

**New Insurance Products/Services and Solicitation Rules**

**June 7, 2013**

**Working Group on the Provision of Insurance Products/Services**

## Working Group on the Provision of Insurance Products/Services

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## **Introduction**

Along with the changes in social conditions in Japan, such as the declining birthrate and rapidly aging population, the Japanese nationals' needs for insurance products and services are changing. The method of selling insurances is also changing and becoming diverse, including the large-scale insurance agents such as insurance shops and insurance sales involving no face-to-face contact such as online shops.

Based on the changes noted above, it has become increasingly important for insurance companies to:

- Offer more extensive range of insurance products and services in accordance with the customers' new demand arisen from the aging population etc. and
- Reinforce rules and regulations related to the solicitation and the sale of insurances in line with the diversification of sales channels.

In view of the above, at the Financial System Council's General Meeting on April 11 2012, the State Minister for Financial Services addressed the necessity to review issues relating to (1) the provision of insurance products and services and the scope of business of insurance companies etc. that meet various needs of the insurance policyholders, and (2) the solicitation and sale of insurances that are simple and easy-to-understand; while considering the overall regulatory regime.

The Financial System Council's Working Group on the Provision of Insurance Products/Services (the "Working Group") was established in order to consider these issues. To date, the Working Group met 16 times to discuss in depth (1) the provision of insurance products and services ((i) new insurance products; (ii) the concerted business system<sup>1</sup> and (iii) the rules and regulations related to the scope of business); and (2) rules and regulations relating to solicitation and sale of insurance products ((i) rules and

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<sup>1</sup> The provision as to "concerted business system" is stipulated under the Article 101, etc. of the Insurance Business Act (Act No. 105 of 1995) as an exception to Anti-Monopoly Act. Under this system, multiple insurance companies are permitted to underwrite insurances, with the terms and conditions including insurance premium that are uniform across the insurance companies. Examples of insurance products include those difficult to underwrite for a single insurance company due to substantially large insurance amount upon insurance event and the mandatory vehicle liability insurance that insurance companies are obligated to underwrite based on the government's social policy.

regulations related to insurance solicitation, (ii) rules and regulations related to agents for multiple insurance companies and insurance brokers, and (3) the scope of applicability of the insurance-related regulations). This report provides the summary of discussions.

## **1 New insurance products/services**

In line with the changes in social conditions such as the declining birthrate and the aging population, the Japanese national's needs and expectation towards the insurance and services provided by insurance companies and groups are changing. At the same time, some consider it concerning that insurance companies and groups are unable to deal with such changes of needs adequately, as their scope of business is restricted under the Insurance Business Act and other related rules and regulations.

As such, it is adequate to make necessary revisions in order to cope with various needs in the future while paying attention to the impacts on policyholders and the soundness of insurance companies' operations when lifting the bans on new services and business upon understanding the rationale behind the existing rules and regulations.

### **1-1 New insurance products**

The scope of insurance products that insurance companies can underwrite is currently restricted by the limitative listing<sup>2</sup> in the rules and regulation. Hence, an additional provision should be inserted in case a new insurance product needs to be introduced.

#### **1-1-1 Fertility treatment insurance**

With the growth of social concern in the fertility treatment, the demand for the fertility treatment insurance started to increase because the treatment requires he substantial

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<sup>2</sup> Article 3-4 and 3-5 of the Insurance Business Act and Article 4 of the Ordinance for Enforcement of the Insurance Business Act (1996 Finance Ministry Ordinance No. 5) (the "Enforcement Regulation")

costs.<sup>3</sup> However, it is currently unclear whether the insurers can underwrite insurance for the cases of infertility with unidentified causes.

Fertility treatment has attributes that are insurable, including the contingency element and the economic needs to supplement the high costs involved with it. The treatment is also socially meaningful. On the other hand, in order to determine reasonable level of insurance premium, the actuarial analysis is essential. For fertility insurance, it is also necessary to deal with the moral risk and the adverse selection issues arisen from the situation where the receipt of fertility treatment is entirely up to the policyholder's decision.<sup>4</sup> These issues should be incorporated in the process of the actual product development. In addition, insurers should be careful not to create complex products that are incomprehensible to the users.

Considering the above, the Working Group considers it appropriate for insurers to underwrite fertility treatment insurance after they design the product with further consideration so that they can manage the risks and cope with any problems based on the features of this insurance.

### **1-1-2 Direct benefit payment to service providers**

Currently, benefit payments for life insurance policy and accident/sickness fixed rate insurance policy (the "Life Insurance Contract etc.")<sup>5 6</sup> are allowed in cash only. However, due to the aging population, there are growing needs for receiving benefit in goods and services from the reliable service provider, such as nursing care when the insured becomes older and funeral services at the time of death of the insured.

The Working Group acknowledged the existing issues as per legally allowing the

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<sup>3</sup> Under the Ministry of Health, Labour and Welfare's program to provide funding to specified fertility treatment for couples suffering from infertility, the Japanese government provides monetary support for the fertility treatment for couples legally married and funds part of the costs of specified high cost fertility treatment. The number of couples utilizing this program is increasing.

<sup>4</sup> Further, the product development should take into consideration the fact that the decision regarding the types and frequency of fertility treatment is up to the policyholders' wish.

<sup>5</sup> Article 3-4-1 and 3-4-2 of the Insurance Business Act and Article 2-1 of the Insurance Act

<sup>6</sup> Payment in kind is legally permitted to cover the damages caused for casualty and third-sector insurances (Article 3-4-2 and 5 of the Insurance Business Act)

payment of life insurance benefits in kind<sup>7</sup> as follows:

- How the insurance company assures quality of goods and services to be delivered in the future; and
- How the insurance company manages the price risk associated with the goods and services while maintaining financial soundness<sup>8</sup>

On the other hand, if the insurance company introduces its business partner (the “Business Partner”) to the policyholder who wishes to purchase goods and services from such Business Partner, there is no specific legal restriction for the insurance company in making benefit payments directly to the Business Partner (the “Direct Payment Services”).<sup>9</sup> Therefore, the insurance company, to some extent, can meet the customer’s needs to receive payment in kind. It is noted that in this case, the policyholder can also select the payment in cash if he or she is not satisfied with the quality and price of goods and services offered at the time of payment, while the insurance company is obliged to make payments to the Business Partners only up to the contractually insured amount, thereby avoid the exposure to price risk. Therefore, risks and concerns related to allowing the payment in kind under the Life Insurance Contract, etc. can be mitigated substantially. Hence, the Working Group recommends to focus on improving customer services first by clarifying the availability of Direct Payment Services under the Life Insurance Contract, etc. It is appropriate for the time being to continue reviewing for the actual start of payment in kind services under the Life Insurance Contract, etc.

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<sup>7</sup> “On Revision to Insurance Act” (Report by Second Subcommittee, Sectional Committee on Financial System, Financial System Council, January 31, 2008). The report includes the following issues regarding the payments in kind under life insurance contract:

- Goods and services are involved with the price risk, making it difficult to calculate insurance premium, liability reserve, etc.
- In terms of method of sharing the price risk, there is an issue whether to regulate or leave it to the individual contracts.
- It is necessary to review surveillance methodology to ensure fulfillment of payment in kind such as the continuous provision of services.

<sup>8</sup> It should be noted that under the existing regulation allows structuring of insurance products with variable insurance amount based on the predetermined formula linked with the indices such as price index in an attempt to mitigate inflation risk.

<sup>9</sup> In this case, the insurance company’s obligation is to pay insurance amount, not goods/services to be provided by the Business Partner.

It should be noted that if the insurance company conducts the solicitation by stating that “upon insurance event, the insurance company will introduce the Business Partner to the customer, and if the customer chooses to purchase goods and services from such Business Partner, then the Direct Payment Services will be made available” and by referring to the details and quality of the goods and services provided by the Business Partner, then it is necessary to protect the customer’s such expectation towards goods and services by the Business Partner, since this will be the important factor in making decision to purchase insurance policies. Thus it is important to mandate the provision of information related to the goods and services by the Business Partner<sup>10 11</sup> and the establishment of an appropriate procedure for introducing the eligible Business Partner.<sup>1213</sup>

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<sup>10</sup> The following information should be provided to the customer.

- Details and quality of the goods and services provided by the Business Partner
- Criteria for selecting the Business Partner
- The customer reserves the right to select payment in cash instead of purchasing goods and services from the Business Partner upon insurance event
- The customer reserves the right to receive the difference between insurance amount and costs for acquiring goods and services (if there is shortage, then the customer is obliged to make payments)
- Explanation as to circumstances in which it is impossible to introduce the Business Partner that can deliver goods and services of the quality and contents initially expected

<sup>11</sup> In providing the information, it is important to avoid confusing the customer and clarify the party delivering the goods and services is the Business Partner, not the insurance company.

<sup>12</sup> Specifics to the procedure include the following:

- Obtain agreement from the Business Partner in advance that the costs of the goods and services will be made by the insurance company
- Set details and quality of goods and services, and appropriate procedure as to method of communication and payment upon usage of the services by the customer with the Business Partner.
- Set measures to make sure that upon insurance event, the goods and services are provided by the Business Partner with the same level of content and quality as initially explained including: verification of detail and quality of goods and services provided by the Business Partner, replacement of the Business Partner in case of problems.

When introducing the Business Partner, it is left at the insurance company’s discretion how in depth it will promise to the customer in terms of specifics of the goods and services. If the insurance company decides to incorporate detailed goods and services and the provider of detailed goods and services in the agreement, it means loss of flexibility as the insurance company needs to find the Business Partner exactly matching the described. Thus, in this case, the insurance company will be required to establish a system with better integrity.



In addition, it is appropriate to require insurance companies to give advice to customers that upon insurance event, they still have the option to select payment in cash instead of receiving payment in kind from the Business Partner.

## **1-2 Expansion of business scope of insurance companies/groups**

There are certain restrictions as to the scope of business for insurance companies and their group companies due to the necessity to have them concentrate on engaging in the insurance business in order to protect policyholders.

However, with the changes in social conditions such as the declining birthrate and the aging population, contents of additional services provided by insurance companies and their group companies along with their insurance services, or services that are expected to be provided integrally with the insurance services have been changing. For example, the Working Group was advised that there may be no problem to allow as part of insurance group companies' business the operation of day-care center that are in demand and socially significant.

For the scope of business for insurance companies and their subsidiaries, it is the general view that the decision to allow them to operate a specific business should be made carefully, considering the improvement of user-friendliness, the operational efficiency of the insurance group and the maintenance of international competitiveness, while paying attention to the potential impact of the new business in question on the soundness of the primary business of the insurance group.<sup>14</sup> In this regard, the business that is related or similar to the existing business and will likely to improve user-friendliness if provided integrally with the insurance service should be allowed as a group business.<sup>15</sup> In light of this concept, it seems acceptable to allow the operation of

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<sup>13</sup> It is noted that making benefit payments to a third party simply based on the policyholder's instruction after the insurance event (normal payment by instruction) does not require any of such obligation as this does not involve the customer's expectation towards quality of goods and services.

<sup>14</sup> "On Regulating the Scope of Business for Banks and Insurance Company Groups" (Report by the Second Subcommittee, Sectional Committee on Financial System, Financial System Council, December 18, 2007)

<sup>15</sup> Services related to nursing care, dealing and auctioning of second hand products for which there is a certain level of demand should be classified as business for subsidiaries

day-care center as a group business because it is similar to the already-permitted operation of nursing home, etc. in that they both provide services in the welfare facilities. The operation of day care center also has a strong connection with the real estate business currently allowed as the business of subsidiaries.

It is noted that the decision as to whether to allow certain business as the insurance company's business or subsidiary's should be made following the existing principle.<sup>16</sup> Namely, the potential businesses should be examined for similarity with the primary business, their risk profile and the potential impact on the primary business. Those with very close connection to the primary business should be classified as the insurance company's businesses; and others should be recognized as subsidiaries'. Based on this, the aforementioned operation of day-care center should be classified as subsidiary's business.

### **1-3 Greater utilization of the concerted business system**

In order to diversify risks and deal with the massive insurance risk that a single insurer cannot cover on its own, the concerted business for certain types of insurance products, such as the aviation insurance, is permitted as an exception to the prohibition under the Anti-Monopoly Act.

It should be noted that in addition to the exception above, there is a potential growth in demand for covering risks for which no insurance is currently available. However, lack of sufficient data necessary to conduct actuarial analysis for structuring products would make it difficult to generate risk assessment for the new product areas with no underwriting history.

In such a case, if multiple insurers can jointly underwrite the insurance, it is possible to reduce time necessary to collect data for actuarial analysis and diversify risk. This in turn will result in the promotion of the development of products that are currently unavailable, which is socially significant.

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if found no issues based on this concept.  
<sup>16</sup> "On Regulating the Scope of Business for Banks and Insurance Company Groups" (refer to the footnote 14)

As such, the act of underwriting insurance jointly by multiple insurers should be analyzed from the practical point of view, including legal issues.<sup>17</sup>

## **2 Rules regarding insurance solicitation/sales**

### **2-1 Restructuring of rules and regulations concerning insurance solicitation**

Rules and regulations for insurance solicitation under the existing Insurance Business Act consist of (1) certain prohibited actions applied to insurance companies and solicitors<sup>18</sup> and (2) obligations of insurance companies to develop/reinforce relevant systems.<sup>19</sup> Specific obligations in the process of insurance solicitation, such as the use of policy overview and warning information documents (the Policy Overview, etc.)<sup>20</sup> and the documentation confirming that the customer's needs are met by the insurance product to be purchased (the "Intention Confirmation Document"),<sup>21</sup> are stipulated based on the above (1) and (2). It is noted that the above (1) succeeded to the Law Concerning the Control of Insurance Solicitation enacted in 1948 (Law No. 171 of 1948) and the (2) was introduced under the 1998 Financial System Reform Law (Law No. 107 of 1998). For additional needs for the governance to obligate insurance companies to manage and give guidance to the insurance solicitors, it has always been the case to apply the above (1) first, then (2) if it is not possible to resolve by using (1). This basic structure has not been changed since 1998.

However, channels for insurance solicitation have become diverse, and sales of insurance at banks, at walk-in insurance shops and via the Internet have been increasing. Additionally, insurance agents are expanding in size. Hence, the relationship between the insurance company and the insurance agent, as seen in the relationship between the large-scale agent for multiple insurance companies and the contracted

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<sup>17</sup> For example, examination whether taking the concerted action to collect necessary data required to calculate the premium amount when structuring the insurance product will breach provisions under the Article 101-1 and 101-2 of the Insurance Business Act.

<sup>18</sup> Article 300-1 etc. of the Insurance Business Act

<sup>19</sup> Article 100-2 of the Insurance Business Act, the Article 53-7 of the Enforcement Regulation, etc.

<sup>20</sup> Refer to Section II-3-3-2(2)②、II-3-3-6(2)②、II-3-5-1-2(17) of the Comprehensive Guidelines for Supervision of Insurance Companies (the "Guidelines for Supervision")

<sup>21</sup> Refer to the Section II-3-5-1-2(18) of the Guidelines for Supervision

insurance company, does not necessarily fit in the relationship assumed under the existing rules and regulations, where a specific insurance company, understanding the entire business operation of insurance solicitors, manages and instructs them.

Further, the banking and securities business sectors are governed by the Banking Act and the Financial Instruments and Exchange Act, not by the Insurance Business Act. Thus banks and securities firms are required active provision of information (including the obligation to deliver documents to be issued prior to concluding a contract), in addition to prohibition of certain activities and the obligation of reinforcing relevant systems.<sup>22</sup>

Hence, in order to retain legal capability to deal with the changes in insurance solicitation such as solicitation channels, it is necessary to: (1) clearly stipulate the basic rules such as the obligation to provide information in the law and make them applicable to insurance solicitation activities as a whole, and (2) shift to a legal regime that governs insurance solicitors as well as insurance companies as primary entities of supervision instead of focusing on insurance companies. Considering the above, the Working Group recommends the revision of rules and regulations regarding insurance solicitation in the following manner.

## **2-2 Creation of basic rules for insurance solicitation**

In order for Japanese nationals to select insurances suitable for their own needs and properly deal with potential risks, it is desirable that insurance companies and solicitors should understand the customers' needs accurately, recommend insurance products that are suitable to such needs, and appropriately explain the details of insurance products recommended. Customers should purchase insurance products only if they understand the products fully. For the purpose of assurance, the existing regulations regarding insurance solicitation should be modified to include (1) the obligation to understand the customer's intention, recommend insurance products to meet the customer's needs and execute contracts upon confirmation that the recommended

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<sup>22</sup> Article 12-2 of the Banking Act (Act No. 59 of 1981) and Article 37-3 of the the Financial Instruments and Exchange Act (Act No. 25 of 1948)

products match the customer's needs; and (2) the obligation to provide information on insurance products to the customer.

### **2-2-1 Obligation to ascertain the customer's wishes and requirement**

Customers are exposed to various risks, and their needs for insurance (risks that should be covered by insurance) are different from one another. Thus in soliciting insurance, we need to ensure that the insurance solicitor understands risks that each customer is exposed to and his or her needs for insurance accurately.<sup>23</sup> The customer, via the insurance solicitor's recommendation for products matching their needs and an easy-to-understand explanation, should understand risks he or she is exposed to and needs for insurance, then execute the insurance policy.

In this regard, customers are given an opportunity, prior to execution of contracts, to confirm for final whether the recommended insurance product matches with their needs via the use of the Intention Confirmation Document as set forth under the obligation of insurance companies to develop/reinforce relevant system.<sup>24</sup> However, in recent years, the Working Group was advised that this procedure has not been as effective as initially expected.<sup>25</sup>

In order to improve the legal environment in which customers can enter into insurance transactions by recognizing their risk exposure and the risks to be covered by insurance, the Working Group suggests inserting the following clause in the relevant regulations: "Insurance companies or insurance solicitors shall understand the customer's intention, <sup>26</sup> recommend products matching such intention, and provide

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<sup>23</sup> The customer's needs include the needs acknowledged by the customer through the course of communicating with the insurance solicitor.

<sup>24</sup> Article 100-2 of the Insurance Business Act, Article 53-7 of the Enforcement Regulation, and Section II-3-5-1-2 (18) of the Guideline for Supervision.

<sup>25</sup> The confirmation document was introduced as a specific measure in relation to the consumer's responsibility to "make decision to purchase recommended insurance product by the insurance solicitor, etc. by confirming that the recommended product meets his or her needs instead of believing into the recommendation" as stated in Section II. 2. (1) of "Interim Summary of Issues on Sales and Solicitation of Insurance Products in accordance with Suitability Rule."

(Report by The Study Team on Insurance Product Sales and Solicitation, March 1, 2006)

<sup>26</sup> The customer's needs include the needs acknowledged by the customer through the course of communicating with the insurance solicitor. (Refer to the footnote 23)

easy-to-understand explanation including reasons why the recommended product is in line with such intention, thereby assuring that the customer is aware that the selected product is suitable at the time of contract execution.

If the uniform approach to capture the intention of customers is made compulsory, there is a risk that such approach will become perfunctory or cause excessive burden on insurance companies, solicitors and customers, as it is difficult to come up with the approach that captures characteristics of all types of solicitations. Considering this, it seems appropriate to stipulate principles as guidance (general obligation clause) from the regulatory point of view, and let insurance companies and solicitors devise methodologies in terms of specific products or types of solicitation.

Further, as the specific methodologies to satisfy the above principles should be selected considering the types of products and solicitation, it is appropriate to provide standardized goals by stipulating the standard applied to all types of products and solicitation in the Guidelines for Supervision, including the following:<sup>27 28</sup>

- (1) Capture the customer's intention prior to providing explanation on an individual insurance plan in detail such as insurance amount and insurance premium.<sup>29</sup> Then recommend an individual insurance plan designed based on the customer's intention and provide detailed explanation along with the reasons why such plan is following such intention. Thereafter, verify the customer's final intention before executing the insurance policy, compare the final intention vs. initial, and confirm the difference.
- (2) Every time the insurance solicitor recommends the individual insurance plan with the information including the insurance amount and premium, the solicitor should explain the process of designing such plan, the assumption used regarding the

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<sup>27</sup> A methodology that does not satisfy the (1) and (2) can be recognized as valid, depending on the attributes and channel of the insurance product in question. However, even in such cases, solicitation process must involve the acquirement of the customer's intention, recommendation and explanation of insurance product aligned with such intention, and the customer's own verification of intention and suitability of the product.

<sup>28</sup> In either case, individual plan recommended to the customer should be verified for suitability considering the customer's final intention.

<sup>29</sup> There should be no issue in providing general information regarding the product using pamphlet, etc. prior to acquiring the customer's preference as it will serve to clarify the customer's preference.

customer's intention and the linkage between the plan detail and the assumed intention. Prior for signing the contract, compare the final intention of the customer and the intention assumed by the solicitor and confirm that they match.

Further, in view of clarifying the policies in applying the above standard, examples of procedures for major types of insurance solicitation should be outlined in the Guidelines for Supervision as specific means to satisfy the principles.<sup>30</sup>

Finally, by requiring the insurers a legal obligation to understand the customer's intention, the effectiveness of understanding the intention through the solicitation process as a whole will likely improve. Thus, the Working Group requests each insurer to be innovative in simplifying documents and improving the easy-to-understand communication through the entire solicitation process. For example, reduce the volume of documents by combining the Intention Confirmation Documents with the application documents etc. in the overall solicitation process, and consider it satisfactory to include (i) the customer's intention, (ii) the reasons for product recommendation in response to such intention<sup>31</sup> and (iii) a confirmation that the product recommended is aligned with

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<sup>30</sup> Specifically, the Working Group suggest the following procedure:

- ① When recommending the insurance product and providing the product explanation by ascertaining the customer's intention:  
Ascertain the customer's intention by means such as a questionnaire<sup>(\*)</sup> at a certain point in the solicitation process before designing and indicating a specific plan including the insurance amount and the premium to the customer. Then generate a specific plan in line with such intention, and provide an explanation to the customer explicitly including the linkage between the intention and the plan detail. Confirm if the plan is aligned with the customer's final intention confirmed before signing. If there is a gap between the original intention and the final one, provide an explanation to the customer by explicitly including the background and a section to cope with it in the plan .  
<sup>(\*)</sup> It is also acceptable to obtain the customer's confirmation by the customer putting a checkmark on applicable items in the brochure which was used to provide product explanation (or by the insurance solicitor putting a checkmark in front of the customer).
- ② When recommending and providing explanation by inference on the customer's intention:  
Every time the insurance solicitor presents a specific plan containing the insurance amount and premium to the customer, explicitly highlight in the product design document etc. the connection between the customer's intention assumed and the suggested plan. Before signing, confirm whether the assumption of the solicitor matches with the customer's final intention. Then confirm whether the plan meets the customer's final intention.

<sup>31</sup> For example, include the information on the linkage between the customer's intention

the customer's intention.

### **2-2-2 Obligation to provide information**

To ensure that the customer enters into the insurance contract that meets his or her own needs for insurance, it is essential that the customer accurately understands the insurance product as well as the solicitors' recommendation aligned with the customers' intention. Due to the asymmetry of information associated with insurance business between insurance companies/solicitors and the customers and the diversifying product specification as seen in other financial products, in order for customers to fully understand insurance products and services, provision of appropriate information and easy-to-understand explanation to the customer by insurance companies/solicitors has become increasingly important.

As to the disclosure of product information to customers in the process of insurance solicitation, the Article 300 of the Insurance Business Act prohibits "failing to disclose ... any important particular stipulated in the insurance contract" to the policyholder or the insured,<sup>32</sup> breach of which is subject to the criminal penalty.<sup>33</sup> Further, as discussed in the Section 2-1, the obligation to issue the Policy Overview, etc. is set in the Guidelines for Supervision.

However, some view that a flexible application of this clause is not easy because the scope of prohibition of non-disclosure of material information is limited to the content of the insurance contract only, and non-disclosure itself is subject to a criminal penalty, resulting in the situation where the insurer only takes conservative approach as to this provision. Furthermore, the fact that there is no stipulation as to active provision of information has been criticized as lacking a balanced view because the provision of information is required for relatively easy-to-understand financial products such as deposit account etc.

Upon the consideration above, in order to ensure that customers have accurate

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and the recommended product etc.

<sup>32</sup> Article 300-1-1 of the Insurance Business Act

<sup>33</sup> under Article 317-2-7 of the Insurance Business Act, subject to imprisonment up to one year or a fine of up to one million yen or less



understanding of insurance products etc., it is appropriate to explicitly indicate in the relevant regulations the obligations of insurance companies and solicitors to provide information. Namely, insurance companies and solicitors should be obligated under the Insurance Business Act to provide information that is useful for customers in making decision to purchase insurance policies, including the policy overview and warning information. The provision of the policy overview etc. should be re-positioned as the standard approach for providing information based on these obligations.

### **2-2-3 Simplification of solicitation documents**

Various documents are used for soliciting insurance, in addition to legally required document such as the Policy Overview etc., guide to insurance policy, policy provisions and brochures.

The Policy Overview etc. were originally set to provide the minimum required information that is particularly important, by which a general consumer would not lose his or her motivation to understand.<sup>34</sup> In reality, however, there is a concern that the Policy Overview etc. is not as effective as initially expected due to the increased amount of information and complicated contents. For example, some of the Policy Overview etc. includes information to the extent more than the general consumer can understand. Further, some insurance solicitors explain product details using brochures rather than the Policy Overview etc.

Considering the above circumstances, the Working Group communicated with related parties in both life insurance and nonlife insurance business sectors, and encouraged them to reconfirm the information that should be included in the Policy Overview etc. and the significance of such documents in the solicitation process, and revise and simplify the content of the Policy Overview etc. in view of the original purpose of the documents to provide truly material information that the customers should understand in making decision to purchase insurance policy, thereby the Policy Overview etc. will serve the original purposes. Both business sectors are taking voluntary actions to

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<sup>34</sup> Section III.1.(1) of "Interim Summary of Issues: How Information Should be Supplied When Selling and Soliciting Insurance Products" (Report by The Study Team on Insurance Product Sales and Solicitation, July 8, 2005)

simplify the solicitation documents, and provide updated information to the Working Group, by which the Working Group has confirmed that the both business sectors' independent efforts for review/improvement are in line with the issues identified within the Working Group. Creating simple and easy-to-understand solicitation documents will help customers to understand the insurance products offered through the use of such documents during the explanation and through the customer's understanding of them, which is essential to materialize the obligation of insurance companies and solicitors to provide information. Thus, the Working Group encourages both business sectors' continued efforts and innovative actions of insurers towards the creation of easy-to-understand solicitation documents.<sup>35</sup> The Working Group also encourages to create simple and easy-to-understand solicitation documents that are unrelated to the provision of product explanation, such as the Intention Confirmation Documents.

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<sup>35</sup> In addition, if it is found that the existing rules and regulations hinder the efforts to create easy-to-understand documents for the customer, such rules and regulation should be revised as long as the revision will not violate customer protection.

#### **2-2-4 Exemption from restricted acts under the rules and regulations**

Currently, a certain exemption from the obligation on solicitation documents (Policy Overview etc. and Intention Confirmation Paper) is regulated depending on the product feature and the type of solicitation.<sup>36</sup> This is because, in some cases, depending on product feature, customer attributes and types of insurance contract, it is better to set up a procedure based on the agreement of the related parties, rather than relying on the uniform regulatory procedure. In addition, taking a different approach could result in a better explanation to the customer.

Thus, adjustments, such as the exemption from the restricted acts under the rules and regulations if necessary, should be made carefully for specific cases that fit the categories described in the following.<sup>37</sup>

(1) Insurance contracts applicable to general principles to provide information but not applicable to the standard approach:

(A) Contracts for which the obligation to provide information is virtually achieved

(i) Products that are highly customized with special feature for which customers will have better understanding via a different approach devised by the insurer rather than following the set standard,<sup>38</sup> and

(ii) Contracts with small amount of insurance premium<sup>39</sup> (These are generally simple and easy to understand, thus following the standardized approach will likely burden both customers and insurers more than necessary.)

(B) Contracts for which the supplemental provision of information by the group

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<sup>36</sup> For the Policy Overview, etc. refer to Section II-3-3-2(2)②(Note 1), and Section II-3-3-6(2) ②(Notes 1 and 2) of the Guidelines for Supervision and II-3-5-1-2 (18)①for Intention Confirmation Document.

<sup>37</sup> In addition to partly waiving the obligation to provide information itself, apply only the principles without referring to specific requirements to satisfy the obligation to provide information including the issuance of legal documents (policy overview and warning information, etc.), or allow other means to satisfy the obligation.

<sup>38</sup> If the customer, regardless of an individual business owner or a corporate, has no better knowledge on insurance compared than the average consumer, the insurance company and solicitor are required to provide easy-to-understand explanation as to the product in any way.

<sup>39</sup> For the product with the insurance period of less than one year, annualized premium amount should be used if the product is renewable.

policyholder is permitted

(iii) Insurance contracts for which the policyholder is a group but premium payments are virtually made by the insured with the policyholder fulfilling the obligation to provide information given the close relationship<sup>40</sup> with the insured<sup>41</sup> (i.e. It is expected that necessary information is provided to the insured through the policyholder hence there is no need to obligate insurance companies and solicitors to provide information)

(2) Insurance contracts that is exempted from the application of general principles (entirely exempted from the application of the obligation to provide information)

Insurance contracts that are lacking the rationale behind providing information to the insured, as the contract for which the policyholder and the insured are different and the insured does not make premium payments or the insurance premium is extremely small such as

(i) Contracts for which the insured does not make premium payments<sup>42 43</sup>  
(Because the insured is the unilateral beneficiary)

(ii) Contracts with extremely short insurance period<sup>44</sup> and extremely small premium amount born by the insured (the burden of premium payments is so low that it is not meaningful to require giving information to each insured person)

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<sup>40</sup> Examples of such group include: (i) the group that is exempted from the application of the Insurance Business Act (except for those exempted based on the eligibility as to number of the insured) in case it operates a mutual aid association, and (ii) other groups that are eligible for exemption or are considered eligible in light of closeness of relationship between the group and group members, the group and members' interests over the group insurance, eligibility criteria to become a group member and the relationship between the group's activities and the insurance coverage.

<sup>41</sup> In this case, the insurance company and solicitor will not be required to provide information directly to the policyholder, but required to take measures for ensuring that the customer will receive the same level of information that would normally be provided by the insurance company and solicitor.

<sup>42</sup> Examples include the head of household purchasing insurance for his or her family and making premium payments for them, and the corporate entity purchasing insurance for its employees and making premium payments.

<sup>43</sup> It should be noted that if the insured's consent is required based on the Insurance Business Act, the insured should be given sufficient information to decide whether to consent.

<sup>44</sup> For example, those with one month or less and not renewable.

- (iii) Contracts attached to specific services and participation in specific events, etc. and the users/participants of such services/events are insured automatically for damages caused by specific services and events<sup>45</sup>

(This type of policy is attached to a specific event or service, etc. and the intension of the insured is not involved in making decision to purchase such insurance. Hence, it is unlikely that information regarding the insurance separately from the event or service itself would be required.)

- (3) Renewal or partial revision to the existing contract<sup>46</sup> (There is little necessity of repeating explanation for items already explained at closing of the existing contract)

The above concept should be applied to each case, considering the product feature, the assumed customer attributes and the existence of a provider of adequate product explanation other than insurance solicitors. If there is reasonable justification for exemption and there is no concern as to breaching the purpose of the provision related to restricted acts under the rules and regulations related to insurance solicitation, such case should be approved for the exemption or the relaxed restriction should be applied. If an automatic application of the above concept identifies potential problems as to the protection of policyholders etc., such cases should be considered ineligible for the exemption or the application of relaxed restriction.

#### **2-2-5 Reconsideration of the prohibited acts (Article 300 1-1 of the Insurance Business Act)**

As mentioned previously, the policy overview and warning information are defined in the Guidelines for Supervision based on the Article 300 1-1 of the Insurance Business Act. As such, the scope of the “Important Matter” under the Article 300 1-1 is considered broad, covering the entire contents of the policy overview and warning information.<sup>47</sup>

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<sup>45</sup> In selecting specific contracts for exemption, it is important to be careful not to include the product that should obtain the consent from the insured.

<sup>46</sup> In principle, it is considered adequate to provide information as to the change (e.g., in the case of the additional attachment of a rider then the content of such rider).

<sup>47</sup> “Interim Summary of Issues: How Information Should be Supplied When Selling and Soliciting Insurance Products” (Report by The Study Team on Insurance Product Sales and Solicitation, July 8, 2005)

On the other hand, there is a view that the Article should be applied in a restricted manner, given the fact that breach of the Article is subject to the criminal penalty.

Further as mentioned in the Section 2-2-2, if the policy overview and warning information are re-aligned with the obligation to provide information to be newly introduced, the legal interpretation of the “Important Matter” in a broad sense and broad application of the Article 300 1-1 will no longer be necessary.

Thus, the scope of the application of Article 300 1-1 should be reduced through the measures such as limitation to making false statements or re-definition of the “Important Matter” as the critical information that will likely affect the potential policyholder’s decision to execute the contract.

### **2-3 Obligations of insurance solicitors**

As mentioned previously, the relationship between insurance companies and insurance solicitors has become diverse, along with the diversification of insurance solicitation approach. A growing number of insurance solicitors independently recommend and sell multiple insurance products provided by different insurance companies through comparison (the “Recommendation and Sale by Comparison”) and outsource part of their operation related to solicitation. They do not fall under the traditional relationship initially assumed under the insurance regulations, where a specific insurance company understands the whole business operation of the insurance solicitors, manage and instruct them. In this circumstance, insurance solicitors as well as insurance companies should actively endeavor to ensure that the insurance solicitation is performed properly through compliance with the solicitation rules etc. In this sense, insurance solicitors should be made applicable to: (1) the obligation to develop/reinforce relevant systems to maintain compliance with basic rules for insurance solicitation discussed in the Section 2-2; (2) the additional obligations in relation to the Recommendation and Sale by Comparison; and (3) the obligation to manage outsourcing subcontractors if using them for insurance solicitation.

### **2-3-1 Obligation for insurance solicitors to develop/reinforce relevant systems**

Under the existing Insurance Business Act, insurance companies are obliged to develop/reinforce relevant systems<sup>48</sup> while insurance solicitors are not subject to such obligation.

However, some insurance solicitors are large-scale, with hundreds of associated shops mainly consisting of agents for multiple insurance companies.<sup>49</sup> In addition, as discussed previously, they will be subject to the restricted acts under the rules and regulation including the obligations to provide information and confirm the intention of customers. Therefore, it would be necessary for insurance solicitors, aside from being managed and instructed by the contracted insurance companies etc., to establish and improve relevant systems to properly operate their business.

As such, not only insurance companies but also insurance solicitors should be required to establish necessary system for properly conduct of solicitation business<sup>50</sup> based on their size and characteristics of their business.<sup>51</sup>

### **2-3-2 Rules and regulations concerning agents for multiple insurance companies**

Agents for multiple insurance companies are contracted to solicit insurance on behalf of multiple insurance companies. While being managed and given guidance by insurance companies, some of the agents for multiple insurance companies independently established their own solicitation process for the Recommendation and Sale by Comparison. Therefore, agents for multiple insurance companies should make an effort to ensure that their solicitation is appropriate, including the development/reinforcement for the necessary system, rather than solely rely on the management and instruction by

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<sup>48</sup> Article 100-2 of the Insurance Business Act etc.

<sup>49</sup> Defined as the insurance solicitor that are contracted by two insurance companies or more

<sup>50</sup> Insurance brokers should also be applicable to the obligation to develop/reinforce relevant systems based on their size and characteristics as it is also important for them to perform appropriate insurance solicitation.

<sup>51</sup> For example, for the employee of the life insurance company who solicits insurance, if he or she participates in the training and education set up by the life insurance company to assure appropriateness of insurance solicitation, it is considered satisfactory.

the contracting insurance companies.

In addition, some agents for multiple insurance companies maintain fair and neutral position and sell insurance products that satisfy the customers' needs among multiple insurance companies' products. It should be noted, however, that unlike insurance brokers who solicit insurance independently from insurance companies, the existing rules and regulations treat agents for multiple insurance companies as insurance solicitors commissioned by insurance companies. Agents for multiple insurance companies are not legally obliged to act fair and neutral.

The Recommendation and Sale by Comparison by agents for multiple insurance companies may continue expanding. Thus, in order to prevent customers from misunderstanding the legal profile of this type of solicitation and to ensure the appropriateness through maintaining the quality of comparison and recommendation, the Working Group suggest the following revisions to the rules.

Firstly, in order to optimize the Recommendation and Sale by Comparison by the agents for multiple insurance companies, as part of the obligation to provide information, they should be required to: (i) disclose detailed information on the comparable products that are sold by such agents for multiple insurance companies; and (ii) provide justifications clearly for presenting and recommending a specific product.<sup>52 53 54 55</sup>

Additionally, in order to prevent customers from misunderstanding the positioning of

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<sup>52</sup> If the agent for multiple insurance companies recommends specific products on its judgment after narrowing down the range of products to match the customer's needs, the agent for multiple insurance companies should explain the criteria used for filtering.

<sup>53</sup> The insurance solicitor belonging to a single insurance company is also required to explain the linkage between the specific plan and the customer's intention based on the obligation to understand the customer's intention . (See Section 2-2-1).

<sup>54</sup> In the case of product comparison for showing the superiority of the recommended product, the agent for multiple insurance companies is required to provide whole necessary information for the customer to make proper judgment, including the justification for the recommended product's superiority and the accurate overview/feature of other products used in the comparison. (Article 300-1-6 of the Insurance Business Act and Section II 3-3-2 (6) and Section II 3-3-6 (6) of the Guidelines for Supervision.

<sup>55</sup> The agent for multiple insurance companies that simply offer specific product(s) rather than the Recommendation and Sale by Comparison is only required to provide explanation as to reasons for recommending such specific product(s) (Explanation may be given as to the capital relationship with a specific insurance company and other issues related to the administrative procedure and management policies as well as the level of insurance premium and product feature).



agents for multiple insurance companies, the agents for multiple insurance companies should be required: (i) to clearly identify that legally speaking, they function as agents for insurance companies; and (ii) to be prohibited from making presentations which may cause the customer to misunderstand their positioning above.<sup>56</sup>

Further, the obligation to develop/reinforce relevant systems<sup>57</sup> to be applied to insurance solicitors in general will also be applied to agents for multiple insurance companies. Specifically, agents for multiple insurance companies engaged in the Recommendation and Sale by Comparison, in addition to the appropriate provision of explanation on individual products being compared, should be required to develop/reinforce the system that support Recommendation and Sale by Comparison appropriately in line with the size and characteristics of their businesses.<sup>58</sup>

Given the introduction of additional rules, it is desirable that the relevant authority set measures for obtaining information regarding agents for multiple insurance companies, such as the types of insurance solicitation and sales performance and ensure the effective supervision of agents for multiple insurance companies. For example, the Working Group recommends requiring the agents for multiple insurance companies that meet certain criteria (e.g. those contracted with substantial number of insurance companies) to submit report regarding their business operation etc.

Finally, the agent for multiple insurance companies, who is a franchiser managing the trade name and business expertise of the relevant group in the franchising business,<sup>59</sup> should be required to develop/reinforce relevant system not only for its own solicitation

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<sup>56</sup> If the agent for multiple insurance companies represents itself as “fair and neutral,” it may be misunderstood by the customer that the agent takes a neutral position between the contracting insurance company and the customer. Such presentation should be avoided.

<sup>57</sup> See Section 2-3-1.

<sup>58</sup> The independent agent that regularly conducts the Recommendation and Sale by Comparison should be required to develop/reinforce the relevant system to be suitable for the regularity of such business. On the other hand, there is no requirement such as above if the agent for multiple insurance companies in principle does not offer the Recommendation and Sale by Comparison. If such agent conducts the Recommendation and Sale by Comparison upon the request by the customer, the relevant system needs to be reinforced to the extent it is necessary.

<sup>59</sup> A style of businesses where the insurance company A in the relevant group (franchiser) allows using of its trade name and provides the know-how information to the insurance solicitor (the insurance agent B) as the franchisee, who in turn pays franchise fees and solicit insurance under the franchiser’s trade name.

activities but also for educating, managing and instructing other insurance agents that are using the franchiser's trade name and receiving the know-how information as franchisees, because customers naturally expect the franchisees to provide the same level of services as the franchiser.<sup>60</sup>

The Working Group views it unnecessary at this point to make across-the-board requirement as to the establishment of system for disclosing commissions. This is because the revisions discussed above should ascertain the maintenance of the appropriate system for the Recommendation and Sale by Comparison.<sup>61</sup> However, if there is a concern regarding the Recommendation and Sale by Comparison, the relevant authority should examine and verify whether there is a distortion in process of comparison and recommendation due to the level of commissions.<sup>62</sup>

In view of the difficulties associated with managing and giving guidance to agents for multiple insurance companies compared with insurance solicitors contracted with a single insurance company, the Working Group was advised that in order to support insurance companies' disciplinary actions, it may be appropriate to require them to exercise its right to obtain reimbursement against the insurance solicitor, if the insurance company compensates the customer for the damages caused by the insurance solicitor based on the Article 283 of the Insurance Business Act,. The insurance companies should exercise such right appropriately as one of the means to instruct and supervise insurance solicitors. However, insurance solicitors will likely be better disciplined by the clarified legal responsibility under the rules and regulations such as restricted acts and the obligation to develop/reinforce relevant systems that are applied universally to the insurance solicitors based on the concept discussed in the Section 2-1. Hence, it seems appropriate to discuss whether to require exercising such

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<sup>60</sup> Should the franchisee's product offering differ from those advertised by franchiser, the franchisee needs to explain the difference to the customer.

<sup>61</sup> In the discussions of the Working Group, some member addressed a concern as per the fee disclosure that it is difficult to disclose and clearly explain the insurance solicitor's commission to the customer, and the disclosure may result in confusing the customer. There is no direct connection between the amount of insurance premium paid by the customer and the issue whether the offered insurance product matches the customer's needs.

<sup>62</sup> If the inappropriate practice is found in relation to the Recommendation and Sale by Comparison due to the level of commissions, we will have a separate discussion whether to introduce the commission disclosure as a mandatory requirement.

right once the effectiveness of those rules and obligations is confirmed.

### **2-3-3 Insurance solicitors' responsibility to manage subcontractors**

Along with the growth in the size of insurance agents such as insurance shops, not only insurance companies but insurance solicitors have been increasingly outsourcing part of their businesses.

At the same time, the responsibility of insurance solicitors as to managing subcontractors is not clear. That is, the responsibility of insurance solicitors under the Insurance Business Act is uncertain in the event there is a problem with the subcontractor. In addition, there is no stipulation under the regulation as to the administrative organization's right to require reporting and on-site examination to the subcontractor of the insurance solicitor. Therefore, in occurrence of a problem with the subcontractor, the ability to collect information to understand the situation is limited. Further, when a fact-finding regarding the insurance solicitor operation including the information on subcontractor is necessary, it could be difficult to understand the whole aspect of the problem, lacking the authority to request reporting to the subcontractors.

Considering the above, if the insurance solicitor outsources part of its businesses,<sup>63</sup> it is appropriate to require developing/reinforcing relevant systems to confirm that subcontractors are operating business appropriately. It is also appropriate to require the insurance company to obtain information from and give guidance to the insurance solicitors regarding subcontractor management as a part of management and guidance for the relevant solicitors.

Further, to enable the relevant authority to investigate and understand the situation of the subcontractor of the insurance solicitor in case the problem was found, it is appropriate that they have the legal ability to request reporting and on-site examination of the subcontractors of solicitors as well as the subcontractors of insurance companies.

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<sup>63</sup> It should be noted that the re-commissioning the solicitation activities to a third party is prohibited for insurance solicitors except for the cases approved based on Article 275 of the Insurance Business Act.

## **2-4 Scope of applicability of solicitation rules**

In the process of insurance solicitation, it is important to provide appropriate explanation to the customer to ensure that he or she can make a correct decision upon right understanding. To ensure fair and impartial solicitation of insurance, restrictions as to eligible insurance solicitors have been set under Insurance Business Act. Only insurance solicitors etc. registered with the relevant authority are allowed to operate solicitation business.<sup>64</sup>

However, with changing business environment such as emerging large-scale agents and diversifying channels for solicitation, an increasing number of business operators not categorized as insurance solicitors are engaged in activities within the broader sense of insurance solicitation process (i.e. process covering from customer development to signing of contracts) such as the operation of website for products comparison and products recommendation, which do not necessarily fall under the strict definition of insurance solicitation. In this regard, the existing Guidelines for Supervision recognizes the marketing activities to customers aiming for contract execution and the explanation providing product information aiming to the sale of insurance products as insurance solicitation activities.<sup>65</sup> However, while some of the so-called products comparison websites and activities to introduce insurance products do provide information of insurance products, the motivation of these activities (i.e., whether they are aiming for signing of insurance contracts) largely remain unclear. It is difficult to judge whether the activity in question is recognized as insurance solicitation based on the existing benchmark under the rules and regulations.

As discussed above, the existing Insurance Business Act and other related rules do not necessarily incorporate all of the changes in business environment. Hence, it is necessary to reorganize and appropriately set the scope of rules and regulations in relation to insurance solicitation.

### **2-4-1 Restructuring/clarification of the scope of applicability of solicitation rules**

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<sup>64</sup> Article 275 of the Insurance Business Act

<sup>65</sup> Section II-3-3-1(1)② and Section II -3-3-5(1)② of the Guidelines for Supervision

It is not necessarily viewed problematic for the business operator that is not a licensed insurance solicitor to take a part of the broader sense of insurance solicitation process, if necessary product information is communicated to the customers by the licensed insurance solicitor before signing the contract somewhere within the process. However, if there is a flaw in the solicitation process, e.g. customers are given excessive and inappropriate product promotion/recommendation and wrong product information by unlicensed parties before insurance solicitors begin approaching customers, this will leave customers with a wrong impression on the product detail, which may not be fixable even if the licensed insurance solicitors later provide the correct information to them. Therefore, some of activities at the stage before the insurance solicitors begin approaching customers should be regulated by certain rules from the policyholder protection point of view.

In this regard, it is necessary to specify activities among the broader sense of insurance solicitation process that should fall under the scope of the legal definition of insurance solicitation. This should include actions, which, upon occurrence of a problem, would prevent customers from understanding products accurately and would be difficult to correct afterwards. The Working Group suggests referring to the following criteria to determine comprehensively whether the activity in question falls under the definition of insurance solicitation under the Insurance Business Act.

- (i) There is an evidence implying the collectiveness and continuity with solicitation activities by insurance solicitors<sup>66</sup> such as the receipt of reward from insurance companies and solicitors (e.g., the reward linked with the execution of insurance contracts); and
- (ii) Specific insurance products are recommended and explained to the customers.

The above (i) is for avoiding the risk of excessive and inappropriate marketing and product recommendation to the customers; and (ii) is for avoiding the risk of confusing customers by giving specific product information before the licensed insurance solicitors can provide information on such products etc.

It should be reminded that the solicitation rule described above will not have immediate

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<sup>66</sup> Other examples include capital relationship with insurance companies and solicitors.

impact on those activities that are in the broader sense of solicitation process and do not fall under the above criteria. Such activities include the provision of information to the insurance solicitors regarding the information about potential policyholders with no involvement in the recommendation and explanation of the insurance products; and the mere reproduction of the information provided by the insurance companies (the “Solicitation-related Activities”). However, if the third party engaged in the Solicitation-related Activities commits an inappropriate act and breaches the solicitation rules and regulation,<sup>67</sup> this means unbeneficial to the customers. Thus, insurance companies and solicitors, in using the third party for Solicitation-related Activities, should strengthen their management organization to prevent such inappropriate acts.<sup>68</sup>

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<sup>67</sup> For example, based on the criteria, the following activities are recognized as insurance solicitation under the Insurance Business Act, and non-licensed persons are not allowed to operate:

- (1) Provision of of product information such as the product comparison website explaining details of specific insurance product by receiving rewards (e.g. linked with the resultant contract signing) from the insurance companies, etc.
- (2) Provision of recommendation of insurance products (or groups of products) offered by a specific insurance company only, and rewarded by such insurance company etc. as business (activities that breach Section II-3-3-1(1)<sup>③</sup> of the Guidelines for Supervision)

<sup>68</sup> Specific examples of actions as to improving management organization are provided below. It should be noted that if the operator of the Solicitation-Related activities (the “Operator”) is found in breach of the Insurance Business Act when looked at integrally with the insurance solicitor, it means that the insurance solicitor did not manage the operator appropriately, and will be held liable for the breach of the obligation to reinforce/establish relevant systems.

- ① In relation to the the information service as to insurance products (the comparison website, etc) provided by the Operator, confirm whether there are not inappropriate actions which may prevent the customer from understanding the product accurately later at the stage when the insurance solicitor approaches the customer (e.g. the provision of wrong product information and inappropriate evaluation regarding specific products, etc).
- ② In receiving referral as to potential customers from the agent for multiple insurance companies and the Operator for a substantially large amount of fees and incentives, insurance companies and solicitors should be aware that such fee payments will increase the risk of the Operator recommending and giving explanation as to specific insurance products, which is not permitted. The fee level should be carefully set, and close monitoring of the Operator’s business is essential.
- ③ Confirm whether the Operator’s process of obtaining the customer’s consent to provide personal information to a third party etc. is appropriate in light of the Personal Information Protection Law, etc.
- ④ Confirm if the Operator is violating the solicitation rules such as providing special advantage to the customer.

#### **2-4-2 Other issues**

The casualty insurance agent that is a corporate entity is allowed to let employees engage in insurance solicitation by registering with the relevant authority. Such employees had been limited to those under an employment agreement with the relevant insurance agent. However the criteria was removed following the review conducted in relation to the deregulation in 2000.

As a result, there is a risk that some casualty insurance agents, ignoring the natural obligation to educate, instruct and manage their employees' solicitation activities, hire a third party and register it as the employee using the outsourcing agreement as the evidence of the relationship and use such third party for insurance solicitation without fulfilling the obligation.

Under such circumstance, regardless of the contractual relationship, it is appropriate to make it clear that employees are deemed eligible and allowed to conduct insurance solicitation on behalf of the insurance solicitor only when they are properly educated, instructed and managed by the insurance solicitor based on the relevant rules and regulations.<sup>69</sup>

#### **2-5 Rules and regulations pertaining to insurance brokers**

The function of the insurance broker was introduced via the revision of the Insurance Business Act in 1995. Insurance brokers are positioned independently of insurance companies and solicit insurance on behalf of customers.<sup>70</sup> Insurance brokers are required to maintain security deposits and owe fiduciary duties to the customers, in addition to general rules and regulations related to insurance solicitation.<sup>71 72</sup> However,

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<sup>69</sup> In principle, it shall be reminded that re-commissioning of insurance solicitation is prohibited under the rules and regulations.

<sup>70</sup> Article 25-2 of the Insurance Business Act

<sup>71</sup> Article 3-3 of the Insurance Business Act

<sup>72</sup> On the other hand, while agents for multiple insurance companies are subject to the management/instruction etc. by insurance companies, the additional requirement is not applicable to them as they are positioned as agents acting on behalf of insurance companies.

the insurance broker system has not been utilized as much as expected initially, with only limited 37 insurance brokers currently in operation (as of December 2012). Currently, the business domain of insurance brokers is mainly the insurance business for companies, with little activities in the area of insurance for individuals.

On the other hand, given the substantial earning opportunity associated with the insurance sales, there is a risk that insurance providers may behave for their own benefits and limit their product offerings. In this case, customers will be left with few satisfactory alternatives. Therefore, it is important to create the environment where the customer can clarify and recognize his or her needs and make decision to buy insurance products based on the adequate information and variety of alternative products. The Working Group was advised of the necessity to improve relevant systems so that the function of insurance broker is utilized to its full potential.<sup>73</sup>

Based on such circumstance, the rules and regulations should make clear that brokers would conduct business on behalf of customers. At the same time, so that the customers can easily obtain brokerage services from the fair and neutral parties, the existing rules and regulations regarding insurance brokers, if there is no issue as to the policyholder protection, should be relaxed to encourage new entries and invigorate insurance brokers' activities. Specifically, the Working Group suggests the following revisions.

- (i) Clarification of positioning of insurance brokers by legislating the engagement agreement;
- (ii) Simplification of agreement;
- (iii) Removal of the approval system for the brokerage business for long-term insurance contracts (insurances with 5 year contract term or more); and
- (iv) Reduce the level of minimum required security deposit

The Working Group was advised of taking a positive view as to the reduction of the amount of minimum required security deposit and the use of liability

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<sup>73</sup> "Financial Industry: Desirable State in the Medium- and Long-Term (Present State and Future Outlook)" (Report by Financial System Council's Working Group on the Medium- and Long-Term Modalities of the Japanese Financial Industry, May 28, 2012)



insurance as alternative credit enhancement, considering that there has been no issue to date and that the requirement of security deposit is not common in foreign countries. At the same time, some addressed the concern with the reduction of minimum required deposit, as liability insurance does not cover damages caused on purpose. Considering these issues combined with the fact that insurance brokers are supervised by the relevant authority, the Working Group recommends, as the initial step, a reduction of minimum required amount to JPY20 million from JPY40 million while reducing the cut-off amount that can be replaced with liability insurance to JPY20 million or above from JPY40 million or above. The provision should retain flexibility to require additional deposit if deemed necessary for the purpose of customer protection.<sup>74</sup>

It is noted that further discussion is necessary to analyze impacts and problems of allowing insurance brokers to receive brokerage directly from customers from the perspective of protecting insurance policyholders and from the practical point of view.

## **Conclusion**

The report outlined the issues addressed at series of meetings held by the Working Group and its views/recommendations on such issues. The Working Group expects related parties to reinforce/develop the relevant systems based on the discussion in the report.

It should be noted that the Working Group's recommendations as to insurance solicitation will require substantial revisions to solicitation rules under the existing Insurance Business Act. The rationale behind the recommended changes is to set up a systematic framework aligned with the diversifying solicitation channels through which customers can purchase truly necessary insurance products, upon understanding and making decision to purchase insurance products based on the easy-to-understand product explanation. The Working Group requests the relevant authority to proceed with the system reform and do the management on them based on such rationale, at the

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<sup>74</sup> Further reduction to JPY10 million yen should be considered if there is no issue for a certain period.

same time avoid excessive interference with each related party's innovative efforts for improvement. The Working Group also requests insurance companies and solicitors to recognize that some of the solicitation issues are left open to independent efforts of them and the related industry group, hoping the insurance solicitation function will be enhanced through innovative efforts by insurance companies and solicitors. Further, the Working Group also requests insurance companies and solicitors to continue their efforts to achieve insurance solicitation with strong capability, through accurate understanding of customers' needs and the provision of appropriate advice and easy-to-understand explanation to them. Finally, in order for consumers to have ability to choose insurance products that meets their needs, they need to be facilitated to obtain certain level of knowledge on insurance. The Working Group concludes this report by asking the relevant authority and related parties in the insurance industry for further promotion of the financial education.<sup>75</sup>

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<sup>75</sup> See "Report of Study Group on Financial Education" (Study Group on Financial Education, April 30, 2013) etc., for information on the importance of financial literacy of the consumer and efforts for improvement.