Review of Regulations on Group Management of Insurance Companies

December 2, 2011

Working Group on Regulatory Approach to Group Management of Insurance Companies

Introduction

In recent years, due to Japan's low birthrate, aging population, people's changing needs, and other changes in the environment faced by the domestic insurance market, the amount of policies in effect and insurance premium revenues are in a continual declining trend. Meanwhile, to enter overseas markets, mainly Asia, the United States and Europe, there is an increase in Japanese insurance companies purchasing overseas insurance companies. Another issue is, amidst the progress in moves to reorganize and merge insurance companies in Japan, how management efficiency will be enhanced and services will be improved as insurance company groups.

Considering this situation, at the March 7, 2011 General Meeting of the Financial System Council, the Minister for Financial Services consulted the regulatory approach in order to contribute to enhanced group management of insurance companies, including a review of operating scope regulations of subsidiaries concerning insurance company purchases of foreign insurance companies.

In order to study these consultation items, this working group was established and met nine times to deliberate on (1) Operating scope regulations of subsidiaries concerning insurance company purchases of foreign insurance companies, (2) Large credit regulations concerning credit to subsidiaries etc. of insurance companies, (3) Subcontracting of insurance solicitation, (4) Regulatory approach to transfers of insurance contracts, etc. This report summarizes those study results.

1. Operating Scope Regulations of Subsidiaries concerning Insurance Company Purchases of Foreign Insurance Companies[1]

(1) Basic Approach

The regulations on operations scope of companies which an insurance company can make into a subsidiary (possible subsidiary companies) are applied regardless of whether the subsidiaries are domestic companies or foreign companies, considering the intentions of other business prohibitions established to ensure the soundness of insurance company's management. [2]

On the other hand, many foreign countries have not established such operations scope regulations regarding subsidiaries of insurance companies. In cases where the insurance company of such a country competes with a Japanese insurance company in the purchase of a foreign insurance company, a Japanese insurance company which is forced to apply conditions of selling companies other than possible subsidiary companies is placed in a disadvantageous situation during bidding. It is pointed out that this creates an obstacle to entry into overseas markets.

In recent years, Japanese companies have increasingly purchased foreign insurance companies, and these purchase needs are expected to continue increasing. It is thought important to develop an

[1] Here, "foreign insurance company" signifies "Foreign companies which engage in Insurance Business" (Insurance Business Act, Article 106, Paragraph 1, Item 8).

[2] Possible subsidiary companies are limited to within a certain scope, such as insurance companies, banks, and foreign companies which engage in insurance business (Insurance Business Act, Article 106). Also, subsidiaries of subsidiaries are regarded as subsidiaries (Insurance Business Act, Article 2, Paragraph 12).

environment for easier international business expansion of insurance companies, and increase the options in a way that contributes to stronger business foundations of insurance companies.

The problem described above can arise when purchasing a foreign insurance company subject to subsidiary operations scope regulations which differ from Japan's regulations. Therefore, it is appropriate to think separately when studying the overall approach to subsidiary operations scope regulations, including domestic companies. Also, even when reviewing the operations scope of subsidiaries of purchased foreign insurance companies, upon the consideration of the intentions of subsidiary operation scope regulations established to ensure soundness of insurance companies, certain rules are considered necessary.

Considering the above points, it is appropriate to make needed revisions, while maintaining the current framework of subsidiary operations scope regulations, and limiting the revisions to those regulations which become obstacles in purchases foreign insurance companies.

(2) Regulatory Techniques

Considering that the obstacle described above arises when purchasing foreign insurance companies, among the subsidiaries of foreign insurance companies purchased, even for companies other than possible subsidiary companies already allowed to be held, in principle, it is appropriate to allow holding, but only within a certain time period.

Also, if conditions are found which make its disposal difficult within a certain time period, then under certain conditions such as approval by the authorities, it is appropriate to exceptionally allow holding which exceeds that time period.

2. Large Credit Regulations concerning Credit to Subsidiaries etc. of Insurance Companies

In order to ensure soundness of finances of insurance companies[3], large credit regulations concerning credit to subsidiaries etc. of insurance companies are established to eliminate concentration of credit to specified borrowers. These are not waived, even if the credit recipient is a subsidiary.

This is why acquired shares as a percentage of the insurance company's total assets could exceed the ceiling of large credit regulations in some cases, such as when insurance company intends to purchase a large insurance company in Japan or overseas, or when it intends to spin off a certain insurance unit.

Acquisition of insurance subsidiary shares by purchase of an insurance company is done to expand the earnings opportunities of the insurance company's main business. This differs from

[3] For credit (including acquisition of shares) to the same person (Including persons in a special relationship with the same person itself. However, only the same person itself if the credit recipient is an insurance company's subsidiary, an insurance holding company which has an insurance company as its subsidiary, or such an insurance holding company's subsidiary), there is a ceiling at 10% of total assets (3% of total assets in the case of total amount of loan or guarantees of liabilities) (Order for Enforcement of the Insurance Business Act, Article 48-3).

asset investment related credit risks, and can be considered an issue of how it manages risks related to business development of its main business as an insurance company.

Therefore, inspection and supervision of the appropriateness of risk management for the insurance business itself may be more important than large credit regulations. Regarding this point, the introduction of consolidated solvency margin ratio regulations has made it possible to check the soundness on an insurance company group basis.

Considering the above points, if limited to the scope in which there is appropriate risk management by the insurance company, and effective supervision by the authorities is possible, then only if it does not violate the intention of eliminating concentration of credit to specified recipients, could we consider waiving application of large credit regulations for insurance subsidiaries.

Specifically, among the credits to insurance subsidiaries,[4] firstly, regarding acquisition of shares with a strong aspect of business risks, it is appropriate to exclude these from large credit regulations. Moreover, for loans and other credits such as guarantees of liabilities, considering that their credit risk aspect is stronger than for shares, then while observing the actual state of future operations, if it is confirmed that there are no problems, it could be appropriate to waive application.

3. Reconsignment of Insurance Solicitation

(1) Basic Approach

Regarding insurance solicitation, to ensure it is proper and to protect insurance policyholders, only direct consignment from the insurance company to insurance solicitors is allowed.

On the other hand, amidst progress in forming insurance company groups, to utilize the sales bases of other insurance companies in the group, there are needs for allowing reconsignment from other insurance companies as the reconsigners.[5]

Regarding broadly allowing reconsignment, there is the problem of whether the insurance company which is the consigner is able to appropriately manage down to the insurance solicitors who are reconsignees. However, if the insurance company becomes the reconsigner, and reconsigns to a person who itself is also consigning insurance solicitation, then insurance solicitors who are reconsignees could be appropriately managed as insurance solicitors it directly consigns itself.

Also, if such a reconsigner is an insurance company in the same group as the consigner, by creating a uniform policy on management of insurance solicitors in the same group, it may be possible to have appropriate handling based on the consigner's insurance solicitor management policy.

[4] Including holding companies with subsidiaries which are mainly companies engaged in insurance business.
[5] Reconsignment of insurance solicitation via an insurance company in the group is expected to boost efficiency of operations in the group, and is also expected to have the insurance company with rich human resources perform management of insurance solicitors, thereby enhancing the quality of training and management of insurance solicitors.

Considering the above points, only if an insurance company in the same group is the reconsigner, and if the reconsigner also itself has an insurance solicitor reconsignee to which it consigns insurance solicitation, then it is appropriate to allow reconsignment of insurance solicitation. (See attachment)

(2) Measures to Ensure Proper Insurance Solicitation

If reconsignment is allowed, then to ensure proper insurance solicitation by insurance solicitors who are reconsignees, it is appropriate to take the following measures.

[1] If reconsignment is done, this requires consent of the insurance company which is the consigner.
[2] The insurance company which is the consigner must take measures to ensure proper insurance solicitation by reconsignees. For example, this consigner maintaining the ability to demand that reconsigners change or cancel reconsignment contracts with reconsignees.
[3] The reconsignee's compensation liability for damages to insurance policyholders shall be borne by both the consigner and reconsigner.
[4] For an insurance company which does insurance solicitation as a result of reconsignment of another insurance company in the group, this requires approval by the authorities. When providing approval, the authorities shall check whether the consigner and reconsigner each build systems to ensure proper insurance sales by reconsignees.[6]

4. Regulatory Approach to Transfers of Insurance Contracts

(1) Regulations on Transfers of Insurance Contracts

[1] Basic Approach

Under current law, when the insurance company does a business reorganization, it is possible to utilize transfers of insurance contracts in addition to a merger, company split, etc.[7] But

[6] Specifically, it could be required to check the following points.
(i) Consigner's System for Managing Insurance Solicitors
- Did it create a policy on insurance solicitation (including qualifications and abilities required of reconsignees), and build a system for granting consent for reconsignment in accordance with that policy?
- Is a system built which enables demanding improvements in operations as needed, for example by periodically checking the status of the reconsignee's operations, and the status of the reconsigner's training and management of the reconsignee?
- If the reconsignee is found to be inappropriate as a person for doing insurance solicitation of the consigner, then is it possible to change or cancel the reconsignment contract?

(ii) Reconsigner's System for Management of Insurance Solicitors（←(i)と違う文にしている理由は何？）
- Is a system built for choosing reconsignees based on the consigner's policy?
- Is a system built for appropriate management of reconsignees? (Examples: Are human resources obtained with sufficient knowledge and experience concerning the reconsigned operations? Is there a system for sales promotion based on the consigner's policy?)

[7] Transfers of insurance contracts are also done in practice in mergers and company splits.

transfers of insurance contracts have not necessarily been utilized sufficiently until now, for the following reasons.

- When doing a transfer of insurance contracts, there is a regulation which requires whole transfer of “insurance contracts for which the policy reserve is calculated on the same basis” (transfer unit regulation). This is a certain restriction on its use.
- Current regulations have the aspect of lacking sufficient consideration for insurance policyholders whose policies are transferred without their individual agreement. This creates concerns about active utilization of transfers of insurance contracts.

Regarding this current situation, on the one hand, giving transfers of insurance contracts a certain degree of flexibility makes it easier to, for example, reorganize the insurance company by each sales channel, and to focus business resources in special fields so that the efficiency of operations of insurance companies can be increased. Also, assuming that soundness of the business which guarantees certain payment of insurance benefits can be secured, for transfers of insurance contracts in which one expects enhancement of various services such as handling when there is an insured accident or consultation or inquiry from insurance policyholders, insurance policyholders could also benefit.

On the other hand, change of the insurance company is an important change in the insurance contract. Therefore, it requires sufficient consideration of protection of insurance policyholders, and requires sufficient consideration for obtaining policyholder convenience associated with the transfer.

From this viewpoint, even in cases where it has become possible to flexibly transfer insurance contracts, product development must be done carefully by insurance companies, and cancellation and withdrawal from sales must not be done easily.

Considering the above points, regarding regulations on transfers of insurance contracts, instead of the current regulation for a transfer unit which is the “policy reserve is calculated on the same basis,” to maintain fairness between policyholders and to protect policyholders, for insurance contracts subject to transfer (transfer subject contracts), it is appropriate to decide whether to transfer from the viewpoints of rationality of selection criteria, clarity of subject scope, necessity of transfer, etc., while doing the required review described below.

[2] Measures which Should be Taken When Reviewing Regulations on Transfers of Insurance Contracts

For transfers of insurance contracts, an objection procedure is established for insurance policyholders and the authorities’ approval must have been received currently, but when reviewing regulations on transfers of insurance contracts, from the viewpoints of fairness between insurance policyholders and protection of policyholders, it is appropriate to take further measures as follows.

i. Aims of Transfer of Insurance Contracts

The authorities examine the aims and effects of transfer of insurance contracts (including convenience of insurance policyholders), from the viewpoint of protection of insurance policyholders.[8]

ii. Rational Grouping of Transfer Subject Contracts

The authorities examine whether the selection criteria for transfer subject contracts are rational, and whether the subject scope is clear. Also, in the objection procedure described in v. below, the original transferring company bears the obligation to provide sufficient information about effects on policyholders.

Moreover, the appropriateness of calculation of policy reserves concerning transfer subject contracts shall be ensured by calculations using future cash flow analyses, etc., examination by the authorities, and checking by appointed actuaries.[9]

Also, regarding handling of surplus in transfers, based on the following thinking, the authorities check in examinations whether appropriate distributions are done.[10]

- In cases where the subject transfer contracts have dividends, regarding surplus other than allocations already made to individual insurance policyholders as dividend reserve etc., if the original transferring company is a stock company, then one can think that such surplus pertains to the original transferring stock company.[11]
- If the original transferring company is a mutual company, and if the transfer subject contracts are member contracts, then one can think that such surplus basically pertains to members (insurance policyholders). Therefore, from the viewpoint of protection of policyholders transferred, such surplus must also be appropriately distributed to policyholders transferred.[12]

iii. Payment Capacities of the Original Transferring Company and Transferee Company

For payment capacities of both insurance companies after the transfer, the assumption is that their solvency margin ratios exceed 200%. But the solvency margin ratio could change depending on the risk characteristics of policies in effect and the insurance company's asset investment methods. Thus it is not suitable to simply compare whether numbers are high or low, so it is not appropriate to establish a uniform criteria for the degree of difference between the solvency margins of the original transferring company and transferee company.

[8] For example, it cannot choose contract groups with profitability problems and transfer their insurance contrats, without providing sufficient policy reserves.

[9] Regarding appropriate calculation of policy reserves, study is now being done for calculation of policy reserves on an economic value basis. When this becomes established, calculation on an economic value basis could also be considered.

[10] Regarding distribution of surplus, there are specialized and technical issues, so based on the basic thinking described above, it may be desirable if the authorities and related parties do a practical study from the viewpoint of fairness among insurance policyholders.

[11] However, development of products which provide a dividend when they extinguish is not prohibited by the regulations. Therefore, there was also the opinion that it is not appropriate to have the entire surplus remain in the original transferring company.

[12] Possible distribution methods: Pay a one-time benefit when the insurance contracts are transferred, or the transferee company manages by segmented accounting.

On the other hand, considering that the insurance policyholder may have used the solvency margin ratio when choosing the insurance company, the solvency margin ratios of the original transferring company and transferee company before and after the contract transfer are also factors when the authorities decide whether to allow the transfer. Also, the original transferring company is obligated to provide the insurance policyholder with information on these levels during an objection procedure.

iv. Ensuring Appropriate Service Levels

After transfer of the insurance contracts, the authorities examine whether the transferee company has a system which is able to appropriately provide various services to insurance policyholders. During an objection procedure, the original transferring company is obligated to provide insurance policyholders with information on such services after the transfer.

v. Information Given During an Objection Procedure, and Information Provision Methods

During an objection procedure, the insurance policyholder must be provided with sufficient information to enable an appropriate decision on whether to approve or reject the transfer. For this purpose, information (services and solvency margin ratios after transfer, etc.) which contributes to the insurance policyholder's decision on whether to transfer the insurance contract is added as content of information provided during the objection procedure.[13] And for information provision methods, in addition to the type of advertisements placed until now, individual notices to transferred policyholders shall be required.

For the method of information provision upon bankruptcy which requires fast actions, it is acceptable to use the same type advertisements as until now.

vi. Handling of Insurance Policyholders who Stated Objections

If the objections do not fulfill the requirements and the contracts transfer is done, then the contracts of the insurance policyholders who stated objections are also transferred. Therefore, there must be sufficient protection of insurance policyholders who stated objections.

Therefore, the following new measures shall be taken.

a. The requirement for objections succeeding is lowered from the current one-fifth, to become one-tenth.[14]

[13] Currently, the gist of the transfer agreement and the balance sheets of the original transferring company and transferee company are disclosed (Insurance Business Act, Article 137, Paragraph 1).

[14] Same as when insurance contracts are inherited due to a company split. However, in the case of a merger or transfer/succession of all insurance contracts, the original transferring company does not remain, and there are no problems of unfairness between insurance policyholders transferred vs. insurance policyholders remaining in the original transferring company. Therefore, it may be appropriate to maintain the current requirement of one-fifth. For mergers or contract transfers during bankruptcy, this is a measure due to an unavoidable reason, so it may be appropriate to maintain each current requirement: while the objection success requirement shall be one-fifth, it shall be one-tenth when accompanying changes in contract terms.

b. In approval applications, the number of people who stated objections and the material reasons for objections must be submitted to the authorities, which shall be referred to when approving.

It is also appropriate to study measures to prevent disadvantageous treatment due to cancellation, when an insurance policyholder who stated an objection wants to cancel his contract.

(2) Sales Suspension Rule

If insurance contracts are transferred, then from the time of the shareholders meeting (general meeting of members) resolution on the transfer until the time the insurance contracts are transferred or until it is decided not to transfer them, the original transferring company must not conclude insurance contracts which are the same type as the insurance contracts it intends to transfer (sales suspension rule).

On the other hand, for example when a foreign insurance company's Japan branch is incorporated in Japan, if transfer of insurance contracts is done with the assumption of business continuity, there is the possibility that necessary renewals of insurance contracts cannot be done, which has the negative effect of inconveniencing insurance policyholders.

The sales suspension rule was created because the original transferring company retains insurance contracts concluded after deciding on the scope of transferred policyholders, for a situation which lacks protection for insurance policyholders.

Regarding this point, if insurance which is the same type as insurance contracts subject to transfer is solicited during the transfer process, one could consider handling this by explaining to people intending to become policyholders that those contracts are subject to transfer, obtaining their agreement and transferring them also.

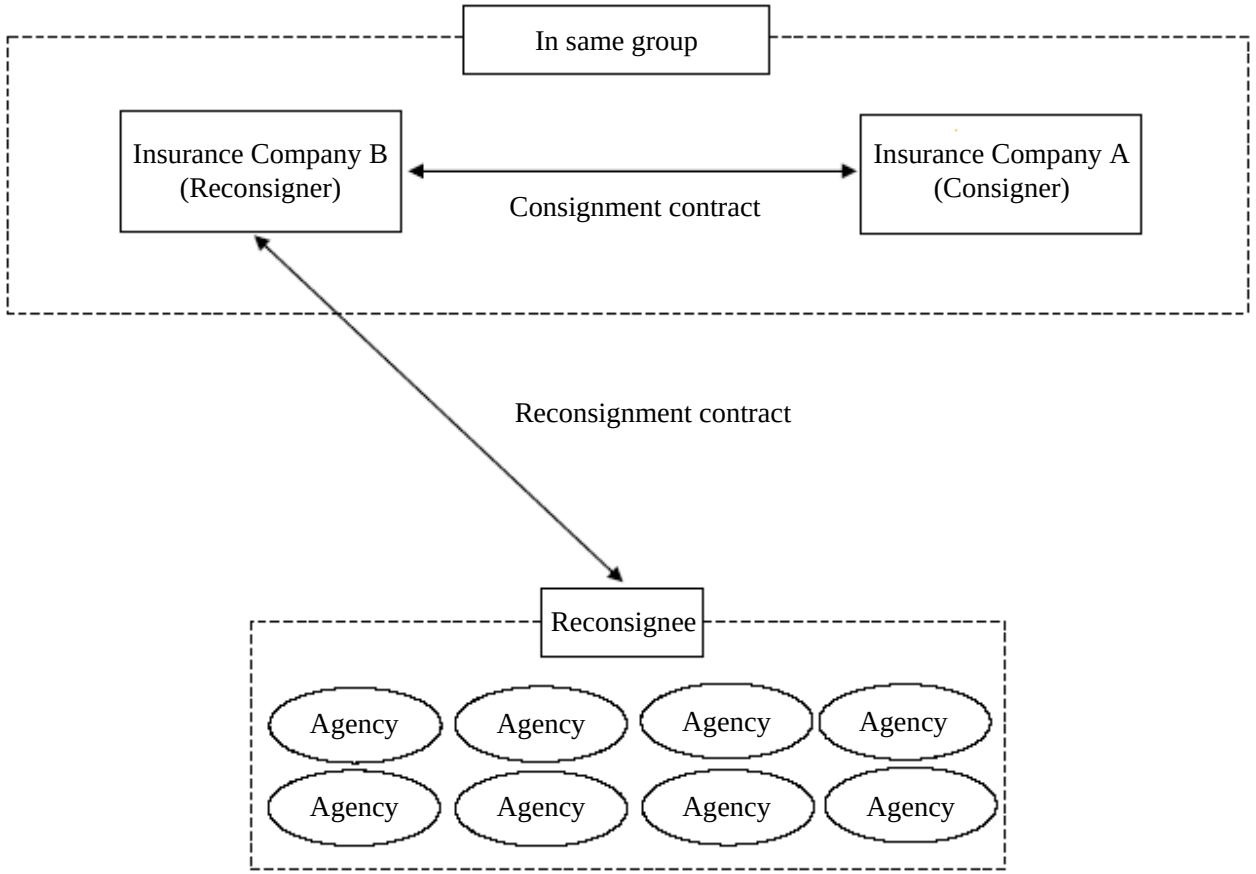
Therefore, when insurance contracts subject to transfer are solicited during the transfer process, it is appropriate to obtain the consent of insurance policyholders for transfer of insurance contracts to the transferee company and eliminate the sales suspension rule.

Conclusion

The above are results of deliberation in this working group. It is hoped that related parties will consider the approach shown in this report, and proceed with appropriate system developments.

The conclusion is that enabling Japanese insurance companies to smoothly purchase foreign insurance companies and reorganize businesses in their groups will lead to stronger business foundations and more efficient operations of insurance companies, and consequently lead to enhanced services and convenience for policyholders. It is desirable that the authorities and insurance companies will fully consider this and take appropriate actions.

(Reference) Reconsignment of Insurance Solicitation, with Insurance Company in Same Group as Reconsigner



*Each agency becomes a reconsignee

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As of December 2, 2011

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