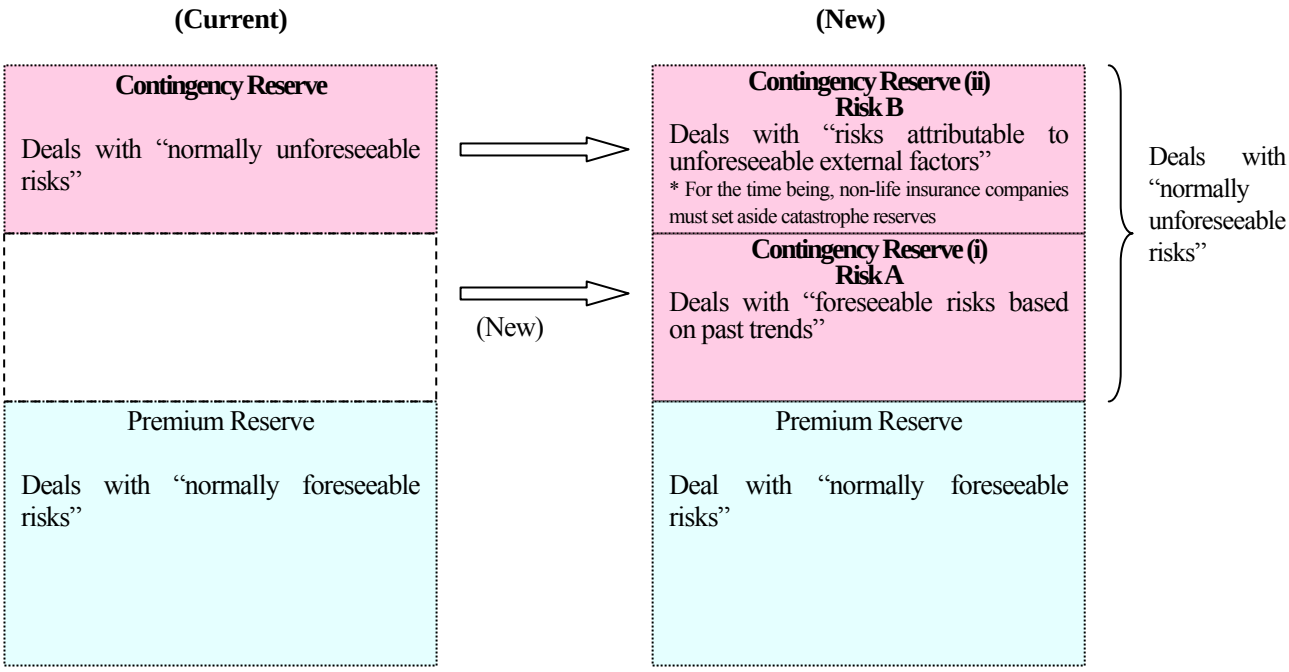
(iii) Setting Aside Contingency Reserves

Contingency reserves (i) must be set aside to the level at which 99% of the risks relating to the incidence of an insured event are covered (i.e., "risk A"). **(Figure 2: Cases II and III)**

For the time being, contingency reserves calculated by the conventional method[(Note 1)] must be set aside as contingency reserves (ii) corresponding to "risks attributable to unforeseeable external factors" (i.e., "risk B").

* For the time being, non-life insurance companies must set aside funds as "catastrophe reserves"[(Note 2)] as they always have.

Figure 4: Premium Reserves and Risks of Contingency Reserves



(Note 1) Current cap on contingency reserves of life insurance companies (example of those related to third-sector products)
- Risk of hospitalization due to illness = [Daily hospital expenses incurred due to illness] x [Average number of days for which benefits are expected to be paid] x 0.0075.

(Note 2) Current catastrophe reserves of non-life insurance companies
- 160% of net income from premiums

(iv) Solvency Margin Standard

- The magnitude of risk is a tenth of the amount calculated as the cap on "contingency reserve (i)" because it is set aside to prepare against risks for 10 years.
- The amount set aside as "contingency reserve (i)" is newly included in the solvency margin.

(2) Disclosure of Implementation Status, etc.

The incidence of an insured event under third-sector products is taken into account with respect to each situation in which benefits are payable. When making a forecast upon conducting a stress test and liability adequacy test, insurance companies are required to disclose the following information in disclosure journals as the model used is unique to each company.

- Approach to ensuring appropriateness of policy reserves set aside for third-sector products, and the reasonableness and appropriateness of the stress test and liability adequacy test (especially the method of setting the incidence of risks)
- Implementation status of stress test and liability adequacy test (status of additional premium reserves and contingency reserves)
- Status of payment of claims, etc. with respect to the premium in each category such as medical care, cancer and nursing care.

(3) Implementation of Periodic Offsite Monitoring

- Insurance companies will be monitored periodically with respect to contract trends by product and trends in the rate of profitability, incidence, etc. The results will be utilized as basic data to request insurance companies to take proper action.

(4) Enhancement of Risk Management Structure, etc.

(i) Ensuring Effectiveness of Option to Change Assumed Rate

At present, the dominant view is that the exercise criteria are unclear for insurance policies with the option to change the assume rate and it is difficult to exercise it in practice. Therefore, the FSA decided to introduce transparent numerical criteria for exercising the option to change the assumed rate and oblige insurance companies to explain the reasonableness of the expected incidence, the criteria for exercising the option to change the assumed rate (numerical criteria), nature of changes, etc. as important matters at the time of solicitation and enhance the provision of information to policyholders such as the outlook for changes in the premium, in an effort to ensure the effectiveness of the option to change the assumed rate in cases where the incidence of an insured event deteriorates.

(ii) Enhancement of Actuary Functions

In addition to confirmation by actuaries based on their existing practical criteria, the FSA decided to newly implement liability adequacy tests, etc. and enhance the checking functions of actuaries with respect to the level of policy reserves set aside. The FSA also decided to oblige actuaries to submit a written statement that an actuarial check has been conducted upon filing an application for product approval.

(iii) Disclosure of Reinsurance

The FSA decided to require the disclosure of reinsurance utilization status in cases where reinsurance is utilized to manage the long-term uncertainties of third-sector insurance.

4. Enforcement Date, etc.

- A statement written by an actuary that he/she has performed an actuarial check is required for applications for approval filed on or after May 1, 2006. The disclosure of reinsurance and insurance-related income/expenditure status is applicable to the fiscal year commencing April 1, 2006 and thereafter.
- The option to change the assumed rate is applicable to cases in which solicitation for insurance is done or a contract is concluded on or after April 1, 2007. Furthermore, amendments relating to premium reserves, contingency reserves and the solvency margin standard including the implementation of stress tests and liability adequacy tests are applicable to the fiscal year commencing April 1, 2007 and thereafter.

Establishment of Funding Rules for IBNR Reserves of Non-life Insurance Companies

The Financial Services Agency (FSA) published a draft document on funding rules for Incurred But Not Reported (IBNR) reserves of non-life insurance companies and the enhancement of actuaries' involvement and checking services, etc. on February 27, 2006 and invited public comments from the said date to March 27, 2006. Five public comments were received in total from members of the General Insurance Association of Japan (GIAJ), the Foreign Non-Life Insurance Association of Japan (FNLIA) and individuals.

1. Overview of Amendments

Among the reserves for outstanding claims in non-life insurance companies, **Incurred But Not Reported (IBNR) reserves**[(Note 1)] had to be calculated previously by such methods as "calculating the shortfall in the reserve which was not identified at the time when the reserve for outstanding claims was initially set aside by comparing the reserve for outstanding claims set aside in a particular fiscal year with the actual claims and normal reserves for outstanding claims recognized a year later and recognizing it as IBNR reserves in consideration of the rate of increase of loss incurred" under the provision of Ministry of Finance's Official Notification No.234. However, there are problems with this calculation method, including the failure to sufficiently identify shortfalls for so-called **"long-tail"**[(Note 2)] insurance products, which require more than one year for claims to be paid from the occurrence of an insured event.

Therefore, the FSA decided to establish funding rules for IBNR reserves for such insurance products backed by a more precise actuarial calculation method based on the statistical analysis of data on incurred claims with respect to each accident year.

In addition to the calculation of IBNR reserves, considering that actuarial fields are becoming more important than ever in non-life insurance companies, as exemplified by the increasing importance of estimating the policy reserves, etc. of non-life insurance companies in an appropriate and rational manner, the scope of non-life insurance companies required to appoint actuaries has been expanded and Cabinet Order, etc. have been established to enhance actuaries' involvement and checking services.

(Note 1) What are "reserves for outstanding claims" and "IBNR reserves"?

Reserves for outstanding claims are one of the insurance liabilities based on insurance contracts. Pursuant to the provisions of the Insurance Business Law, claims, reimbursements, etc. which became payable under insurance contracts in each fiscal year but have not yet been accounted for as expenditure must be declared by insurance companies as "reserves for outstanding claims".

Reserves for outstanding claims consist of two components, namely, "normal reserves for outstanding claims in which the amount payable with respect to an already-reported event is estimated individually" and "IBNR reserves calculated by estimating the claims, etc. for which the reasons for making a payment prescribed in an insurance contract are deemed to exist already even though the existence of such reasons has not yet been reported" at the end of the fiscal year. IBNR reserves must be calculated by using the calculation method set forth in the official notification specified by the FSA Commissioner.

IBNR is the acronym for **I**ncurred **B**ut **N**ot **R**eported.

(Note 2) What is "long tail"?

The expression "long tail" is used to describe the long period of time taken to have claims paid from the occurrence of an insured event.

2. Description of Amendments

(1) New Funding Rules for IBNR Reserves

Previously, the FSA had provided for voluntary automobile insurance, personal accident insurance and other specific types of insurance that fall in insurance categories in which it is mandatory to set aside IBNR reserves, and required that the amount of the IBNR reserves be calculated by using a specific formula and set aside accordingly. The scope of insurance categories in which it is mandatory to set aside IBNR reserves has been expanded, to include all insurance contracts except compulsory automobile liability insurance and earthquake insurance. Furthermore, the FSA required that each underwriting classification be screened in a certain way with respect to each insurance type (hereinafter referred to as "calculation unit"), and required that if the insurance products are deemed "long tail" and important as a result of screening, the IBNR reserves be calculated based on statistical estimation, and if the insurance products are deemed otherwise, an amount calculated by using a specific formula be set aside.

The FSA amended the Comprehensive Guideline for Supervision of Insurance Companies to incorporate the approach to screening.

(2) Actuaries

(i) Non-life Insurance Companies required to Appoint Actuaries

Non-life insurance companies required to appoint actuaries were previously limited to companies dealing in insurance types which involve the calculation of premium reserves (savings-type insurance) and long-term third-sector insurance. The scope of non-life insurance companies required to appoint actuaries has been expanded, in order to include all non-life insurance companies as a fundamental rule, except non-life insurance companies which specialize in either compulsory automobile liability insurance or earthquake insurance.

(ii) Enhancement of Actuaries' Involvement and Checking Services

Under the Insurance Business Law, etc., actuaries are required to be involved in actuarial matters relating to the calculation method of premiums, etc. Previously, actuaries of non-life insurance companies were required to be involved only in savings-type insurance and long-term third-sector insurance contracts. The scope of their involvement has been expanded, to include all insurance contracts except compulsory automobile liability insurance and earthquake insurance. The scope of their checking services regarding the appropriateness, sufficiency, etc. of policy reserves has also been expanded, to include all insurance contracts except compulsory automobile liability insurance and earthquake insurance.

In addition, the appropriateness of IBNR reserves of non-life insurance companies, which was previously not subject to actuaries' checking services, has been added to their list of checking services considering that their estimation affects the soundness of insurance companies and due to the introduction of actuarial statistical estimation as a result of the latest amendments.

(iii) Stricter Qualification Requirements for Actuaries

The calculation method of premiums and policy reserves is becoming increasingly sophisticated and complex, following the deregulation of premiums and the diversification of insurance products in recent years. Furthermore, advanced knowledge and experience are required more than ever before, in order for actuaries to execute their involvement and checking services, in response to the introduction of statistical estimation of catastrophe reserves for risks of natural disasters and the IBNR reserves. In consideration of these circumstances, the FSA specified full membership of the Institute of Actuaries of Japan and a certain level of practical experience as necessary qualifications of actuaries.

Furthermore, the FSA amended the Comprehensive Guidelines for Supervision of Insurance Companies to encompass matters that need to be considered when appointing actuaries at insurance companies, the approach to developing a structure for the fulfillment of actuaries' duties, perspectives of supervision regarding the fulfillment status of actuaries' duties, etc.

(3) Other Amendments (Comprehensive Guideline for Supervision of Insurance Companies)

In addition to establishing funding rules for IBNR reserves of non-life insurance companies, the FSA made the following amendments.

(i) Perspectives on Reversal of Reserves for Price Fluctuations

In response to suggestions that the description of the perspectives on the reversal of reserves for price fluctuations is unclear, the FSA made amendments for the purpose of clarifying the description. (The amendments were aimed at clarifying the description, not at revising the approach.)

(ii) Treatment of Reference Loss Cost Rate

In the case of insurance products using a reference loss cost rate calculated by the Non-Life Insurance Rating Organization of Japan, if the same reference loss cost rate is used even if it has been revised more than a year ago, the rate used is deemed to be unique to the insurance company and not based on a reference loss cost rate. Therefore, the FSA made amendments to incorporate a requirement that a report or data be submitted on the reasonableness and appropriateness of the rate to be continuously used under Article 128 of the Insurance Business Law.

3. Timing of Application, etc.

The amended Cabinet Order, the amended Official Notification, etc. came into force (became applicable) on May 1, 2006.

The new funding rules for IBNR reserves of non-life insurance companies and provisions relating to actuaries are applicable to fiscal year 2006 and thereafter.

Overview of Government Ordinances, Ministerial Ordinances, etc. on Revision of Safety Net for Insurance Companies

I. Purpose and Course

The Law for Partial Amendment of the Insurance Business Law, etc. promulgated on May 2, 2005 and enforced on April 1, 2006 (2005 Law No.38, hereinafter referred to as "Amending Law") was mainly about two amendments: (i) amendment aimed at dealing with cooperatives not governed by any laws; and (ii) amendment aimed at revising the policyholder protection system, etc.

Among the two, in order to make the necessary amendments, etc. associated with the enforcement of (ii) amendment aimed at revising the policyholder protection system, etc., the draft amendment of government ordinances, ministerial ordinances, etc. was released to the public on October 12, 2005, promulgated based on the comments, etc. on the draft received during the public consultation period and enforced on April 1, 2006.

This article outlines the government ordinances, ministerial ordinances, etc. relating to the revision of the safety net for insurance companies: firstly, an overview of the government ordinance (see Chapter II below), and secondly, an overview of the ordinance of the Cabinet Office and the Ministry of Finance, the Cabinet Office ordinance, etc. (see Chapter III below).

The policyholder protection system, which used to be commonly referred to as a "safety net for insurance", is referred to as a "safety net for insurance companies" in this article based on the view that it is deemed appropriate to do so in conjunction with the fact that due to (i) amendment aimed at dealing with cooperatives not governed by any laws as stated above, those who are engaged in insurance business but not insurance companies (including foreign insurance companies, etc., hereinafter the same) and not to the objective of financial aid, etc. of insurance policyholders protection corporations ("small-claims and short-term insurance businesses" referred to in Article 2, Paragraph 18 of the Insurance Business Law revised under the Amending Law (hereinafter referred to as "new Insurance Business Law"), "specific insurance businesses" referred to in Article 2, Paragraph 3 of the Supplementary Provisions to the Amending Law, etc.) came into existence.

II. Overview of the Government Ordinances

1. Introduction

The Government ordinances relating to the revision of the safety net for insurance companies are aimed at making necessary amendments, etc. associated with the revision of the financing measures of the Life Insurance Policyholders Protection Corporation of Japan under the Amending Law.

2. Overview

(1) Definition of *Tokurei* Members

Revised financing measures under the Amending Law are temporary measures (Article 1-2-14, Paragraph 1 of the Supplementary Provisions to the new Insurance Business Law) targeted at life insurance companies (including foreign life insurance companies, etc., hereinafter the same) which received an order to place operations of an insurance company and management of its assets under Insurance Administrator as referred to in Article 242, Paragraph 1 of the Insurance Business Law during the three-year period between April 1, 2006 and March 31, 2009 and other life insurance companies set forth in government ordinances ("*Tokurei* members" referred to in Article 1-2-14, Paragraph 1 of the Supplementary Provisions to the new Insurance Business Law). The revised Enforcement Ordinance of the Insurance Business Law amended by the Government Ordinance (hereinafter referred to as "new Enforcement Ordinance") defined life insurance companies set forth in government ordinances as life insurance companies concerning which the commencement of corporate reorganization proceedings was filed for during the said three-year period, etc. (Article 8-5 of the Supplementary Provisions to the new Enforcement Ordinance).

(2) Criterial Date for Balance of Debt of Life Insurance Policyholders Protection Corporation, etc.

The ground design of the revised financing measures under the Amending Law is to enable the government to provide assistance, assuming that expenses required to provide financial assistance, etc. in the event of the bankruptcy of a *Tokurei* member are paid by contributions made by life insurance companies as a fundamental rule, in cases where the sum of the balance of debt of the Life Insurance Policyholders Protection Corporation of Japan (referred to as "LIPPC" in (2) hereunder) and the expected amount of such expenses exceeds the amount set forth in government ordinances in consideration of LIPPC's balance in the long run, on the condition that the fear under the provision of Article 1-2-14, Paragraph 1 of the Supplementary Provisions to the new Insurance Business Law is recognized (the said Paragraph).

The new Enforcement Ordinance has determined the amounts, etc. constituting the ground design as follows, having been delegated by the new Insurance Business Law (the said Paragraph).

(i) Criterial Date for Balance of LIPPC's Debt

The criterial date for the balance of LIPPC's debt was set on the day on which the approval of the *Tokurei* member's reorganization plan was approved by the court (Article 8-6 of the Supplementary Provisions to the new Enforcement Ordinance). As government assistance is a last resort, focusing on the fact that the balance of debt decreased along with repayments, the criterial date was set as late as possible, insofar as the criterial date adopted was deemed to be sufficiently clear-cut in legal terms as a constituent of the said groud design.

(ii) Treatment of Accrued Contributions, Delinquency Charges and Surplus Cash

If there are any contributions not paid by the due date or delinquency charges as of the criterial date of

the balance of LIPPC's debt (referred to in (i) above), government assistance is a last resort, so the balance of debt is determined by assuming that the amount equivalent to such accrued contributions and delinquency charges has been appropriated to pay back the debt (Article 8-7, Item 3 of the Supplementary Provisions to the new Enforcement Ordinance).

Cases in which there is surplus cash in the policyholder protection funds as of the criterial date of the balance of debt are also treated in the same manner (Article 8-7, Item 2 of the said Supplementary Provisions).

(iii) Amount in Consideration of LIPPC's Balance in the Long Run

The amount set forth in government ordinances in consideration of LIPPC's balance in the long run is ¥460 billion (purview of Article 8-8 of the Supplementary Provisions to the new Enforcement Ordinance).

As the aforementioned provisions alone might unjustly impose a heavy burden on LIPPC if the consecutive criterial dates of the balance of debt (referred to in (i) above) are close to each other in the event of a series of bankruptcies of multiple life insurance companies, necessary provisions have been established to prevent such unjust imposition from arising (proviso of Article 8-8 of the said Supplementary Provisions).

(3) Recognition Procedures, etc. in the Event of Bankruptcy of a *Tokurei* Member

As the provisions on the procedures for providing government assistance to LIPPC have been delegated to government ordinances (Article 1-2-14, Paragraph 2 of the Supplementary Provisions to the new Insurance Business Law), provisions for the said procedures have been established (Article 8-9 of the Supplementary Provisions to the new Enforcement Ordinance), and the authority to recognize the "fear" set forth in Article 1-2-14, Paragraph 1 of the Supplementary Provisions to the new Insurance Business Law—which is a requirement for government assistance—was retained by the Prime Minister instead of being delegated to the FSA Commissioner (Article 14-2 of the Supplementary Provisions to the new Enforcement Ordinance).

(4) Abolition of Exceptions to Cap on LIPPC's Debt

As financing measures targeted at *Tokubetsu* members (Article 1-2-13, Paragraph 2 of the Supplementary Provisions to the Insurance Business Law) was to "redevelop a safety net worth ¥500 billion for bankruptcies between fiscal 2003 and fiscal 2005 (industry's share: ¥100 billion, government's share: ¥400 billion)", an exception had been made so that the cap on LIPPC's debt would be ¥960 billion for some time instead of the original ¥460 billion (Article 37-4 of the Enforcement Ordinance of the Insurance Business Law) (Article 13 of the Supplementary Provisions to the Enforcement Ordinance of the Insurance Business Law prior to the revision by the Government Ordinance). The new Enforcement Ordinance has abolished this exception in conjunction with the revision under the Amending Law, in other words, limited the exception to that relating to *Tokubetsu* members (Article 13 of the Supplementary Provisions to the new Enforcement Ordinance).

III. Overview of the Ordinance of Cabinet Office and Ministry of Finance, the Cabinet Office Ordinance, etc.

1. Introduction

The Ordinance of the Cabinet Office and the Ministry of Finance, the Cabinet Office Ordinance, etc. concerning the revision of the safety net for insurance companies can be narrowed down to the following three and are explained in the following order:

- Revision of compensation rate, etc. in consideration of types of insurance contracts, such as non-life insurance contracts, the assumed rate of interest, etc. (see Section 2 below);
- Establishment of provisions for "performance-linked insurance contracts" (see Section 3 below); and
- Other amendments (see Section 4 below).

2. Revision of Compensation Rate, etc. in Consideration of Types of Insurance Contracts, such as Non-life Insurance Contracts, the Assumed Rate of Interest, etc.

(1) Revision of Safety Net for Non-life Insurance Companies

(i) Amendment of Scope of Contracts as the Object of Compensation relating to Non-life

Insurance Companies

a. Expansion of Scope of Contracts as the Object of Compensation (Types of Insurance Contracts)

The report titled "On Revision of the Policyholder Protection System" released by the Second Subcommittee of the Financial System Council on December 14, 2004 (hereinafter referred to as "Second Subcommittee's Report") states that "it is deemed appropriate to… abolish the classification of non-life insurance by insurance type". In response, the scope of contracts as the object of compensation concerning non-life insurance companies (including foreign non-life insurance companies, etc., hereinafter the same) was set to encompass direct insurance contracts in general in Japan (Article 50-3, Paragraph 1 of the revised Order on Special Measures, etc. to Protect Insurance Policyholders, etc. amended by the Ordinance of the Cabinet Office and the Ministry of Finance (hereinafter referred to as "new Protection Order"); see also Item b. and Section 3(3) below).

b. Maintenance of Provisions on Scope of Contracts as the Object of Compensation (Attributes of Policyholders)

The Second Subcommittee's Report states that "it is deemed appropriate to compensate an insurance contract in which the policyholder is an individual or a small enterprise (such as companies with no more than 20 employees) who is generally considered to have limited ability to collect information, etc. and strongly require protection". Accordingly, insurance contracts (excluding household earthquake insurance contracts and compulsory automobile liability insurance contracts) in the so-called second sector (non-life insurance) excluding automobile insurance enjoy compensation only if the policyholder is an individual, "small corporation" or an association for condominium management (Article 50-3, Paragraph 1, Item 6, Article 50-3, Paragraph 2 and Article 50-3, Paragraph 3 of the new Protection Order).

(ii) Scope of "Specific Contracts as the Object of Compensation"

The following insurance contracts are specific contracts as the object of compensation under the provision of Article 245, Item 2 of the new Insurance Business Law under which "operations relating to cancellation of specific contracts as the object of compensation" need not be suspended even after receiving an order to place operations of an insurance company and management of its assets under Insurance Administrator ("contracts as the object of compensation with little need of being sustained for the purpose of protecting policyholders, etc. as set forth in ordinances of the Cabinet Office and the Ministry of Finance" (Article 1-6-3, Paragraph 1 of the new Protection Order)).

- Household earthquake insurance contract (Article 1-6-3, Paragraph 1, Item 4 of the new Protection Order)
- Second-sector contracts as the object of compensation (except household earthquake insurance contracts and compulsory automobile liability insurance contracts) (the said Paragraph, Item 4)
- So-called overseas travel accident insurance contracts in which the past health conditions, etc. of the insured are not included in the important facts, etc. that should be declared by the policyholder, etc. upon taking out insurance ("specific overseas travel accident insurance contracts" (the said Paragraph, Item 3))
- So-called personal accident insurance contracts with an insurance period of one year or less in which the current or past health conditions, etc. of the insured are not included in the important facts, etc. that should be declared by the policyholder, etc. upon taking out insurance ("short-term personal accident insurance contracts" (the said Pargraph, Item 1))
- The savings component of so-called third-sector insurance contracts (excluding specific overseas travel accident insurance contracts, short-term personal accident insurance contracts and the following contracts) (the said Paragraph, Item 2)
  - Savings-type personal accident insurance contracts with annuity payments (the said Paragraph, Item 2, Subitem *i*)
  - So-called asset-building ("*zaikei*") personal accident insurance contracts (the said Paragraph, Item 2, Subitem *ro*)
  - So-called personal accident insurance contracts for defined-contribution pension plan (the said Paragraph, Item 2, Subitem *ha*)

(iii) "Operations relating to Cancellation of Specific Contracts as the object of Compensation"

The period during which "operations relating to cancellation of specific contracts as the object of compensation" can be carried out even after receiving an order to place operations of an insurance company and management of its assets under Insurance Administrator (Article 245, Item 2 of the new Insurance Business Law) was set at three months from the day on which the insurance company which received the said order suspends the operations (excluding those set forth in each item of Article 245 of the said Law) in consideration of the suggestions made in the Second Subcommittee's Report (refer to (iv) below), etc. (purview of Article 1-6-2, Paragraph 1 of the new Protection Order).

In order to protect policyholders, etc., if the last day of the said period falls on a holiday, the said day is to be counted out (proviso of the said Paragraph), and the FSA Commissioner is required to publicly announce the said period and the last day without delay after the suspension of the operations referred to above (Article 1-6-2, Paragraph 2 of the new Protection Order).

(iv) Compensation Rate of "Specific Contracts as the Object of Compensation"

The Second Subcommittee's Report states that:

"in consideration of such characteristics, it is deemed appropriate to guarantee the payment of claims in full for the occurrence of insured events under non-life insurance contracts for a certain period after the bankruptcy, and introduce a framework that encourages policyholders to smoothly and promptly switch to other sound insurance companies in the meantime.

It is deemed appropriate to set the period during which the payment of claims is guaranteed in full at around three months, considering that it gives policyholders grace to cancel their contracts with the failed insurance company and take procedures to switch to other insurance companies."

In response to this, the compensation rate of claims for insured events which occurred during the period concerning specific contracts as the object of compensation stated in (iii) above was set at 100% (proviso of Article 1-6, Paragraph 1, Item 3, proviso of Article 1-6, Paragraph 1, Item 6, etc. of the new Protection Order).

The Second Subcommittee's Report states that even "considering that the expenses incurred by the policyholder protection system will increase due to the guarantee of the payment of claims in full for a certain period", "assuming that there is no surrender charge for early cancellation, even if the current compensation rate at 90% is reduced to, say, around 80%, the compensation level is deemed to be sustainable virtually at the current level for many policyholders who are expected to switch to other insurance companies in the early stages after the bankruptcy of an insurance company". Accordingly, the compensation rate for specific contracts as the object of compensation is set at 80%, excluding the compensation rate of claims for insured events which occurred during the period referred to in (iii) above (purview of Article 1-6, Paragraph 1, Item 3, the said Paragraph, Item 4, purview of the said Paragraph, Item 6, purview of Article 50-5, Paragraph 1, Item 3, the said Paragraph, Item 4, purview of the said Paragraph, Item 6, etc. of the new Protection Order).

(2) Revision of Compensation Rate according to Assumed Rate of Interest in Insurance Contracts

(i) Definition of "Contracts assuming a High Rate of Interest" and "Base Interest Rate"

Article 245, Item 1, Article 270-3, Paragraph 2, Item 1, etc. of the new Insurance Business Law clearly states that the compensation rate may vary with the rate of interest assumed in the insurance contract. Accordingly, "contracts assuming a high rate of interest" to which a low compensation rate should be applied are defined as "insurance contracts whose assumed rate of interest serving as the basis of calculation of… the premiums or policy reserves… have consistently exceeded the base interest rate over the past five years (limited to those with an insurance period… exceeding five years)" (Article 50-5, Paragraph 3 of the new Protection Order).

The "base interest rate" in the above definition is "…the rate set by the FSA Commissioner and the Minister of Finance with respect to each type of license, which is based on and exceeds the annual average investment yield over the past five business years (referring to the investment yield calculated by dividing the sum of the investment yield in each of the past five business years by five) of all licensed insurance companies… by license type (Article 1-6, Paragraph 4, Item 2 of the new Protection Order). Specifically, it is set at 3% per annum for life insurance companies as well as for non-life insurance companies (Article 2 of on the Notification of the FSA Commissioner and the Minister of Finance concerning contracts assuming a high rate of interest).

(ii) Compensation Rate and "Compensation Deduction Rate" of "Contracts assuming a High

Rate of Interest"

On February 16, 2005, the Second Subcommittee of the Financial System Council approved the policy to "make the compensation rate of policy reserves under the policyholder protection system for contracts assuming a high rate of interest lower than that for other contracts." Accordingly, if contracts as the object of compensation with a compensation rate of 90% ("direct life insurance contracts, etc." (Article 1-6, Paragraph 2 of the new Protection Order)) correspond to "contracts assuming a high rate of interest" ((i) above), the compensation rate of such contracts as the object of compensation was set at "90% minus the compensation deduction rate" (the said Paragraph, Article 50-5, Paragraph 2, etc. of the new Protection Order).

The "compensation deduction rate" refers to "…the rate calculated as set forth by the FSA Commissioner and the Minister of Finance based on the portion of the assumed rate of interest that exceeds the base interest rate" (Article 1.6.4.1 of the new Protection Order). Specifically, it is set forth as "the sum of the assumed rate of interest in each of the past five years minus the base interest rate in each year divided by two" (Article 1 of the said Notification).

[Example] Assumed rate of interest in each of the past five years was 5% per annum / Base interest rate was 3% per annum
Compensation deduction rate = (5－3)×5÷2 = 5
Compensation rate = 90 － 5 = 85%

However, compensation by insurance policyholders protection corporations is nothing but a "top-up" based on a system especially established for the protection of policyholders in the bankruptcy proceedings under bankruptcy laws. Therefore, if "90% minus the compensation deduction rate" falls below the expected payment rate assuming bankruptcy proceedings under bankruptcy laws ("expected base payment rate"), the expected payment rate becomes the compensation rate (Article 50-5, Paragraph 2 and the said Article, Paragraph 5 of the new Protection Order).

3. Establishment of Provisions on "Performance-linked Insurance Contracts"

(1) Scope of "Performance-linked Insurance Contracts" and Other Insurance Contracts requiring Establishment of Special Accounts

Provisions have been established for insurance contracts for which there is an obligation to establish special accounts under Article 118, Paragraph 1 of the new Insurance Business Law ("performance-linked insurance contracts (i.e., insurance contracts which promise the policyholder to pay insurance benefit and other benefits based on the results of investing the money received as premiums) and other contracts set forth by Cabinet Office ordinances) (Articles 74 and 153 of the revised Enforcement Regulation of the Insurance Business Law amended by the Cabinet Office Ordinance (hereinafter referred to as "new Enforcement Regulation")).

As the provisions are extremely technical, the table below shows what kind of insurance contracts are actually included in the provision of each item of Article 74 of the new Enforcement Regulation.

Article 74 of New Enforcement Regulation		Insurance Contracts Actually Included in Corresponding Items
Item 1 ("Performance-linked insurance contracts")	Subitem *i*	Defined Contribution Annuity Insurance, Group Pure Endowment Insurance, Variable Government Pension Investment Fund Insurance, Pension Fund Association Insurance (former Employees' Pension Fund Association Insurance), National Pension Fund Association Insurance
	Subitem *ro*	New Corporate Pension Insurance, Defined Benefit Corporate Pension Plan Insurance, Employees' Pension Fund Insurance, National Pension Fund Insurance
Item 2		None at present
Item 3		Individual variable insurance and individual variable annuity insurance (limited to those with a minimum guarantee on some insurance benefits, etc. based on investment results)

(2) Establishment of Provisions on Management of Special Accounts for "Performance-linked Insurance Contracts"

As a prerequisite condition to explicitly providing that in the reorganization plan of an insurance company more favorable terms and conditions for creditors' rights based on performance-linked insurance contracts can be set than for those based on other insurance contracts (Article 445, Paragraph 3 of the revised Law on Exceptions, etc. to Reorganization Procedures for Financial Institutions, etc. amended by the Amending Law), Article 118, Paragraph 3 of the new Insurance Business Law was newly established to delegate the "method of managing assets belonging to special accounts and other necessary matters relating to special accounts" to Cabinet Office ordinances. In response, the establishment of the following system was made obligatory for the purpose of managing assets belonging to special accounts for performance-linked insurance contracts ("specific special accounts" (Article 75-2, Paragraph 1 of the new Enforcement Regulation)) by distinguishing them from assets belonging to general accounts and assets belonging to special accounts other than specific special accounts (the said Article and Article 154-2 of the new Enforcement Regulation).

- Segregated custody in a clear and distinct manner
- Development of a system to ensure that the aforementioned segregated custody is implemented by the custodian of assets belonging to specific special accounts
- Obligation to prepare and store prescribed books and records

Necessary transitional provisions have also been established (Article 2 of the Supplementary Provisions to the amending Cabinet Office Ordinance).

It is acceptable to store and prepare the aforementioned books and records in electronic format (Appendices 1, 2 and 3 of the revised Enforcement Regulation concerning Financial Laws and Regulations under the Jurisdiction of Cabinet Office of Law on Use of Information and Communication Technology for Storage, etc. of Documents by Private Business Operators, etc. amended by the amending Cabinet Office Ordinance)

(3) Exclusion from Definition of Contracts as the object of Compensation

The Second Subcommittee's Report states that "it would be desirable to develop a system that makes it possible to deal with, in particular, group annuity insurance with no minimum benefit guarantee without diminishing the policy reserves assuming strict segregated custody, so that the assets for such insrance would substantially be preserved even in the event that an insurance company goes bankrupt, in order to maintain consistency with pension trusts which are similar financial instruments. It is deemed appropriate to exclude such insurance from the scope of the policyholder protection system if such a system is realized". On February 16, 2005, the Second Subcommittee of the Financial System Council

approved the policy to "develop a system that makes it possible to deal with group annuity insurance, etc. accounted for in special accounts (limited to that with no minimum benefit guarantee) without diminishing the policy reserves while obliging strict segregated custody and to exclude such insurance from the scope of compensation under the policyholder protection system." With this in mind, the portion of performance-linked insurance contracts which relates to specific special accounts has been excluded from the definition of contracts as the object of compensation (Article 50-3, Paragraph 1 of the new Protection Order).

4. Other Amendments

(1) Establishment of Provisions on Policy Reserves as a Subject of Financial Aid for Compensation of Policy Reserves and Policy Reserves which Serve as Basis of Calculation of Contributions by LIPPC Members

(i) Clarification of Scope of Policy Reserves as a Subject of Financial Assistance for Compensation of Policy Reserves

In response to comments received in the course of public consultation (refer to Chapter I. above), "policy reserves" as a subject of financial aid for compensation of policy reserves (Article 270-3 of the Insurance Business Law) were clearly defined as **individual "policy reserves"** in the context of amounts to be set aside for the insured under individual insurance contracts, NOT **"policy reserves" under supervisory law** which are accounted for as liabilities by insurance companies pursuant to the Insurance Business Law (Article 50-4, Paragraph 1, Item 1 of the new Protection Order).

(ii) Maintenance of Provisions on Policy Reserves which Serve as Basis of Calculation of Contributions by LIPPC Members

Considering that so-called policy reserves for minimum guarantee risks of variable annuity insurance, etc. do not correspond to "policy reserves" as a subject of financial aid for compensation of policy reserves according to (i) above, in order to strike a balance between benefits and burdens, half of the amount of such policy reserves is excluded from the "policy reserves" serving as the basis of calculation of contributions by LIPPC members (Article 25-2, Paragraph 1, Item 2 of the new Protection Order). Necessary transitional provisions have been established (Paragraph 4 of the Supplementary Provisions to the amending Ordinance of the Cabinet Office and the Ministry of Finance).

(2) Amendments to Improve Transparency of Insurance Policyholders Protection Corporations

The Second Subcommittee's Report states that "it has been suggested that it is important to make the procedures within the corporations transparent and further enhance the disclosure of information, in order to prevent the demerits of conflict of interest from arising and to discipline the operation of the corporations". In response, the following improvements were sought with respect to the transparency of insurance policyholders protection corporations.

- The establishment of provisions on disclosure of the composition, proceedings, etc. of the steering committee and the assessment and examination board, disclosure of proceedings, etc. (Articles 8-5, 12-2, 15-5, 19-2 and 37 of the new Protection Order)
- Extension of display period of financial statements, etc. of insurance policyholders protection corporations (Article 39.2 of the new Protection Order)

Necessary transitional provisions have been established (Paragraphs 2, 3 and 5 of the Supplementary Provisions to the amending Ordinance of the Cabinet Office and the Ministry of Finance).

(3) Amendments to Ensure that Policyholders, etc. Understand Insurance Policyholders Protection Corporations System

(i) Duty to Provide Explanation upon Solicitation

The Second Subcommittee's Report states that "it is necessary to exercise ingenuity so that an easy-to-understand explanation is provided to policyholders about the system upon solicitation after the reform of the system." With this and introduction of a compensation deduction rate system for contracts assuming a high rate of interest (see Section 2(2) above) in mind, an obligation was imposed to provide an explanation of the scope of contracts as the object of compensation upon solicitation for direct insurance contracts in Japan (upon solicitation for direct life insurance contracts, etc. (see Section 2(2)(ii) above) with an insurance period of more than five years, an explanation of the scope of contracts

as the object of compensation and the compensation deduction rate system for contracts assuming a high rate of interest) by issuing a document or by other such appropriate means (Article 53, Paragraph 1, Item 8 of the new Enforcement Regulation).

(ii) Ensuring Understanding in Actual Bankruptcy Procedures

The Second Subcommittee's Report states that "in the event of revising the contract terms in actual bankruptcy procedures, an easy-to-understand explanation should be provided to policyholders regarding, for example, the impact of such revision on the face amount, etc. of each insurance contract in concrete terms." Taking this into account, the following matters were added to the list of notes to be appended to the public notice on transfer of insurance contracts, etc. and the public notice on the revision of contract terms (Article 251, Paragraph 1, Article 255, Paragraph 1 and Article 255-4, Paragraph 1 of the Insurance Business Law) (Article 1-10, Item 2, Subitems *i* and *ro* and Article 1-13, Item 3, Subitems *i* and *ro* of the new Protection Order).

- Matters relating to the application of the compensation deduction rate system to direct life insurance contracts, etc. corresponding to contracts assuming a high rate of interest (see Section 2(2)(ii) above)
- Matters concerning the relationship between the revision of contract terms and changes in the rights of policyholders, etc. over insurance benefits, etc. (including illustration of the said matters)

(iii) Disclosure of Amount of Contributions made by Each Insurance Company

The Second Subcommittee's Report states that:

"the policyholder protection system is a framework to protect policyholders, etc. of a failed insurance company based on the corporations' financial assistance, etc. in the event of the bankruptcy of an insurance company, and as a fundamental rule, the expenses must be incurred by other insurance companies.

However, the insurance company's burden is deemed to ultimately lead to policyholders' burden. This is rational considering that the purpose of the system is to protect policyholders, but it has been suggested that efforts should be made to provide a more intelligible explanation to improve the policyholders' understanding, including explicitly stating the burden."

In consideration of the above, the amount of contributions made by each insurance company (Article 265-33, Article 1 of the Insurance Business Law) was added to the list of matters to be stated in the explanatory documentation (Article 111 of the Insurance Business Law, so-called disclosure materials) (Appendix to the new Enforcement Regulation concerning Article 59-2, Paragraph 1, Item 3, Subitem *ha* thereof (life insurance companies related) and Appendix to the new Enforcement Regulation concerning Article 59-2, Paragraph 1, Item 3, Subitem *ha* thereof (non-life insurance companies related)). Necessary transitional provisions have been established (Article 3 of the Supplementary Provisions to the amending Cabinet Office Ordinance).

(4) Expansion of Scope when Application for Bridging, etc. of Insurance Contracts is Possible

The Second Subcommittee's Report states that:

"Under the existing system, it is possible for the corporation to underwrite an insurance contract only if there are no prospects for the appearance of a white-knight insurance company. However, it has been pointed that, especially in the event of the bankruptcy of a non-life insurance company, there is a problem in that even if speedy processing is required due to the large number of short-term contracts, etc., there is a risk of having trouble finding a white-knight insurance company and not being able to commence procedures at an early date. Taking such a problem into account, it is deemed appropriate to enable the corporation to decide on underwriting in the early stages after the bankruptcy if it is rationally determined that it would be appropriate to commence procedures promptly."

In response, cases in which it is possible to apply for bridging, etc. of insurance contracts have been delegated to the ordinances of the Cabinet Office and the Ministry of Finance (Article 267, Paragraphs 1 and 2 of the new Insurance Business Law). Accordingly, "cases in which it is difficult to execute the transfer, etc. of insurance contracts due to the lack of prospects for a white-knight insurance holding company, etc. to gain approval as the principal insurance shareholders, etc. of the failed insurance company at an early date and the lack of prospects for a white-knight insurance companyor a white-knight insurance holding company, etc. to appear except the aforementioned white-knight insurance holding company, etc." were added to the list of cases in which it is possible to apply for bridging, etc. of insurance contracts, and necessary provisions were established (Article 48-2, Item 2 and Article 48-3, Item 2 of the

new Protection Order).

Supervisory Guideline for Small-claims and Short-term Insurance Businesses (So-called Unlicensed Cooperatives)

On April 1, 2006, a "small-claims and short-term insurance business" system was introduced as a new measure to protect policyholders, etc.

Upon its introduction, the viewpoints to be taken by supervisory authorities—the Financial Services Agency (FSA) and Local Finance Bureaus—in dealing with small-claims and short-term insurance businesses were systematically defined and compiled in the form of a document titled "Supervisory Guideline for Small-claims and Short-term Insurance Businesses", which is regarded as a supplementary issue to the Comprehensive Guideline for Supervision of Insurance Companies.

Specifically, it describes the perspectives, etc. on items to be evaluated in supervision, namely, (i) governance, (ii) financial soundness and (iii) operational appropriateness. As the registration of businesses and other such affairs are handled by the respective Local Finance Bureaus, it also states the points to be considered, etc. in the clerical process. The outline is shown in the Appendix.

As small-claims and short-term insurance businesses are expected to vary widely in terms of insurance products, company size, etc., the perspectives on structural aspects especially to ensure financial soundness and operational appropriateness will be determined according to the actual circumstances of the business rather than requiring that all the perspectives be applied across the board. Due consideration will be given to avoid the mechanical/uniform implementation of the Supervisory Guidelines.

[Appendix]

Supervisory Guideline for Small-claims and Short-term Insurance Businesses
(Comprehensive Guideline for Supervision of Insurance Companies [Supplementary Issue])

I. Basic Approach

○ Supervision of small-claims and short-term insurance businesses is aimed at protecting policyholders, etc. by regulating so-called unlicensed cooperatives which have conventionally underwritten insurance without any legal basis with respect to certain parties, through their inclusion into the definition of insurance businesses under the Insurance Business Law.
○ The Supervisory Guideline is regarded as a supplementary issue to the Comprehensive Guideline for Supervision of Insurance Companies, and systematically defines the viewpoints to be taken in the supervisory administration of small-claims and short-term insurance businesses, the basic approach of various types of regulations, supervisory perspectives and matters to be considered, and supervisory methods in concrete terms. Items not addressed by the Supervisory Guideline are to be handled by referring to the Comprehensive Guideline for Supervision of Insurance Companies.
○ As small-claims and short-term insurance businesses are expected to vary widely in terms of insurance products, company size, etc., it is necessary to determine the perspectives especially on structural aspects according to the actual circumstances of the business rather than requiring that all evaluation items in supervision be fulfilled across the board. (Due consideration must be given to avoid the mechanical/uniform implementation of the Supervisory Guideline.)

II. Evaluation Items in Supervision

○ Governance

Examine the effectiveness of governance of small-claims and short-term insurance businesses.

* Examine whether or not the governance function is working according to the characteristics and size of the small-claims and short-term insurance business by conducting various interviews, etc.

* As the insurance division of a specific insurance business (Note) might be spun-off and established as a subsidiary, give consideration to the involvement status of major shareholders, holding company, etc.

○ Financial Soundness

Examine the management structure to ensure financial soundness of small-claims and short-term insurance businesses.

* With respect to small-claims and short-term insurance businesses, establish provisions for setting aside policy reserves, etc. properly, measures based on solvency margin ratio (i.e., a measure of the ability to deal with normally unforeseeable risks), development of risk management structure for reinsurance, etc. as in the case of insurance companies.

<Unique Perspectives on Small-claims and Short-term Insurance Businesses>
* State the method of confirming after-the-fact checks regarding premiums, policy reserves set aside, etc.
* With respect to the sustainability of insurance business, set a business sustainability confirmation point in consideration of short-term products.
* Develop a risk management structure for asset management considering that investment limited to safe assets such as deposits and government bonds is required.

○ Operational Appropriateness

Examine compliance structure, etc. of small-claims and short-term insurance businesses

* Provide for perspectives to be taken at the time of solicitation and conclusion of insurance contracts, as an appropriate insurance solicitation structure needs to be established under the Insurance Business Law, as in the case of agents, etc. of insurance companies.

<Unique Perspectives on Small-claims and Short-term Insurance Agents>
(i) Prevention of inappropriate solicitation activities based on multilevel marketing
(ii) Appropriate measures for solicitation within the cap on claims

<Unique Perspectives on Business Operations of Small-claims and Short-term Insurance Businesses>
(i) Written explanation of revision of premiums, etc. in automatically-renewed contracts
(ii) Written explanation of lack of safety net
(iii) Written explanation of cap on claims, etc.
(iv) Measures to obtain signature and seal impression from policyholder after explaining the above

III. Points to Consider: Clerical

○ As registration and other such supervisory affairs are handled by the Local Finance Bureau as a fundamental rule, matters entrusted internally to the Local Finance Bureau are stated and the following points to consider in the clerical process in the supervision of small-claims and short-term insurance businesses are stated:

* Dealing with entities engaged in insurance business without registration, etc.
* Registration affairs regarding small-claims and short-term insurance business
(i) Registration procedures in concrete terms, perspectives upon review (organization, system, personnel composition, etc.)
(ii) Handling, etc. of small-claims and short-term insurance business register (make it available for public inspection)
* Registration affairs regarding small-claims and short-term insurance agents
* Method of confirming deposits, etc. paid before commencement of small-claims and short-term insurance business
* Major points to consider in off-site monitoring (conducting periodic interviews, etc.)

IV. Product Screening

State the perspectives for screening when a notification has been filed by a small-claims and short-term insurance business about the establishment of a new insurance product or the revision of an existing product.

* Is there any risk of the product name, etc. being misunderstood by policyholders?
* Clarity and simplicity of matters stated in general insurance clauses
* Clarification of coverage commencement date
* Clarification of events, etc. which nullify the insurance contract
* Fairness and rationality of exclusions
* Appropriateness of payment, claims procedures, etc.
* Points to consider regarding actuary's written statement

V. Points to Consider: Interim Measure Period

State the points to consider with respect to specific insurance businesses (Note).

(i) Notification of specific insurance business
(ii) Insurance solicitation regulations and operational monitoring targeted at specific insurance business
(iii) Supervision of specific insurance business
(iv) Transfer of insurance contracts from specific insurance business
(v) Underwriting insurance exceeding cap on underwriting

(Note) "Specific insurance business" refers to an entity which underwrites insurance with respect to certain parties as of April 1, 2006.

Overview of Government Ordinances, etc. for Introduction of Policyholder Protection Rules for Cooperatives Previously Not Governed by Any Laws

The Law for the Partial Amendment of the Insurance Business Law, etc. (2005 Law No. 38, hereinafter referred to as "Amended Law") promulgated on May 2, 2005 was mainly about two amendments: (i) amendment aimed at dealing with cooperatives previously not governed by any laws; and (ii) amendment aimed at reviewing the policyholder protection system, etc.

Among the two, (i) amendment aimed at dealing with cooperatives previously not governed by any laws specifically included:

a. Reviewing the scope of application of "insurance businesses" and as a general rule, regulating by the Insurance Business Law so-called cooperatives that were not governed by any laws; and

b. Establishing a new regulatory framework ("small-claims and short-term insurance business", here in after referred to as "SSIB") such as a registration system for businesses which provide only small-claims and short-term insurance on the condition that the size of the business is within a certain limit.

In response, draft amendments to the Enforcement Ordinance, Enforcement Regulation, etc. of the Insurance Business Law were published and public comments were invited for the purpose of providing for matters left to government ordinances, Cabinet orders, etc. in the Amended Law. Based on comments, etc. on the draft received during the public consultation period, government ordinances, etc. were promulgated on March 10, 2006 and enforced on April 1, 2006.

Major amendments are outlined below.

1. Enforcement Date of the Law for the Partial Amendment of the Insurance Business Law, etc.

The Amended Law came into force on April 1, 2006, and the "SSIB" system was launched on the same date.

2. Insurance excluded from Definition of "Insurance Business"

Insurance excluded from the definition of "insurance business" refers to: insurance provided by local authorities with respect to a business or its executives and/or employees within its jurisdiction; insurance provided by a company or its consolidated subsidiaries, etc. with respect to the company, its subsidiaries, its executives, employees, etc.; insurance provided by a vocational school or some miscellaneous school with respect to its students; and insurance provided with respect to 1,000 parties or less, etc. However, insurance provided to 1,000 parties or less is included in the definition of "insurance business" if: it is provided by two or more organizations that are closely related to each other with respect to more than 1,000 parties in total; it involves reinsurance underwriting; or the total annual premiums received from one individual exceeds ¥500,000.

3. Insurance Period, Cap on Claims, etc. of Insurance which can be Underwritten by SSIBs

(1) The insurance period of insurance which can be underwritten by SSIBs is one year in the case of life insurance, medical insurance, etc. and two years in the case of non-life insurance. The cap on claims is as follows.

(i) Ordinary severe disability or death:	¥3 million
(ii) Hospitalization benefits, etc. in the event of illness or injury:	¥800,000
(iii) Severe disability or death due to injury:	¥6 million
(iv) Non-life insurance:	¥10 million

Various provisions have been established for adjustment purposes, such as restricting the benefits in the event of death in cases where benefits have been paid for severe disability.

(2) In cases where a SSIB underwrites multiple insurance contracts for one insured person, the total amount of claims under all insurance contracts must be no more than ¥10 million, and the total amount of claims according to the insurance categories referred to in (1)(i) through (iv) must be no more than the respective amounts set forth in those categories.

However, if insurance referred to in (1)(iv) includes personal liability insurance in which insured events are

expected to have a particularly low incidence (excluding those relating to driving an automobile), a cap of ¥10 million is set separately.

(3) SSIBs are not permitted to underwrite insurance under which more than 100 people are insured in total per policyholder (in the case of multiple insurance, this refers to the sum total).

(4) As an interim measure, the cap on claims under insurance which can be underwritten by an existing business by reinsuring the excess portion over a period of seven years from the enforcement date is set at five times the respective amounts set forth in the insurance categories referred to in (1) (or three times the amount in the case of insurance referred to (1)(ii)).

4. Restrictions on Business Size

The limit of the size of SSIBs was set to be no more than ¥5 billion in annual premiums received (including commissions received from reinsurance companies when applying reinsurance and deducting reinsurance premiums).

5. Minimum Capital, Funds and Deposits

Minimum capital or funds of a small-claims and short-term insurance business and the amount of deposits to be paid upon the commencement of business are ¥10 million each. Deposits must be increased as the premium income increases, in increments of 5% of net premiums received.

As an interim measure to enable the smooth transition of existing businesses operating on a small scale, the minimum capital or funds of small organizations (with no more than 5,000 parties in total) and the amount of deposits to be paid by them are both halved from ¥10 million to ¥5 million for a period of seven years from the enforcement date.

6. Scope of Related Operations

Related operations which can be carried out by SSIBs with the Prime Minister's approval include insurance solicitation, investigation of insured events, preparation of documents, etc. on behalf of other small-claims and short-term insurance businesses or insurance companies.

7. Measures relating to Business Operations

SSIBs are obliged to take measures to make SSIB agents to provide an explanation upon insurance solicitation about the possibility of the revision of premiums, etc. for renewal-type insurance, about the insurance being outside the scope of the safety net and about the cap on the amount of claims under insurance that can be underwritten, by issuing documents or by other such appropriate methods.

8. Nature of Disclosure

SSIBs are required to disclose explanatory documentation on their operational and financial status to the same extent as insurance companies. SSIB whose capital, etc. exceeds ¥300 million is obliged to conduct an external audit.

9. Setting Aside Policy Reserves

SSIBs are required to set aside as much in policy reserves as insurance companies in order to protect policyholders. Calculation categories have been provided for according to the kind of insurance which can be underwritten by SSIBs.

In cases where an insurance contract is subject to reinsurance, policy reserves may not be set aside for the portion subject to reinsurance. In addition, the criteria for setting aside special contingency reserves have been relaxed as an interim measure, etc., in consideration of the burden of setting aside funds incurred by existing businesses.

10. Solvency Margin Standard

As in the case of insurance companies, a framework was established so that orders to take necessary supervisory measures can be issued (prompt corrective action) in the event that the solvency margin indicating the small-claims and short-term insurance business's ability to pay claims, etc. falls under 200%.

11. Other

Registration and application procedures, depositing procedures, scope of subsidiaries and other details of the system have been provided for in Cabinet orders and public notices.

【Hot Picks from the Financial World】

* We deliver the hottest information of the times in this section, selected from among questions and answers given at the Minister's press conferences etc. If you wish to find out more, we invite you to visit the "Press Conferences" section of Financial Services Agency's website.

Q. In response to the disciplinary actions taken against ChuoAoyama PricewaterhouseCoopers, its business partner, PricewaterhouseCoopers, seems inclined toward establishing a new auditing firm. What are your views and thoughts on this?

A. I think any company can conduct an audit *per se* as long as it has the capabilities, so it is not strange to consider establishing a new company.
What matters is whether or not people with professional expertise required to conduct audits will come together, and it depends on whether or not they have strict values of some kind for such an extremely crucial social mission as audit, so it doesn't matter what kind of establishment they are in.

(from the press conference following a cabinet meeting on Friday, May 12, 2006)

Q. Various problems have been found in life insurance and non-life insurance companies since last year, such as the non-payment of fringe claims and misrepresentations in pamphlets. What are your views on the fact that incidents which could undermine confidence in the industry have been revealed one after the other?

A. The FSA's basic administrative stance has been to take administrative action against any industry under its jurisdiction if undesirable acts are found in light of the facts, laws and regulations, no matter what company it is, regardless of its size, and we are committed to keeping this basic stance into the future.

(from the press conference following a cabinet meeting on Tuesday, May 23, 2006)

Q. Major banks have announced their financial results. They are announcing one after the other that they will fully pay back the public funds, on the back of their unprecedented and extremely good financial results. What are your thoughts on this?

A. Of course, good financial results are better than bad ones, but the issue of public funds remains, and from our point of view, it is still not good enough because even if the financial results improved, the deposit interest rate remains at such low levels and banks are still not able to pay corporation tax.
Therefore, the major banks must properly fulfill their financial intermediary function, which is the primary objective of the financial sector. Also, they should fulfill their financial mission to properly distribute resources in the Japanese economy by taking risks based on their own judgment.

(from the press conference following a cabinet meeting on Tuesday, May 23, 2006)

Q. In relation to banks' financial results, reversal of bad debt reserves was huge at Mitsubishi UFJ Financial Group and other banks, and there are claims that their provisioning might have been excessive. What is your opinion on this?

A. As provisioning was done in accordance with the standards at the time, I think no provisioning was done with the knowledge that it would be excessive from the start.

(from the press conference following a cabinet meeting on Tuesday, May 23, 2006)

Q. Murakami Fund has submitted a notice of closing its investment advisory business in Japan to relocate to Singapore. At a time like this when there are various repercussions, their move seems to be elusive of the FSA. What is your view on such a move to relocate overseas by a Japanese business that appears to be elusive of the FSA?

A. If they relocate to Singapore, the laws of Singapore will be applied, and Singapore is no heaven as its laws are rather strict. Furthermore, if Mr. Murakami and his group engage in various investment activities in Japan, they will be subject to Japanese laws and regulations as a matter of course. As for the tax law, taxes will be imposed according to the tax treaty between Singapore and Japan.

(from the press conference following a cabinet meeting on Tsuesday, May 16, 2006)