

Annual Supervisory Policy for Insurance Companies, etc. for Program Year 2011

The Comprehensive Guidelines for Supervision of Insurance Companies, the Supervisory Guidelines for Small-Amount and Short-Term Insurance Providers and the Comprehensive Guidelines for the Supervision of Approved Specified Insurance Providers systematically set out the basic approaches for the supervisory processes aimed at insurance companies, small-amount and short-term insurance providers and approved specified insurance providers, respectively. The Financial Services Agency (FSA) formulates and publishes supervisory policy for each program year so as to clarify the priority matters in supervision, as prescribed in these guidelines.

The Great East Japan Earthquake and experiences thereafter in the previous program year renewed awareness of the extremely important roles that the insurance industry plays in people's lives and for the stability of economic activities, by providing insurance coverage against various risks in people's lives.

This program year, the FSA will supervise insurance companies, etc. so they may continue to fully demonstrate these important functions, placing priority on the areas of (1) Promoting the Sophistication of Risk Management, (2) Improving Customer Protection and Convenience for Users and (3) Taking a Supervisory Response Corresponding to the Characteristics of Insurance Companies, etc. in accordance with the "Basic Concept on Future Supervision of Financial Institutions" as described below.

It should be noted that these supervisory policy were drawn up in light of the circumstances that surrounded financial institutions as of August 2011, and may be subject to review as necessary.

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

(1) Environment Surrounding Financial and Capital Markets

Due to the effects of the Great East Japan Earthquake, the Japanese economy remains in a difficult situation. However, reflecting supply chain reconstruction, the Japanese economy is expected to continue to pick up. Even in this situation, there are downside risks that could stem from constraints of electric power supply, the consequences of the nuclear accident, further slowing down of overseas economies, and volatile fluctuations in exchange rates and stock prices.

Even when Japan is in such a difficult situation, the world economy has been moving on instead of halting, and special attention should be paid to movements in foreign economic conditions and financial and capital markets. In doing so, amidst today's advancing globalization, it is important to enhance the resilience of the economic and financial system, to minimize effects on our country in the event of any crisis from emerging global economic risks.

Looking at conditions in each country, for example at emerging economies, their

economic growth supported by domestic demands is contributing to the creation of investment opportunities and new consumer markets in developed countries. On the other hand, attention should be paid to risks of real estate prices and inflation. The U.S. economy faces downside risk due to its continued high unemployment rate, falling housing prices, etc. In Europe, financial system concerns remain, amid concerns over fiscal conditions in some countries.

Under these circumstances, in the fiscal year ending in March 2011, insurance companies generally gained a certain level of positive net income, but largely due to the effects of the Great East Japan Earthquake, earnings declined in their main business. The conditions require a continuing focus on risks faced by insurance companies: the effects of the earthquake, etc. on domestic economic trends, the effects on the financial system from overseas real economies, global flows of funds, and trends in international commodity market conditions. Therefore, more advanced risk management is required to ensure financial soundness.

(2) Approach Taken by Supervisory Authority

Amid these circumstances, the FSA will continue to place Better Regulation as the basis (engaging in open and deep discussions with financial institutions, disseminating information to the public, sharing and linking information on the economic and financial situations in Japan and overseas, and improving the transparency and predictability of regulatory actions) and striving to have it become further embedded and deepened. In particular, in accurately managing various risks, customer protections, etc., financial institutions are strongly expected to be aware of each long-term managerial issues. They are also expected to conduct positive managerial improvements, and make appropriate, fast and responsible business judgments under the appropriate leadership of management personnel. Moreover, toward recovery and reconstruction from the Great East Japan Earthquake, each insurance company must continue to properly and swiftly handle insurance payments, etc. for the victims.

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

1) Financial Administration with a High Risk Sensitivity

In order to accurately respond to currently conceivable risks, the FSA will gain a deeper understanding of the macro economy and financial and capital markets, and deepen its understanding of how these factors affect the soundness of financial institutions, so as to identify and understand the risks which accumulate in each financial institution and in the financial system with a forward-looking perspective. The FSA will also enhance integration of on-site inspection and off-site monitoring to detect risks at an early stage.

It is also important to check whether major risks are fully assumed in the financial institution's business continuity plan, in order to maintain and ensure financial functions even if an unexpected event occurs. This should include the consideration of the experience of the recent Great East Japan Earthquake. Especially regarding IT systems, considering that if a problem occurs it would have large impacts on

insurance payments and business continuity, it is important to have a backup system for failures in each insurance company.

2) Financial Administration from a Citizen's and User's Point of View

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

3) Supervisory Response with a Forward-looking Perspective

The FSA will strive to take actions to follow the progression of international discussions and consider environmental changes. In addition to a short-term response, it will also implement medium and long-term responses with an eye on the future, while considering common structural issues faced by Japanese financial institutions such as strengthening profitability of their main business.

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

The FSA will help financial institutions to autonomously improve management and make better business judgments via frank and deep discussions and the distribution of information with financial institutions. Above all, the FSA uses exchanges of opinions and other methods to introduce to other financial institutions the innovative initiatives of each financial institution concerning the performance of financial intermediary functions (insurance coverage in the case of insurance companies, etc.), risk management, improvement in customer protection and convenience for users, etc. It thereby works to enhance the quality of the entire financial industry.

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

- In addition to performing joint interviews with the Inspection Bureau and encouraging other forms of closer cooperation with the Inspection Department, the FSA will also cooperate with foreign authorities via supervisory colleges, and proactively contribute to international standard-setting bodies.
- The necessity of collecting reports and documents to be submitted will be periodically reviewed once a year, as part of consideration for reducing the burdens on financial institutions.
- Through the thorough fostering, securing and training of specialized human resources, the FSA will redouble efforts for human resource development.

2. Promoting the Sophistication of Risk Management

Considering the review of solvency margin ratio (more stringent risk measurement, etc.) and the newly-introduced consolidated regulation coming into effect in March 2012, the FSA will encourage more advanced risk management and appropriate information disclosure, as it continues its efforts to ensure the financial soundness of insurance companies. Also, in order to encourage advanced risk management, it is important to construct a regulatory and supervisory framework consistent with such techniques. Thus

study is proceeding towards the future introduction of economic value-based solvency regime.

(1) Encouragement for an Established Enterprise Risk Management (ERM)

1) In view of the increasing diversity and complexity of risks faced by insurance companies, it is desirable for insurance companies not only to ensure their equity base and appropriate disclosure of financial information, but also to develop systems to comprehensively manage all risks and entirely control their business, in conformity to their business strategy. From this viewpoint, based on the results of the field tests towards an economic value-based solvency regime last year, the FSA will conduct ERM interviews continuously. It will also monitor whether each insurance company develops an appropriate risk management system under the leadership and strong commitment by management, corresponding to the company's size and risk characteristics, while considering the status of their own company's equity capital.

2) For the oversight of risk management systems, the FSA will encourage initiatives which match each insurance company's characteristics and monitor for example, the status of asset liability management (ALM) corresponding to the insurance company's liabilities characteristics, not just plainly oversee and assess risk management conditions.

3) Also, under these harsh business circumstances, business consolidation and a diversification of businesses in terms of its scope and areas are becoming predominant options for the management of an insurance group with a view to active business development. The FSA will focus on the supervision of such insurance companies as a group and monitor the corporate governance system of its holding company and the progress of integration of its management information system, as well as the implementation and effectiveness of group-wide enterprise risk management system.

4) The FSA will also encourage initiatives for each of the insurance companies to ensure confidence in markets, such as disclosure of material financial information including the solvency margin ratio and financial instruments held, as well as solid disclosure of information which contributes to an accurate understanding of the company's financial status and risk information.

(2) Review of Solvency Assessment, etc.

1) The FSA will promote preparations for the smooth introduction of solvency margin ratios with more stringent risk measurement and on a consolidated basis which apply to insurance companies and groups headed by an insurance holding company (both come into force from March 31, 2012). These revisions will be informed to policyholders and market participants.

2) Economic value-based solvency regimes, which contribute to the proper understanding of the financial conditions of insurance companies as well as to the

sophistication of their risk management by evaluating their assets and liabilities on a market consistent basis, are being studied even by organizations such as the International Association of Insurance Supervisors (IAIS) in recent years.

Under these circumstances, the FSA has conducted field tests towards an economic value-based solvency regime. The FSA will, with a view to implementing this regime, further study various practical issues discovered through these field test processes in cooperation with professional organizations such as the Institute of Actuaries of Japan and the Non-Life Insurance Rating Organization of Japan.

3) In view of the revision to the international accounting standards on insurance contracts by the International Accounting Standards Board (IASB), the FSA will also advance considerations on how the insurance supervisory accounting in Japan should be over the medium term.

Furthermore, prior to the standard being finalized, the FSA will promote examination for any necessary convergence with the current international accounting standards.

3. Improving Customer Protection and User Convenience

Improving customer protection and convenience for users at financial institutions not only helps achieve a sound national economy, but also helps stabilize the Japanese financial system by enhancing citizens' trust in financial institutions. In particular, an insurance company provides a broad range of security and compensation functions to prepare against unexpected situations for its customers, and must be able to swiftly and reliably demonstrate those functions when needed. Therefore, it is important for each company's management to fully demonstrate leadership, and ensure business continuity and thoroughly implement strict control of customer information, solicitation and insurance benefit payments, to build a sense of security and trust among their customers. Based on this, it is important to provide insurance products and services from the customer's viewpoint, using innovative ideas which more accurately meet customer needs.

In particular, compliance in terms of customer protection should not mean simple compliance with laws and regulations. Rather, it is important as trusted financial institutions with a highly public nature, that they are aware of the levels sought by customers, and meet those expectations. To this end, the financial institutions must also recognize that complaints and requests for consultations from customers may provide them with opportunities to discover potential customer needs, and must respond appropriately and actively.

Considering the above, this program year, the FSA will place priority on examination of the following initiatives by insurance companies for enhancing customer protection and user convenience.

In this regard, the FSA will respect the insurance companies' own initiatives and focus on motivating them to behave appropriately. The FSA will also pay attention to whether each insurance company has implemented an internal control system involved by the management team so as to check; (1) whether the company serves its customers with products that fit their needs under its business policy, (2) whether or not the company's incentives are skewed by short term profits or a conflict of interests, and (3) whether the

management policy is penetrated into the marketing division.

Furthermore, the FSA will cooperate with the Consumer Affairs Agency as needed.

(1) Ensuring Business Continuity

1) Examination of Information System

Computer systems of financial institutions are at the core of their business operations. As highly public social infrastructure, a failure of any information system of the financial institutions would have a tremendous impact on users and communities and might even cause serious damage to public confidence toward financial institutions. The FSA will thus place priority on overseeing whether each insurance company identifies risks of its management information systems, whether it secures sufficient system resources reflecting changes in the IT environment, whether it has implemented proper management strategies regarding information system investments, including staff deployment and education, risk management strategies in the event of system failure, and an internal control.

2) Review of Business Continuity System

Considering the experience of the recent Great East Japan Earthquake, the FSA will work on understanding the status of each financial institution's verification of whether its existing business continuity plan has functioned effectively, whether such plan sufficiently assumes major risks, such as earthquakes and other natural disasters, pandemic influenza and large electricity blackouts, whether the countermeasures against such major risks are sufficient, etc.

Electricity supply capacity has decreased since the earthquake, and each financial institution is now implementing electricity conservation policies this summer in each area in Japan, especially in areas under the coverage of Tohoku Electric Power Company, Tokyo Electric Power Company and Kansai Electric Power Company. The FSA will carefully watch these electricity conservation policies, and whether there are impacts on the business continuity of critical locations, such as information system centers.

(2) Thorough Management of Information Security

Customer information forms the basis of financial transactions, and it is important to strictly manage it also from the viewpoint of protecting personal information. In addition, it is important to strictly manage corporate information in order to increase trust in market transparency and fairness. From these viewpoints, the FSA will firmly encourage the appropriate maintenance of internal control systems for information security, and the enhancement of rules on professional conduct to prevent inappropriate actions of officers and employees (such as information leaks or insider trading).

Also, the firewall regulations were revised two years ago, and a principles-based framework was introduced to encourage financial institutions to have an autonomous management system to deal with conflict of interests. The FSA will supervise whether the insurance companies have a proper system in place to satisfy both customer convenience and the prevention of conflict of interests.

(3) Development of Appropriate Insurance Payment Management System

1) After discovering problems concerning payments of insurance benefits, orders were issued for improvement of business operations against several insurance companies. Based on these orders, insurance companies are progressing in the development of effective systems for timely and appropriate payment of insurance benefits, including the development of specific initiatives to bring to light the possibilities that insurance benefits are not being paid appropriately. Regarding this problem, under the understanding that payment of insurance benefits is the most important responsibility for insurance companies, the FSA will place priority on overseeing whether after improvement, their payment management systems continue to fully demonstrate their functions organizationally and continually.

2) The FSA will monitor closely whether internal control systems have been implemented to provide each customer with swift and appropriate claims guidance administration, etc. from the viewpoint of customer protection and user convenience in the event a cause for payment of insurance benefits occurs. The above system includes the mechanism whereby an insurance company which received an insurance claim advises the claimant on other payments available throughout the payment processes.

3) Regarding payment of insurance benefits related to the Great East Japan Earthquake, the industry and each company are actively proceeding with various initiatives from the victim's standpoint, and quickly paying insurance benefits, not just waiting for payment orders from policyholders. The FSA will encourage this approach of active initiatives from an insurance policyholders' perspective to be continued in peace time.

(4) Establishment of Appropriate Distribution System of Insurance Products

The FSA will monitor whether each insurance company observes sales and solicitation rules for insurance products and has a proper system to provide explanations which fit the needs, knowledge and experience of customers, which includes whether the company guide and manage insurance agents to purpose. The FSA will monitor the above points by making use of reports from insurance companies, etc., results of inspections conducted by inspection departments, and information from the Counseling Office for Financial Services Users. The FSA will also verify that proper distribution control systems are built in insurance agents.

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

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

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

2) The FSA will also watch carefully whether for the financial Alternative Dispute Resolution (ADR) system introduced in October last year, i) financial institutions sincerely work for quick dispute resolution, such as by actively disclosing required information, ii) systems have been prepared for its easy use nationwide, iii) the ADR system is introduced as needed when there are consultations from customers, etc.

4. Taking a Supervisory Response Corresponding to the Characteristics of Insurance Companies, etc.

Insurance companies have diverse business sizes, ranging from large companies which actively develop in diverse businesses and regions including overseas and mergers, to generally small companies such as small-amount and short-term insurance providers and approved specified insurance providers. Also, the distribution channels of insurance products are also becoming more diverse, and now include those focusing on distributors or agencies, or on mail-order sales. In consideration of these circumstances, the FSA must take a supervisory response according to the business scale, style and such other attributes of insurance companies, etc.

Considering the above, this program year, the FSA will supervise insurance companies from the following viewpoints. In order to efficiently ascertain the actual practices, focused off-site interviews will be conducted in cooperation with the Inspection Bureau, based upon the type of operations of the insurance company.

(1) Insurance Groups

With regard to insurance groups, in light of cases where losses recorded by a financing subsidiary within a group have led to deteriorated business conditions for the entire group, the FSA will examine the operational appropriateness and financial soundness of groups as a whole in accordance with the Guideline for Financial Conglomerates Supervision, etc. In doing so, the FSA will work closely with overseas authorities, especially in cases where an insurance group has its head office or a base located in a foreign country.

Furthermore, in view of the fact that since July 2010, the IAIS has been working toward the creation of a common assessment framework for insurance group supervision, the FSA will also actively participate in international discussions on insurance group supervision.

(2) Small and Medium-sized Insurance Companies

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

(3) Small-Amount and Short-Term Insurance Providers

Given that most small-amount and short-term insurance providers only started their businesses a short while ago, the FSA will provide guidance and supervision for each

provider as necessary with respect to such aspects as their internal control systems, their financial soundness and their operational appropriateness. In doing so, the FSA will focus careful monitoring on small-amount and short-term insurance providers which have problems with financial soundness, etc.

(4) Approved Specified Insurance Providers, etc.

The “Act for Partial Revision of the Act for Partial Revision of the Insurance Business Act, etc.” (2010 Act No.51) has come into effect since May 13, 2011. Regarding the approval of specified insurance business based on this, this program year, the FSA will conscientiously handle consultations from applicants, and work to inform and thoroughly implement the purposes of regulations. It will also strive to smoothly process approval applications.

For specified insurance providers which received approval, the FSA will also provide careful guidance and supervision regarding cash flow and business appropriateness.

(5) Distribution Channels

1) In cases where an insurance company, etc. is engaged in non-face-to-face solicitation, as exemplified by mail-order sales using advertisements on TV, internet or other such media, the FSA will monitor whether they are engaged in appropriate solicitation for their respective channels, including by checking whether there are any risks that the advertisement may mislead customers about the features of the insurance policy.

2) Regarding over-the-counter sales of insurance products at banks, etc., the FSA will continue to oversee the implementation status of measures aimed at preventing the detrimental effects of such sales, and oversee the extent to which insurance solicitation rules, such as providing customers with an appropriate explanation of the features of insurance policies, are being observed by banks.

(6) Accelerate and Ensure Effective Product Examinations

The “Comprehensive Guidelines for Supervision of Insurance Companies” were revised in June 2011 and approval applications and notifications of a simple regular product or a product similar to an existing one of another company, necessary measures are taken, such as the reduction of the examination period to within 45 days, from the standard of within 60 days in principle. Based on this, the FSA is paying attention to enabling fast product revisions to meet customer needs, while ensuring the effectiveness of product examinations.