



JAPAN

FINANCIAL SECTOR ASSESSMENT PROGRAM

May 2024

DETAILED ASSESSMENT OF OBSERVANCE OF INSURANCE CORE PRINCIPLES

This Detailed Assessment of Observance of Insurance Core Principles for the Japan FSAP was prepared by a staff team of the International Monetary Fund and the World Bank as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on April 16, 2024.

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INSURANCE CORE PRINCIPLES

Prepared By
**Monetary and Capital
Markets Department**

This Detailed Assessment Report was prepared by Peter Windsor (IMF) and Ian Tower (IMF external expert) in the context of an IMF Financial Sector Assessment Program (FSAP) mission in Japan from September to October 2023, led by Mahvash Qureshi, IMF and overseen by the Monetary and Capital Markets Department, IMF. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

CONTENTS

Glossary	3
EXECUTIVE SUMMARY	5
ASSESSMENT OF INSURANCE CORE PRINCIPLES	9
A. Introduction and Scope	9
B. Information and Methodology Used for Assessment	9
C. Overview—Institutional and Macroprudential Setting	11
D. Preconditions for Effective Insurance Supervision	22
E. Recommendations	34
F. Authorities' Responses to the Assessment	37
DETAILED ASSESSMENT	39
BOXES	
1. Cooperative Insurance (Kyosai)	10
2. Economic Value-Based Solvency Regulation	12
FIGURES	
1. Selected Countries: Peer Comparison of Insurance Sector	14
2. Profitability and Solvency of Insurers	15
3. Demographic Transition	16
4. Life Insurers—New Policies and Policies in Force	17
5. Non-Life Insurers—Business Mix and Earthquake Insurance Take-up	18
6. Asset Mix of Insurers	19
TABLES	
1. Summary of Observance with the ICPs	25
2. Summary of Observance Level	33
ANNEX	
I. Progress on the 2017 FSAP Recommendations	137

Glossary

ADR	Alternative Dispute Resolution
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
BOJ	Bank of Japan
CALI	Compulsory Automobile Liability Insurance
CGC	Corporate Governance Code
ComFrame	Common Framework for the Supervision of Internationally Active Insurance Groups
CPA/OB	Certified Public Accountants and Auditing Oversight Board
CRA	Corporate Reorganization Act
DIA	Deposit Insurance Act
DICJ	Deposit Insurance Corporation of Japan
ERM	Enterprise Risk Management
ESR	Economic Value-Based Solvency Ratio
EWS	Early Warning System
GIAJ	General Insurance Association of Japan
GIROJ	General Insurance Rating Organization of Japan
Guidelines	Comprehensive Guidelines for Supervision for Insurance Companies
GWP	Gross Written Premium
FSA	Financial Services Agency
FSAP	Financial Sector Assessment Program
FY	Fiscal year (April – March)
IAIG	Internationally Active Insurance Group
IAIS	International Association of Insurance Supervisors
IAJ	Institute of Actuaries of Japan
IBA	Insurance Business Act
IBD	Insurance Business Division
ICPs	Insurance Core Principles
ICS	Insurance Capital Standard
IHC	Insurance Holding Company
IMF	International Monetary Fund
JAFIC	Japan Financial Intelligence Center
J-GAAP	Japan Generally Accepted Accounting Principles
JICPA	Japanese Institute of Certified Public Accountants
JPY	Japanese Yen
KAs	Key Attributes of Effective Resolution Regimes for Financial Institution
LIAJ	Life Insurance Association of Japan
LIPPC	Life Insurance Policyholders Protection Corporation
LFB	Local Finance Bureau
MAFF	Ministry of Agriculture, Forestry and Fisheries
MOCE	Margin over the Current Estimate
MOF	Ministry of Finance
NIPPC	Non-Life Insurance Policyholder Protection Corporation

JAPAN

NPA	National Police Agency
OEIBA	Ordinance for the Enforcement of the Insurance Business Act (sometimes referred to as a Regulation)
ORSA	Own Risk and Solvency Assessment
PM	Prime Minister
SASTI	Small Amount and Short-Term Insurance
SESC	Securities and Exchange Surveillance Commission
SMR	Solvency Margin Ratio
SMRPFI	Act on Special Measures for the Reorganization Proceedings of Financial Institutions
STR	Suspicious transaction reporting
TSE	Tokyo Stock Exchange

EXECUTIVE SUMMARY

This assessment of insurance supervision and regulation in Japan was carried out as part of the 2024 Financial Sector Assessment Program (FSAP). This assessment has been made against the Insurance Core Principles (ICPs) issued by the International Association of Insurance Supervisors (IAIS) in November 2019. The assessment includes the standards of the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame). It is based on the laws, regulations and other supervisory requirements, and practices that were in place at the time of the assessment in September and October 2023.

The Financial Services Agency (FSA) is the integrated regulator of financial services, including insurance but excepting the insurance activities of cooperatives. The FSA conducts both prudential oversight and business conduct regulation and supervision for all sectors, including insurers and insurance intermediaries. The FSA also formulates proposals for new legislation to be enacted by the National Diet (the national legislature of Japan). However, the insurance activities of cooperatives (known as *kyosai* business) which serve, for example, agriculture and fisheries, and are not for-profit organizations, are supervised by relevant government ministries under separate, well-established institutional and regulatory arrangements. Although these cooperatives (known as *kyosai* organizations) include, in the agricultural sector, one of the largest institutions conducting insurance activities in Japan, this assessment focuses on the FSA-regulated insurance sector.

The assessment found an overall good level of observance of the ICPs. Six ICPs were assessed as Observed and twelve Largely Observed. The FSA has made important reforms since the last detailed assessment of observance in 2012, including the implementation of a revised approach to supervision and more effective macroprudential supervision, drawing on the requirements of the IAIS's Holistic Framework for the assessment and mitigation of systemic risk in the insurance sector. It has also developed new guidelines to implement the [IAIS's ComFrame requirements](#) and established supervisory colleges for the four insurance groups that it has identified as Internationally Active Insurance Groups (IAIGs). The new economic value-based solvency regulation based on the Economic value-based Solvency Ratio (ESR), which the FSA plans to apply to all insurers from fiscal year (FY) 2025, is a further far-reaching reform that will address shortcomings in the existing solvency requirements on which this assessment is based.

Areas of observance include licensing requirements, cooperation with other supervisors and anti-money laundering and combating the financing of terrorism (AML/CFT). Regulatory material contains extensive requirements for licensing of insurers and the FSA works closely with applicants to assess whether they meet requirements, even if final decisions on licensing are taken by a minister. The latter potentially exposes the FSA to undue political interference, although no such instances were identified in practice. Requirements for FSA approval of changes in control and portfolio transfers are also comprehensive. The FSA has widely drawn powers to exchange information with other agencies and does exchange (and protect) confidential information in practice, including in the context of supervisory colleges. There is an extensive framework of legislation, guidelines, and supervisory practices on AML/CFT issues. The FSA is equipped with an

escalating set of preventative and corrective measures which it applies in practice. It also has an extensive list of possible sanctions which are applied in practice.

The assessment identified significant gaps in the current framework of regulation and supervision. Six ICPs were assessed as Partly Observed. Resourcing constraints at the FSA underlie many of the issues with observance of the ICPs and meeting most of the recommendations of the assessment will require more resources. Along with the challenges of new regulatory reforms, the FSA is addressing changes to the operating environment of insurers as business models evolve in response to demographic changes and overseas expansion. High profile shortcomings in the conduct of insurers have required more intensive supervision of controls, governance, and culture. The FSA needs a significant increase in resources for insurance supervision to address these challenges. However, with its expenditure still determined and financed by the government—another potential source of political interference—there are constraints on its ability to deliver the necessary new resources.

The assessment found that, partly because of resource constraints, the FSA's approach to insurance supervision is largely reactive. The FSA has been strengthening its risk-based supervision of insurers but should follow a more comprehensive framework. Most supervisory activities are conducted on an industry-wide thematic basis, and the regular risk assessment on individual insurers is not undertaken as a part of a supervisory cycle. Intensive supervision is triggered mainly where problems have been identified, often after risks have crystalized. On-site work, for example, to proactively assess risks and risk management, has not been undertaken for some years, although thematic work has been done on major groups and implementation of the IAIS Holistic Framework involves close assessment of large insurers' financial risks. Inspections reviewed during the mission take the form of intensive investigations once a significant problem has been identified. Conduct issues, therefore, currently dominate on-site supervision work. A fundamental reform of supervision work should be undertaken, with a focus on supervision of individual insurers and larger intermediaries and this reform will require significant enhancement of supervisory resources.

The resolution framework and process of resolution for insurers needs to be carefully reviewed. For life insurers, the resolution framework allows access to public funding under limited circumstances where severe social impacts or impacts on financial markets could arise. Despite this, resolution plans are not required for insurers, as the FSA does not regard any insurer as systemically important. There are as many as three legislative paths to resolution of an insurer with only one practically contemplated. The trigger for resolution the FSA assumes is when there is a likelihood that the insurer will be unable to pay debts or will become insolvent, at which point policyholders and other creditors may possibly experience a loss. The FSA, amongst other parties, may petition the court to begin proceedings and state opinion to the court but lacks decision-making authority in the resolution process.

There is also a need to strengthen the requirements on control functions and extend suitability (fit and proper) requirements. The FSA should ensure that suitability requirements apply to all board members, senior managers, and all key persons in control functions, with

appropriate guidance on qualifications. In addition, the extensive general requirements on risk management and internal controls should be supplemented with clearer requirements for effective, independent, and well-resourced risk management, compliance and actuarial functions, especially for individual insurers (requirements on groups have been improved through ComFrame implementation). The introduction of the ESR can and should be used as an opportunity to make these improvements. Supervision of insurers' governance and risk management, while it has been applied to major groups, should be extended to all insurers, taking a risk-based approach.

Solvency and related requirements fall short of ICP standards, pending ESR introduction. For example, assets and liabilities are not valued on an economic basis. Policy reserves do not include an explicit Margin over the Current Estimate. The SMR is a risk-based requirement but has shortcomings. It is not a coherent total balance sheet approach, nor is it consistently calibrated. The lowest solvency control level is zero percent, too low to be the intervention point using the strongest powers available to the supervisor. In addition, there is inadequate supervisory review of the requirements of Enterprise Risk Management. While the largest groups' Own Risk and Solvency Assessment reports are reviewed annually, many other insurers' reports are not systematically reviewed. The economic value-based solvency regulation will be underpinned by economic valuation requirements, helping to improve observance in this area.

There are extensive requirements applying to intermediaries, business conduct, and insurance fraud, but supervision should be further strengthened. Intermediaries are subject to registration (i.e., licensing) requirements, some supervision, and regulatory standards but a few areas of regulation should be strengthened, including governance. The FSA should also increase its supervision work, which is mainly reactive and could be extended by, for example, undertaking more proactive work on insurers' oversight of agents. There are extensive provisions on all aspects of business conduct, covering insurers, agents, and brokers. The FSA's product approval work, integrated approach to supervision of insurers and agents, and the extensive supervisory materials in its guidelines equip it to identify and respond effectively to conduct issues. As noted, supervision work is, however, mainly focused on addressing significant concerns over past misconduct, often following reports by insurers themselves. Given fraud risks, there is also a need to cover fraud issues more fully in supervision work.

While the FSA has made important strides forward in macroprudential supervision, there is more to do. The FSA now obtains adequate data, performs macroprudential analysis, and uses the results of its macroprudential supervision to inform supervision of individual insurers. However, the FSA's macroprudential supervision of the insurance sector does not include kyosai business. As a result, one of the largest institutions conducting insurance activities in Japan is not included in macroprudential supervision since it is not supervised by the FSA. There are no assessment criteria for assessing the systemic risk of individual insurers and therefore, while the FSA conducts holistic framework monitoring based on eight large insurer's own risk management, this does not constitute a systemic risk assessment. The aggregated data published by the FSA in its annual report is highly summarized profitability and solvency data. It does not include granular aggregated data

disclosures, or comparable data about individual insurers and as a result there is no one place to find data about the Japanese insurance sector as in other major insurance markets.

Finally, there is a need to strengthen institutional arrangements for insurance supervision. As recommended in previous assessments, the FSA's independence should be bolstered by the delegation of insurer licensing powers currently reserved to a minister. The government should also provide for increased freedom for the FSA to determine its expenditure budget and to finance itself independently of government. The separate arrangements for the kyosai business of cooperatives could give rise to differences in approach and in levels of protection for policyholders that are not justified by differences in the markets. The FSA and ministries responsible for supervision of kyosai organizations should increase cooperation, prioritizing coordination on the regulation and supervision of the largest kyosai organizations. In the medium term, the FSA should also periodically review the need for changes to the organization of regulatory and supervisory responsibilities for kyosai business.

ASSESSMENT OF INSURANCE CORE PRINCIPLES

A. Introduction and Scope

1. **This assessment of insurance supervision and regulation in Japan was carried out as part of the 2024 Financial Sector Assessment Program (FSAP).**
2. **This assessment has been made against the Insurance Core Principles (ICPs) issued by the International Association of Insurance Supervisors (IAIS) in November 2019.** The assessment includes standards of the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) included within the ICPs. The scope of the assessment only covered FSA supervision of the insurance sector. Cooperatives conducting insurance activities (kyosai organizations) that are supervised by other ministries were not included in the assessment, but Box 1 provides an overview of kyosai organizations and their supervision.
3. **In 2017, the IMF conducted an FSAP where a focused review of the insurance sector was undertaken rather than a full assessment against the ICPs.** A technical note was published, which contained several recommendations.¹ Annex 1 contains a table of those recommendations along with the authorities update on progress made in addressing those recommendations. Progress against those recommendations was considered in this assessment against the ICPs.

B. Information and Methodology Used for Assessment

4. **The level of observance for each ICP reflects the assessment of its standards.** Each ICP is rated in terms of the level of observance as follows:
 - **Observed:** where all the standards are observed except for those that are considered not applicable. For a standard to be considered observed, the supervisor must have the legal authority to perform its tasks and exercises this authority to a satisfactory level.
 - **Largely observed:** where only minor shortcomings exist, which do not raise any concerns about the authorities' ability to achieve full observance.
 - **Partly observed:** where, despite progress, the shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance.
 - **Not observed:** where no substantive progress toward observance has been achieved.
5. **The assessment is based solely on the laws, regulations and other supervisory requirements, and practices that are in place at the time of the assessment in September to October 2023.** While this assessment does not reflect new and on-going regulatory initiatives, key proposals for reforms are summarized by way of additional comments in this report. The authorities provided a full and comprehensive self-assessment, supported by examples of actual supervisory practices and assessments, which enhanced the robustness of the ICP assessment.

¹ [Japan: Financial Sector Assessment Program-Technical Note-Insurance Sector Regulation and Supervision \(imf.org\)](https://www.imf.org/en/Publications/FSAP/Technical-Notes/2017/01/01/Japan-Financial-Sector-Assessment-Program-Technical-Note-Insurance-Sector-Regulation-and-Supervision)

Box 1. Japan: Cooperative Insurance (Kyosai)

There are many cooperative organizations in Japan, non-profit bodies established by groups of people to carry out a wide range of activities. Anyone who pays the membership fee and meets the terms and conditions can join and take advantage of services offered. These often include mutual aid (kyosai), whereby members share premium payments, establish mutual assets, and make payments in case of death, hospitalization, property damage, or motor accidents.

Provisions of the Insurance Act are applicable also to kyosai policies. However, kyosai business is excluded from the definition of the term insurance business in the Insurance Business Act (IBA). It is regulated under separate, well-established laws and regulations applying to cooperatives (agriculture, fisheries, consumers' livelihood and small and medium-sized enterprises) and supervised by the relevant ministries (Agriculture, Forestry and Fisheries; Health, Labor and Welfare; and Economy, Trade and Industry) as part of their oversight of the cooperatives.

Typical kyosai products are fire kyosai, life, personal accident, and motor kyosai. While some products are tailored to the nature of the membership (for example, specialized coverage for agriculture risks) and most are simple in terms of the coverage and term, many are similar to and compete with products offered by the FSA-regulated insurers within the scope of the IBA. In principle, only members can buy kyosai products, although there are provisions in law allowing non-members to access the services of cooperatives within limits.

Kyosai is provided by a dedicated organization within the cooperative. There are 17 members of the Japan Cooperative Insurance Association (not all kyosai organizations are members), with 78 million members and 130 million policies at end-FY2021. The largest kyosai organization is the National Mutual Insurance Federation of Agricultural Cooperatives (Zenkyoren), part of the Japan Agricultural Cooperative Group supervised by the Ministry of Agriculture, Forestry, and Fisheries under the Agricultural Cooperatives Act. Its size is comparable to the major life insurance companies in Japan.

Kyosai organizations earned nearly Japanese Yen (JPY) 8 trillion in gross written premiums (GWPs) in FY2021, which compares with JPY 41 trillion for the FSA-regulated sector. They had assets of JPY 67 trillion, of which Zenkyoren accounted for around 85 percent. The profits of kyosai organizations are taxed at a lower rate than regulated insurers, reflecting their status as not-for-profit organizations. Other key differences between them are that:

- kyosai organizations may write both life and non-life business on the same balance sheet;
- they are not covered by the policyholder protection arrangements in case of failure of an organization (see the assessment of ICP 12 in this report); and
- they are not covered by the government-backed reinsurance covering earthquake risk on residential property that is included in fire insurance cover in the FSA-regulated sector.

The laws, regulations and supervisory practices applying to kyosai business and FSA-regulated insurance are understood to be similar in respect both to solvency and business conduct issues. However, the divergence might increase as the regulatory and supervisory framework applying to FSA-regulated business develops, for example with the new requirements on Economic value-based Solvency Regulation due to be introduced for FSA-regulated insurers, from FY 2025.

6. In line with paragraph 50 of [the Introduction and Assessment Methodology of the ICPs](#), the IMF and Japanese authorities agreed that ComFrame standards would be included in the assessment. The FSA is the group-wide supervisor for four IAIGs and therefore the ComFrame

standards applicable to group-wide supervisors have been assessed as part of the assessment of each ICP that contains ComFrame standards.

7. The assessors are grateful to the authorities and private sector participants for their cooperation. The assessors benefitted greatly from the valuable inputs and insightful views from meetings with staff of the FSA, the MOF including one of its Local Finance Bureaus (LFBs), MAFF, insurance companies, and industry and professional organizations.

C. Overview—Institutional and Macroprudential Setting

8. The FSA is the integrated regulator of financial services, including insurance but excepting the insurance activities of cooperatives. The FSA conducts both prudential oversight and business conduct regulation and supervision for all sectors, including insurers and insurance intermediaries. The FSA's responsibilities are: (i) ensuring the stability of the financial system in Japan, (ii) protecting depositors, insurance policyholders and securities investors, and (iii) ensuring smooth finance functions.

9. The FSA also has a key policy role, formulating proposals for new legislation to be enacted by the Diet (Parliament). However, the insurance activities of cooperative sectors (known as *kyosai* business) that serve, for example, agriculture and fisheries are not subject to FSA supervision. Such insurance activities, although targeted mainly at the members of the cooperative, falls within the scope of an insurance policy as defined in Article 2 (i) of the Insurance Act 2008, but is exempt from insurance business defined in Article 2 of the IBA and regulated under dedicated legislation. Therefore, *kyosai* business is regulated under separate laws and supervised by relevant government ministries as part of their oversight of the wider cooperative organizations, while the separate institutional and regulatory arrangements are also well-established. Although these cooperatives (known as *kyosai* organizations) include, in the agricultural sector, one of the largest institutions conducting insurance activities in Japan (see Box 1), this assessment focuses on the FSA-regulated insurance sector.

10. Insurance intermediaries are also subject to supervision by the FSA with many responsibilities delegated to 11 LFBs of the MOF. Agents are supervised both directly by the FSA and LFBs and indirectly via the FSA's supervision of insurance companies who use agents; and brokers who are directly supervised by FSA and LFBs.

11. The 11 LFBs are located in Japan's prefectures. LFBs are responsible for regulation and supervision of small amount and short-term insurers (SASTIs)²; all insurance agents with full powers including registration and enforcement delegated to the LFBs; and all insurance brokers with full powers, including registration and enforcement delegated to the LFBs. However, for both SASTIs and agents, the FSA retains certain enforcement powers, and it also has powers to order a SASTI,

² 120 firms at end-March 2023 with total written premiums in the financial year 2022 of JPY 134.6 billion, less than 0.5 percent of the industry total. See ICP 1 detailed assessment for more details.

agent or broker to submit reports or data and undertake inspections. Further details are described in relation to the ICP 1 detailed assessment.

12. The FSA has undertaken regulatory and supervisory reforms in line with international standards and continues to do so with plans to introduce Economic Value-Based Solvency Regulations based on the Economic value-based Solvency Ratio (ESR) in fiscal year 2025. The FSA reforms include instituting a process of monitoring the three largest non-life insurers and five largest life insurers in line with the IAIS Holistic Framework. The FSA has also made a concerted effort to incorporate the requirements of ComFrame within its Comprehensive Guidelines for Supervision of Insurance Companies (the Guidelines). The introduction of economic value-based solvency regulation in fiscal year 2025 will very closely align solvency requirements in Japan with the IAIS global Insurance Capital Standard (ICS). The regulation reform is detailed in Box 2.

Box 2. Japan: Economic Value-Based Solvency Regulation

In fiscal year 2025, the FSA plans to introduce the ESR to replace the current solvency requirements.

The project began with the Study Team on Solvency Margin Standard convened between November 2006 and March 2007. The report of this group pointed out challenges and limitations of the SMR and recommended a study on economic value-based solvency regulation. The report found that the SMR may not sufficiently reflect insurer's medium to long-term risks and would not be an impetus for enhancement of risk management. As a result, the FSA began field tests of an economic value-based valuation and supervisory approach from 2010. This enabled the FSA to assess insurer's preparedness for ESR, practical challenges and quantitative impact of ESR.

The conjunctural and structural challenges provide an impetus for developing the ESR. The Japanese population is declining and aging. There has been a prolonged period of a low interest rates. These major trends have led to Japanese insurers attempting to globalize their business. Within Japan, the needs of the population are evolving away from traditional life insurance products to those products that will assist with the growing burden of healthcare and nursing care of the aging. Insurers also face a risk environment that includes volatility in domestic and foreign economies, increasing severity of natural disasters due to climate change and the emergence of new risks such as cyber risk.

With the intention of Japanese insurers to globalize their business, it was important to consider international developments where economic value-based approaches were being introduced. Soon after the FSA began field testing ESR, the IAIS began its development of the global Insurance Capital Standard (ICS) for Internationally Active Insurance Groups (IAIGs). Field testing for the ICS began in 2014 and moved into the monitoring phase after ICS Version 2.0 was adopted by the IAIS in November 2019. The ICS is intended to be adopted as the prescribed capital requirement for IAIGs by the end of 2024.

There will be substantial similarities between the ESR and the ICS. The ESR will be calculated both on a solo basis and on a group-wide basis as a prescribed capital requirement with insurers and groups required to maintain an ESR level of 100 percent or higher. The minimum capital requirement will use an ESR calculation, but the calibration level of the minimum capital requirement is still under discussion. The introduction of the ESR in a domestic context, including for small and medium insurers, has caused the FSA to consider necessary variations from the ICS as a group-wide prescribed capital requirement. The FSA will treat the group-wide ESR as the implementation of the ICS for IAIGs in Japan.

Accounting-based balance sheets are the starting point of ESR. J-GAAP and IFRS balance sheets can be used as the starting point. At the time of writing, the FSA is considering differences between IFRS and ESR.

Box 2. Japan: Economic Value-Based Solvency Regulation (concluded)

One significant difference between the ICS and ESR in terms of valuation will be the methodology of measuring the Margin Over Current Estimate (MOCE). The FSA has indicated it will adopt a cost of capital approach, similar to the method applied in Solvency II, rather than the percentile method included in the ICS. The cost of capital method uses a 3 percent cost of capital and results in a MOCE that is materially higher than the percentile method used in the ICS for life insurers and a lesser, but still material difference for non-life insurers.

Another valuation issue which is receiving considerable attention is the construction of the discount curve for insurance liabilities. The basic ICS construction of the base yield curve will be used with a last observable term of the Japanese yen at 30 years and an ultimate forward rate of 3.8 percent. This causes issues with the calibration of the interest rate risk charge as Japanese insurers do not use these specifications for their own internal risk management and so hedging programs may not fit with this standard construction of a yield curve. It is usual to allow a spread over the base yield curve to be recognized to reduce volatility across the asset and liability components of the balance sheet and the main point of discussion is how to calibrate the spread over the base yield curve.

In terms of the capital requirement, ICS risk factors are calibrated based on data from IAIGs, but these might not be appropriate in the context of small and medium Japanese domestic insurers. The FSA's analysis based on field testing indicates that the risk factors for life and non-life insurance risks should generally be higher in the Japanese domestic context than for the ICS. The approach to catastrophe risk is likely to rely more on standard measurement models than catastrophe models for earthquake, windstorm, and flood risks in Japan but the FSA is focusing its consideration of internal models on natural catastrophe risk. Market risk factors are likely to be consistent with the ICS, but the FSA continues to consider approaches to interest rate risk and equity risk. The tax effect of the capital requirement is also a continuing area of study for the FSA in comparison to the ICS.

The Introduction of ESR requires the insurance sector to have a robust approach to risk management and so Pillar 2 requirements for risk management are being further developed. Along with the development of ESR, Japanese insurers and the FSA have worked to improve the approach of Japanese insurers to enterprise risk management (ERM). The FSA has expressed the opinion that although many insurance companies have used economic value-based measures in their ERM and Own Risk and Solvency Assessment (ORSA), further sophistication of their approaches is needed.

The FSA is developing a verification framework for the ESR. The actuarial function will verify that insurance liabilities are properly calculated, and a newly created ESR verification function will ensure the appropriateness of ESR calculations. Verifications by independent experts are also being considered.

Pillar 3 disclosure measures are still under discussion. The FSA acknowledges the need for balance between decision-useful information for stakeholders with the workload required to produce the information along with ensuring sufficient focus to the information so that the substance is not lost in the detail. The basic direction take is to disclose quantitative information on the ESR, the balance sheet and sensitivity analysis. Qualitative information will include matters related to risk management.

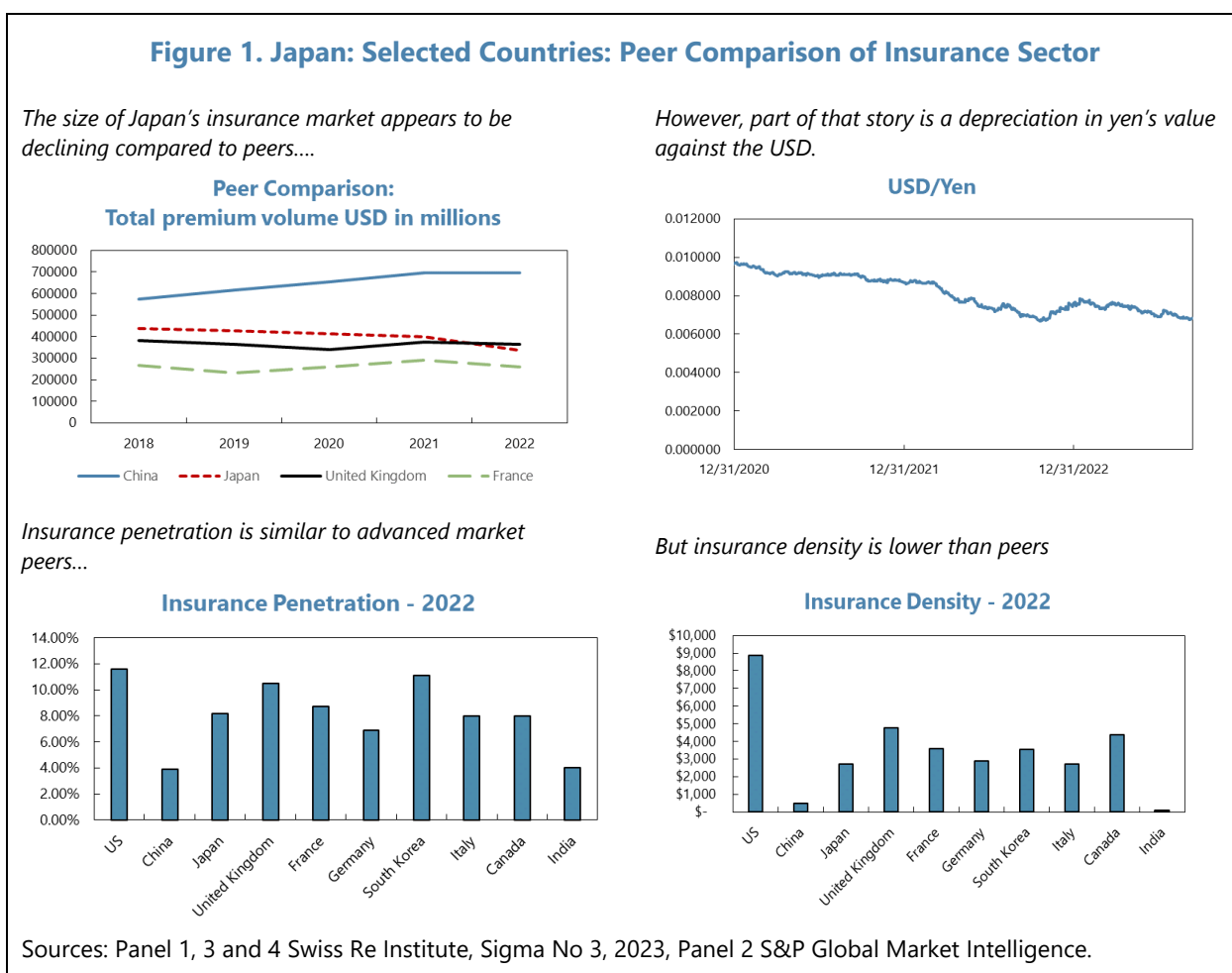
Despite not yet being a regulatory requirement, ESR is being reported by major Japanese insurers. Rating agencies and other analysts are using these ESR to assess capitalization. The FSA is using reported ESR in its macroprudential supervision – these are one of the indicators that are tracked.

One key decision yet to be made, at the time of writing this report, is the design of the ladder of intervention. Under the SMR, there is a ladder of intervention starting at 200 percent SMR with the most severe actions taken at 0 percent. As pointed out in relation to ICP 12, the intervention level where the most severe measures such as suspension of business and entry into resolution should not be at the level of bankruptcy where assets are less than liabilities. The FSA should consider a ladder of intervention where the most severe measures occur before bankruptcy.

Industry Structure and Recent Trends

13. The insurance market statistics that are set out in this report are based on insurers supervised by the FSA only and do not include cooperatives.³ As set out in Box 1, kyosai business can be significant in certain markets and one kyosai organization is among the largest institutions conducting insurance activities in Japan. The insurance market statistics presented here are consistent with the basis of previous IMF focused reviews and detailed assessments.

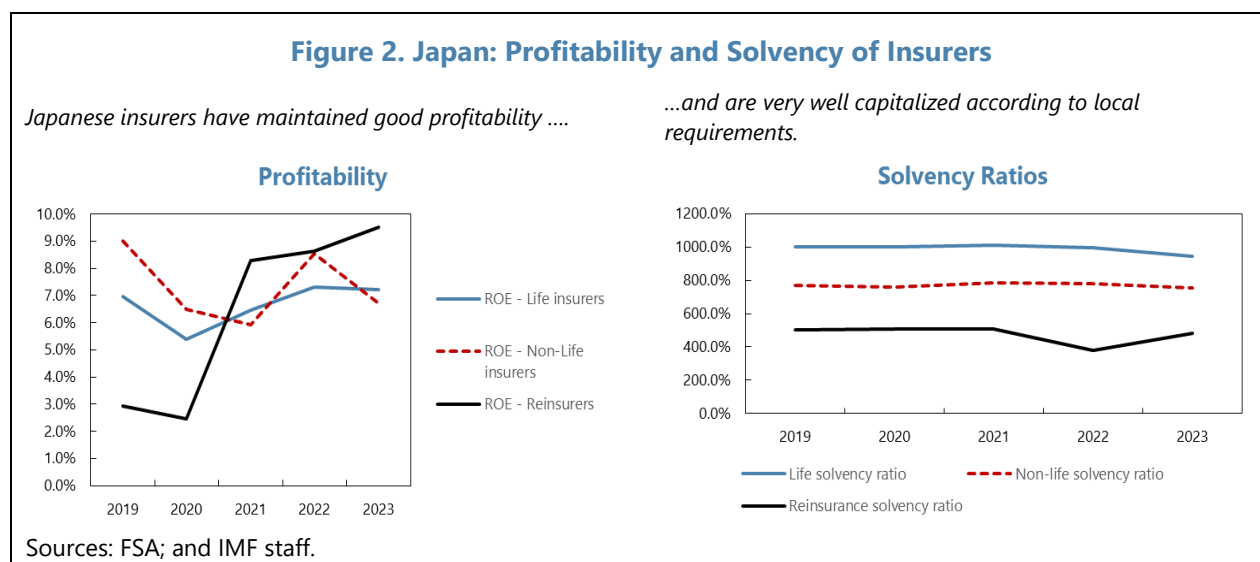
14. Japan had the fourth largest insurance market globally in 2022 by total written premium in USD terms. Japan remained the third largest insurance market in the world for several years, but in 2022 ranked fourth due to strong growth in the UK insurance market and the depreciation of the Japanese yen vis-à-vis the USD reducing the value of Japanese written premium in USD terms. It has high insurance penetration (premiums/GDP) of 8.2 percent comparing well with peers in the top 10 global insurance markets (Figure 1). Insurance density (premiums/population) is relatively low, which may be reflective of Japan’s aging population.



³ The statistics do not include SASTIs which are an immaterial part of the market.

15. There are 42 life insurers, 46 non-life insurers and 9 reinsurers operating in Japan. The number of insurers operating in Japan has remained highly stable, with few new entrants, exits or mergers in the last five years. The non-life sector is highly concentrated with the top four companies representing 82.7 percent of premiums and 88.8 percent of assets. The life sector is slightly less concentrated compared to the non-life sector but still very concentrated compared to other developed markets. The top five life insurers have 62 percent of the sector's assets and 42.6 percent of gross written premium. It has been very difficult for smaller life insurers to compete with the large life insurers and their networks of agents, but other channels for sales, (e.g., through banks or directly over the internet) have exposed the life insurance sector to more competition.

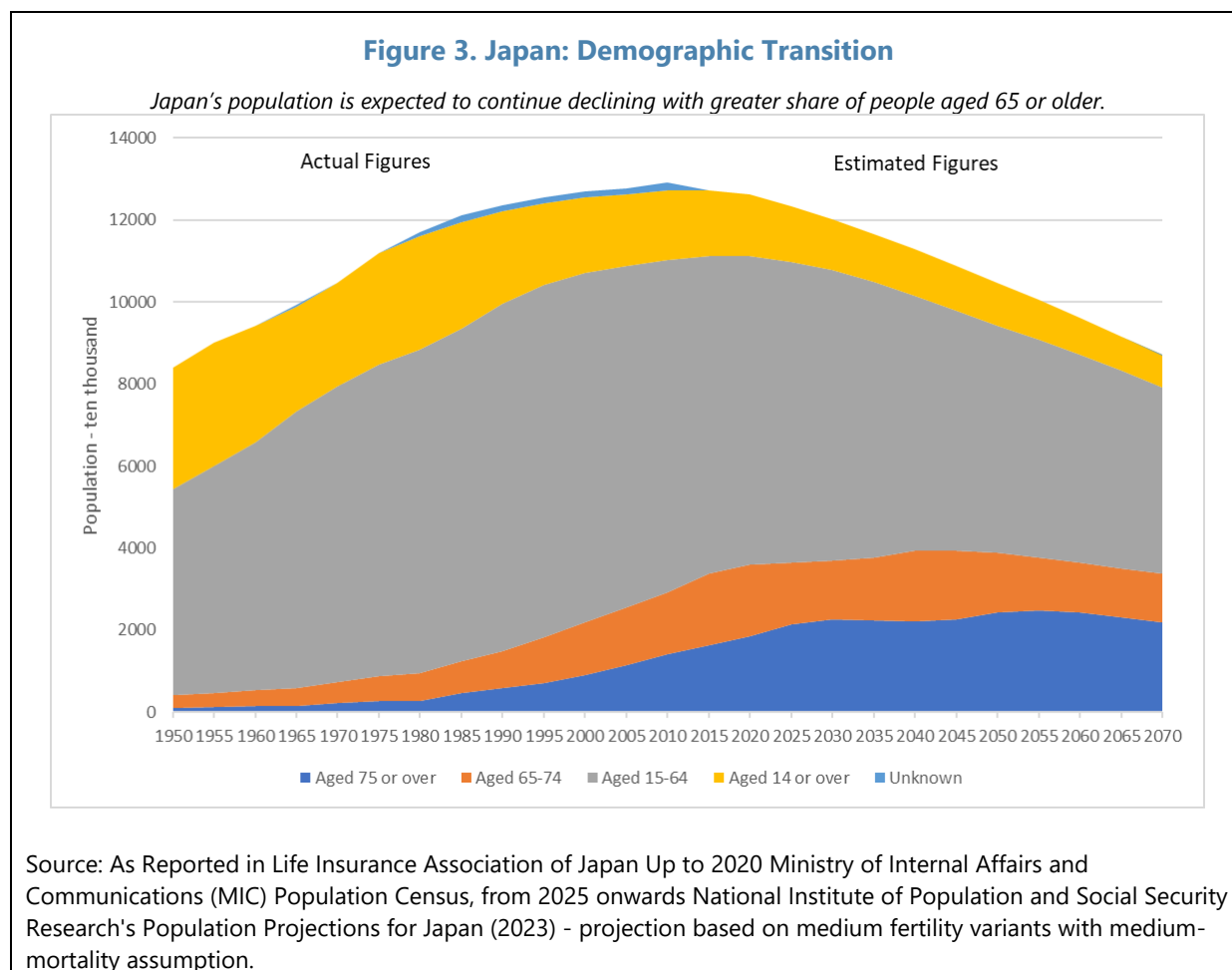
16. The insurance sector is profitable and well-capitalized. Return on equity has been increasing in recent years. Solvency ratios have remained high and stable over time based on the current Solvency Margin Ratio (SMR), as shown in Figure 2. However, this stability is a feature of the manner in which the solvency ratio is calculated (see discussion under ICP 14 and ICP 17).



17. The FSA is moving towards introduction of a more internationally comparable ESR which will show much lower solvency ratios. This is not indicative of any sign of weakness but simply an outcome of the different way of measuring the capital requirement and available capital based on an economic value-based balance sheet. The calibration of the new requirement is clearly different from the SMR. The ESR is closely based on the ICS (see Box 2). ESR will be much closer to 200 percent (margin equates to risk at ESR of 100 percent whereas with SMR margin equates to risk at 200 percent⁴) rather than the 500 percent to 1000 percent range that is seen in Figure 2 for the current solvency requirements (see Detailed Assessment on ICP 17 for a further description of the SMR calculation).

⁴ In the SMR formula, the denominator is total risk divided by 2 so a 200% SMR is needed for margin to equal risk.

18. The life insurance sector is facing a significant evolution of its business model due to the changing demographics in Japan. As shown in Figure 3, the Japanese population is aging and declining. This trend will have a profound impact on the products sold by the life insurance sector and the business strategies employed by life insurers. Traditional life insurance products such as endowment, whole life and annuities are in decline and so called third-sector products, health and medical insurance are increasing in significance.



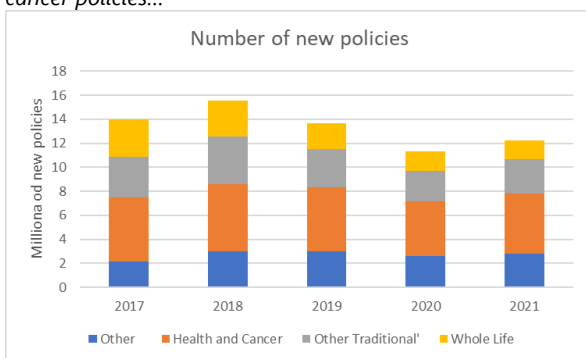
19. The impact of these demographic trends can already be seen in life insurance business in Japan. Figure 4 demonstrates that growth in new business and policies in force is coming from health and cancer insurance, but this is not arresting declines in policy reserves of life insurers in Japan. The health and cancer products are replacing long-term traditional life insurance products in the product mix sold by life insurers but declines in policy reserves of traditional life insurance products based on long-term accumulation of value is outstripping the addition of policy reserves added by these newer protection products. If these trends continue, life insurer balance sheets will continue to shrink.

20. Non-life insurers' business mix has remained relatively stable with some growth in voluntary automobile insurance. Figure 5 shows relatively flat GWPs from 2018 to 2021. While

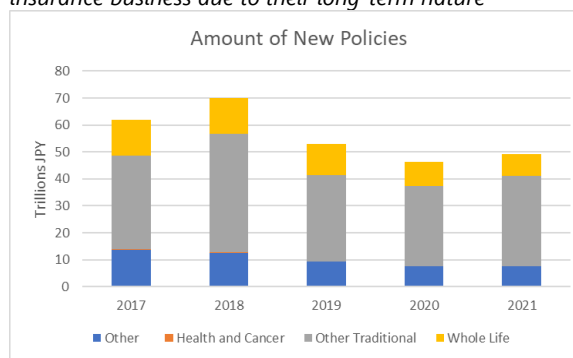
Compulsory Automobile Liability Insurance (CALI) has been included in overall premium, it is a special case. CALI is written on a no loss, no profit basis. CALI premiums are set by the General Insurance Rating Organization of Japan (GIROJ). The GIROJ is also involved in the CALI claims process via its 54 offices across Japan. Investment earnings made on premiums received for CALI are used for measures to prevent automobile accidents and support victims of automobile accidents. Under the Automobile Liability Security Act, investment income on CALI must be set aside in a reserve and dispersed for these purposes. The GIAJ manages the CALI Investment Income Contribution Program.

Figure 4. Japan: Life Insurers—New Policies and Policies in Force

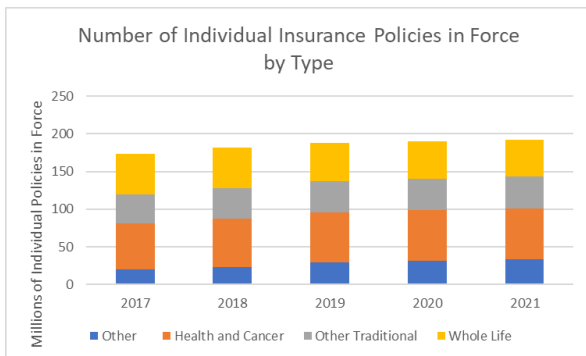
New policies issued are declining except for health and cancer policies...



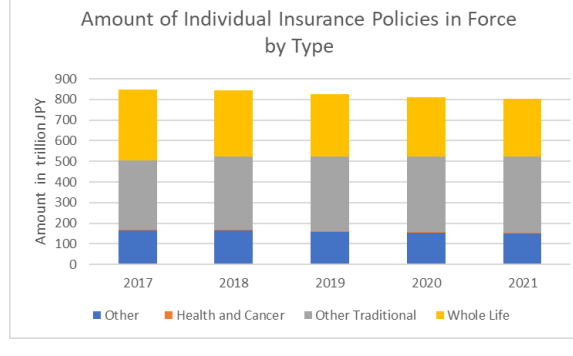
...but reserves are still much higher for traditional life insurance business due to their long-term nature



Overall policies in force are rising driven by health and cancer insurance...



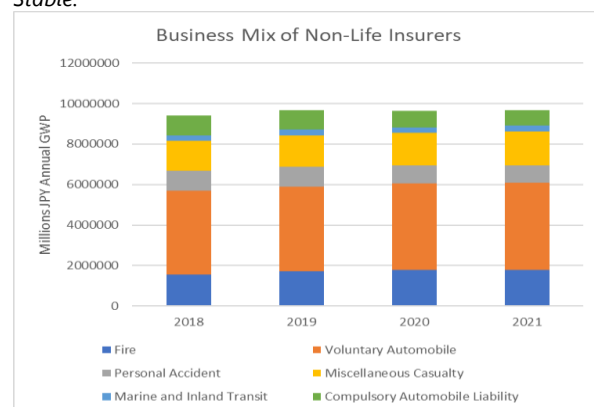
But this is having little impact on the decline in policy reserves of life insurers overall



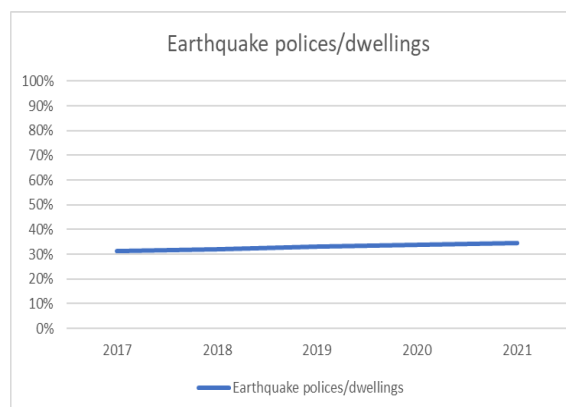
Sources: LIAJ; and IMF staff.

Figure 5. Japan: Non-Life Insurers—Business Mix and Earthquake Insurance Take-up

The Business Mix of Non-Life Insurers Has Been Relatively Stable.



Earthquake Insurance Take-Up Is Low but Trending Up



Sources: FSA, GIROJ; and IMF staff.

21. The GIROJ is established under the Act on Non-Life Insurance Rating Organizations. It is the only rating organization in Japan and is supervised by the FSA. In addition to setting standard full rates for CALI and residential earthquake insurance, it provides reference loss cost rates for other lines of business. The GIROJ acts as a databank for the non-life insurance industry in Japan to enable it to calculate the reference loss cost rates and standard full rates for CALI and earthquake insurance.

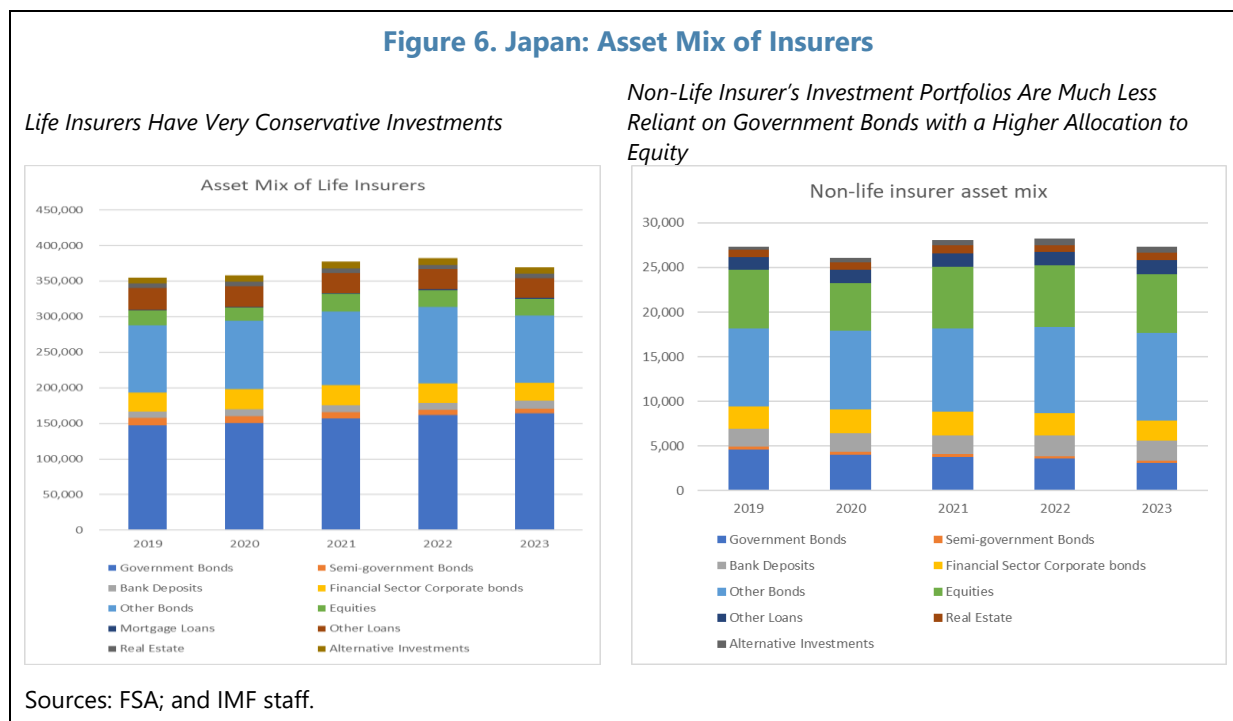
22. Residential earthquake insurance in Japan is conducted through a public-private partnership. Earthquake insurance can be added to fire insurance (homeowner insurance) with the amount insured under the earthquake insurance contract between 30 percent and 50 percent of the amount insured under the fire insurance contract. Fire insurance and earthquake insurance are not compulsory. The take up rate for earthquake insurance is quite low given the significant risks of earthquake in Japan. Figure 5 shows that there is small growth in the take-up rate of earthquake insurance but it remains below 35 percent. This is a significant protection gap in Japan. The premium rate is calculated based on the structure and location of the insured building but with a discount applied according to the earthquake-resistance capability of the structure. Earthquake insurance policies are underwritten by private insurers but are ceded to the Japan Earthquake Reinsurance Co. Ltd which was established by non-life insurers. It retrocedes the risk to insurers and the government up to their predefined indemnity limits and retains any remaining risk. Residential earthquake premium rates are standardized by the GIROJ. As of April 1, 2022, the scheme provided indemnification for earthquake losses up to 12 trillion JPY with non-life insurers retaining only JPY 228.7 billion of that risk. Non-life insurers are also exposed to earthquake risk through other lines of business such as commercial property insurance and automobile insurance and must manage this risk without government support.

23. Until recently, non-life insurance contracts in Japan could be unusually long-term. Until 2015, the maximum insurance period for household fire insurance was 36 years. In October 2015, a decision was taken to shorten this maximum period to 10 years and in October 2022 the

maximum term was shortened to 5 years. Premiums for these long-term contracts are set at the beginning of the contract. The coverage level remained the same so any inflation in value of the insured property increased the retained risk of the policyholder. These long-term insurance contracts have been loss making for the non-life insurers in recent years creating downward pressure on non-life insurer profits.

24. Claims costs have been increasing on fire insurance. In May 2021, the GIROJ increased the reference loss cost rate on household fire insurance by 10.9 percent with insurers increasing insurance premiums by between 4.9 percent and 21 percent since October 2022. Corporate fire insurance reference loss cost rates increased by 6.5 percent with individual insurers increasing premiums by 5 percent to 12 percent. Another factor increasing costs for insurers is that in the global reinsurance market, reinsurance premiums have increased and coverage can be more difficult to obtain.

25. The asset mix of life insurers and non-life insurers has remained relatively stable over the past five years. Life insurers have conservative investment portfolios with significant investments in government bonds (Figure 6), particularly Japanese Government Bonds for which insurers are the largest holders after the BOJ. Most life-insurer assets are interest-bearing. Non-life insurers have less allocation to government bonds, higher allocations to other bonds and to equities.



26. Life insurance bond investments have shown a slight decrease in credit quality from 2019 to 2023 but the portfolios remain high quality overall. AAA assets have declined from 73 percent of the rated portfolio in 2019 to 68 percent in 2023, and AA rated bonds have also

decreased from 9 percent in 2019 to 8 percent in 2023). Over the same period, A rated bonds have increased from 12 percent to 14 percent, BBB rated bonds have increased from 5 percent to 8 percent and below investment grade bonds have increased from 1 percent to 2 percent. A similar trend can be seen in the non-life sector where AAA assets declined from 54 percent of bonds in 2020 to 48 percent in 2023, with most of the shift away from AAA bonds going to AA bonds which increased from 12 percent in 2020 to 16 percent in 2023. There were also small 1 percent increases in A and BBB bond portfolios.

27. Foreign currency bond investments remain significant at 26 percent of all bond investments for life insurers. USD exposure dominates with 19 percent of bond investments in USD. Foreign currency exposure increased from 2019 (27 percent) to 2022 (30 percent) but reduced significantly in 2023 with the increasing cost of currency hedging the reason given for this sharp decrease in foreign currency assets. As reported in the BoJ's Financial System Report October 2023, the currency hedging ratio of major life insurers decreased below 50% in 2022 down from above 60% in the prior year.⁵ There are significant foreign currency liabilities which provide some natural hedging, but the size of the foreign currency liabilities was not provided to assessors. Some foreign currency exposures are naturally hedged through liabilities denominated in the same currency, however there is significant net currency risk maintained on the balance sheet. There is also significant hedging of foreign currency positions.

28. Lapse rates for life insurers remain low even with the economic shock caused by the COVID-19 pandemic. Lapse rates actually declined during 2020 and 2021, returning to pre-pandemic levels in 2023.

Key Risks and Vulnerabilities⁶

29. Insurers are exposed to a range of investment risks through macroeconomic exposures. The key investment risks for life insurers relate to exchange rates and interest rates including base risk-free rates and spreads, and under the SMR emerge quite slowly over time as it is not based on market-based valuation of assets and liabilities. The extent of the economic risk is determined by the extent of asset-liability mismatches. Equity price fluctuations are also a risk for life insurers as they have material equity portfolios. Non-life insurers are particularly exposed to equity risk through their much higher allocation to equities in their investment portfolios with relatively less risk from interest rates as their investment portfolios are typically shorter than life insurers.

30. Life insurers are exposed to pandemic risk through possible changes in morbidity and mortality rates. The recent COVID-19 pandemic had a negative impact on life insurer profits but was not an event that threatened the solvency of life insurers.

⁵ BOJ, Financial System Report, October 2023, Chart III-2-4.

⁶ The TN on systemic risk analysis and stress testing provides more details on the insurance stress test results.

31. Life insurers and non-life insurers are exposed to liquidity risk and the FSA monitors liquidity risk as part of its monitoring of the five largest life insurers and three largest non-life insurers.

Liquidity risk is considered through the lens of insurer's own internal liquidity risk monitoring, including liquidity stress testing. Large insurers are required to have liquidity crisis measures in place in the form of contingency funding plans. Group-wide liquidity risk management is also part of the FSA monitoring. Life insurers liquidity risk may be manifested in mass lapse risk. The FSA monitors it through comparison of policy reserves that are most vulnerable to lapse—those with guaranteed rates lower than one percent—and holdings of liquid assets. Life insurers are also exposed to liquidity risk through derivative positions with the exposure considered low compared to holdings of liquid assets. The FSA considers the potential foreign exchange settlements required for a three-month period and has found that holdings of liquid foreign exchange positions to be sufficient.

32. Non-life insurers are exposed to natural catastrophe risk mainly through the potential impact of typhoons, earthquakes, and flooding.

Non-life insurers must maintain extraordinary contingency reserves on their balance sheet, and more details can be found in the detailed assessment of ICP 14 valuation. In the SMR, non-life insurers risks include catastrophe risks based on the scenarios of the Great Kanto Earthquake in 1923 and the Ise Bay Typhoon in 1959.

33. Systemic risk analysis found that insurers are mostly resilient to the adverse scenario in terms of solvency. Life insurers have significant sensitivity to interest rates and equity prices due to large equity holdings.

Out of 12 life insurers involved in the SMR stress test, only 2 would not remain at over 200 percent SMR, which is the first level in the FSA's ladder of intervention. The nonlife insurance sector is more resilient under the adverse scenario with no insurers below the 200 percent SMR threshold. The systemic risk analysis also included a stress test based on the yet to be introduced ESR. A key feature of the ESR regime is that it is less sensitive to interest rate changes due to liability values responding to the changes in interest rates along with assets responding to that change. Under SMR, only the asset values respond to the change in interest rates. Post-stress all insurers involved in the ESR stress test remained above the hurdle rate of 100 percent. It should be noted, however, that both the SMR and the ESR thresholds are the level at which the margin equates to the risk, as the risk is halved only when calculating an SMR.⁷

34. Systemic risk analysis also included a liquidity stress test considering the impact of variation margining.

There were two approaches used in the liquidity stress tests: a stock-based approach and a cash flow approach. Overall, insurers are not significantly exposed to liquidity risk, but outflows under the FSAP adverse scenario show that available reserves and tradable securities may fall short of covering outflows under stress. Under the prescribed shocks, liquidity pressures are found to be more prominent for insurers showing larger declines in the solvency margin ratio.

⁷ The SMR is calculated as Total Solvency Margin / $\{(1/2) \times \text{Total Risks}\}$ with the minimum level set at 200% which means total risks are covered - $200\% \times \{(1/2) \times \text{Total risks}\}$. The ESR is calculated as Capital Resources/Capital Requirement with the minimum level set at 100% for this exercise, so total risks represented by the capital requirement are covered.

D. Preconditions for Effective Insurance Supervision

Sound and Sustainable Macroeconomic and Financial Sector Policies

35. There is a well-established framework for macroeconomic policy management. The MOF is responsible within the Government of Japan for fiscal policy. Annual budgets are agreed by the Cabinet and sent for debate and approval to the Diet (Parliament). The Bank of Japan (BOJ) formulates and operates monetary policy independently of government, while also being required to maintain close contact with government so that monetary and government economic policies are compatible (Articles 3 and 4 of the Bank of Japan Act). It sets a target for inflation (currently 2 percent per annum). The BOJ's strategic objectives also include ensuring the stability and improving the functioning of the financial system and enhancing payment and settlement services and market infrastructure. It analyzes and assesses risks in the financial system and publishes a Financial System Report semi-annually.

36. The FSA is the single integrated regulator of financial services. It conducts both prudential oversight and business conduct regulation for all financial sectors, while the BOJ conducts supervision of financial institutions which transact with it (in money markets etc.). The FSA employed 1,644 staff at mid-2023. It comprises also the Securities and Exchange Surveillance Commission (SESC) which conducts market surveillance and onsite inspections of securities companies; and the Certified Public Accountants and Auditing Oversight Board (CPAFOB), which oversees the quality of review work performed by the Japanese Institute of Certified Public Accountants (JICPA). The SESC and CPAFOB recommend sanctions, where necessary, which are then imposed by the FSA.

37. There are coordination mechanisms across government bodies with responsibilities for financial stability. There is coordination through the Council for Cooperation on Financial Stability, members of which are senior officials from the BOJ and FSA. The Financial Crisis Response Council is activated by the Prime Minister when government intervention in a troubled financial institution may be necessary. It comprises the PM (chair), the Chief Cabinet Secretary, the Minister for Financial Services, the Minister of Finance, the FSA Commissioner, and the BOJ Governor. It advises the PM, who takes final decisions. In addition, general advice on financial system issues is provided by the Financial System Council within the FSA, which conducts deliberations on the financial system in response to requests from the PM, the FSA Commissioner, or the MOF.

A Well-Developed Public Infrastructure

38. There is a well-developed framework for provision of sound auditing work. The corporate sector, including financial institutions, is subject to the Japanese generally accepted accounting principles (GAAP) for financial reporting issued by the Accounting Standards Board of Japan and endorsed by the FSA. Japanese GAAP has been converging with IFRS under a multi-year program. IFRS may be used by companies which meet certain conditions. There are legislative requirements for independent external audit and audit work carried out by members of the JICPA is overseen by the CPAFOB within the FSA. The legislation requires rotation of audit engagements for listed companies.

39. There is a large actuarial profession. The Institute of Actuaries of Japan (IAJ) is the professional body. It works to maintain and improve the professional performance of actuaries and to promote the sound development of businesses in which they are involved. It has around 5,500 active members (of which around 2,000 are fellows—those who have passed all examinations) working in different professional fields, including the insurance sector. The IAJ engages in various activities, including research, the education of actuaries, and management of a qualifying examination system. It issues standards and guidance on technical issues and develops and publishes mortality tables. Its standards relevant to insurance and the mortality tables are approved by the FSA for use by insurers.

40. Other aspects of infrastructure are well-developed. The judicial system comprises the Supreme Court, several high courts, and numerous summary, family or district courts. The payment and settlement system is reliable and efficient, comprising real time gross settlement for all large-value payments and delivery-versus-payment for all types of securities settlement. There is mandatory central clearing of standardized over the counter derivatives.

Effective Market Discipline in the Financial Sector

41. Legislation in Japan contains several safeguards for disclosure and transparency. The Companies Act sets general disclosure requirements for companies and the Financial Instruments and Exchange Act the requirements for listed companies, which are supplemented by requirements of the Tokyo Stock Exchange (TSE). Companies listed on the TSE are subject to its Corporate Governance Code (CGC), most recently revised in 2021, which does not set binding requirements, but to which listed entities must have regard on a “comply or explain” basis. The Code is mostly principles-based covering issues such as securing the rights and equal treatment of shareholders and the appointment of independent board members as well as ensuring appropriate information disclosure. Market discipline is facilitated by an extensive presence of institutional investors, rating agencies and analysts.

Mechanisms for Consumer Protection

42. There are various mechanisms for consumer protection, including funded policyholder protection schemes. In case of failure of an insurer, two policyholder protection corporations (Life Insurance Policyholders Protection Corporation (LIPPC) and the Non-Life Insurance Policyholder Protection Corporation (NIPPC) may provide financial assistance to support the transfer of insurance contracts to another insurer (a relief insurer), if necessary to facilitate a reorganization plan of the failed company (see ICP 12). If no relief insurer can be found, the policyholder protection corporations will set up a subsidiary to accept the insurance contracts of the failed insurer. It is also possible, in case of a risk of significant disruption to financial markets or other parts of the financial system for the Deposit Insurance Corporation of Japan (DICJ) to be involved, by injecting capital or transfers assets and liabilities.

43. The policyholder protection schemes are funded. The LIPPC and NIPPC are funded by industry levies and there is provision in legislation for their funds to be supplemented, if necessary,

by borrowing (repayable from future levies). In the case of the LIPPC, there is also provision for temporary government financial support in limited circumstances.

44. There are also alternative dispute resolution mechanisms and rights of access to courts to address complaints by policyholders and others. Since 2010, insurers have been required to conclude a contract with an Alternative Dispute Resolution (ADR) institution designated by the FSA and comply with its procedures etc. There are four main ADRs operated by Life Insurance Association of Japan (LIAJ), the General Insurance Association of Japan (GIAJ), the Insurance Ombudsman and the Small Amount and Short-Term Insurance Association. Policyholders also have rights of access to a court to pursue a complaint.

Financial Markets

45. Japan has large and liquid financial markets, including for equities and other corporate securities and insurers have access to foreign securities. The market in Japanese Government Bonds is one of the largest in the world with maturities at issuance extending to 40 years (fixed rate coupon-bearing bonds) and 10 years (inflation-indexed bonds) and 15 years (floating rate bonds). Japanese insurers hold a large share (around 20 percent) of total government bonds. They also have access to liquid markets in domestic corporate bonds and equities. There are also derivative markets available to insurers in Japan. Insurers are not limited to domestic markets, being able to invest in foreign securities, comprising around 30 percent of their securities portfolios in 2022.

Table 1. Japan: Summary of Observance with the ICPs

Insurance Core Principle	Level	Overall Comments
ICP 1-- Objectives, Powers and Responsibilities of the Supervisor	LO	<p>The FSA is clearly identified as the principal insurance sector authority and is empowered to issue certain regulatory requirements and to supervise insurers and intermediaries including groups. Responsibilities retained by the Minister of State for Financial Services, including decisions on licensing, are also clearly established as are arrangements to empower the Local Finance Bureaus by delegation of FSA responsibilities. The FSA focuses mainly on the statutory objectives emphasizing policyholder protection and financial stability. However, its aim of balancing these objectives with meeting the needs for development of the insurance sector, with wider economic benefits, could give rise to conflicts.</p> <p>This assessment covers FSA's responsibilities only. The separate institutional and regulatory arrangements for the insurance activities of cooperatives (kyosai) are also well-established. However, they could give rise to differences in approach and in levels of protection for policyholders that are not justified by differences in the markets.</p>
ICP 2-- Supervisor	PO	<p>Although it is an agency within the Government of Japan, the delegation of most powers to the Commissioner gives the FSA a high degree of operational independence and protection from undue political interference. Nonetheless, the reservation to a minister of key licensing powers and the FSA's dependence on the central government budgeting process expose it to potential interference.</p> <p>Insurance sector resources are low in relation to those available to insurance supervisors in peer countries facing comparable tasks, particularly given the strategic challenges in the sector and regulatory change such as the introduction of the ESR. This assessment highlights areas where the FSA's work is constrained by low levels of resource. The FSA has been growing staff numbers gradually over recent years and plans to bid for more in the next budget process. However, an even more significant change in the level of resources now appears necessary, particularly in the Insurance Business Division for frontline supervision work, if the FSA is to meet its objectives and improve its level of observance of the ICPs.</p>
ICP 3-- Information Exchange and Confidentiality Requirements	O	<p>The FSA has widely drawn powers to exchange information with other agencies and exchanges (and protects) confidential information in practice, with domestic and foreign authorities. However, there is a scope for the FSA to exchange information more proactively with home supervisors in the case of consideration of applications for new licenses from foreign-owned insurers.</p>

Table 1. Japan: Summary of Observance with the ICPs (continued)

ICP 4-- Licensing	O	<p>The IBA and OEIBA contain extensive requirements for licensing of insurers. One concern noted under ICP 2 is that the decision to grant licenses to carry on insurance business are not delegated to the Commissioner of the FSA. That is not a matter for assessment under ICP 4 but is an issue raised under ICP 2.</p> <p>The FSA's process of working with applicants to ensure official applications for licenses are likely to be approved is an extensive process and a pragmatic approach. It means that in most cases the practical decision making about granting licenses is being made by the FSA.</p>
ICP 5-- Suitability of Persons	PO	<p>The legislation covers many of those persons within the scope of the ICP requirements and the FSA receives and responds to notifications of new appointments. It focuses especially on the senior executive positions, regularly holding hearings with nominated persons and taking action where the person is considered unsuitable. It assesses major shareholders appropriately.</p> <p>However, the scope of the suitability requirements is not comprehensive. They do not clearly cover all directors nor all persons holding senior management positions, including all key persons in control functions. There is limited information on FSA's expectations of the knowledge and experience of persons within scope. The FSA also has inadequate resources to conduct regular effective supervision to ensure that insurers are meeting their responsibilities for assessing suitability in practice.</p>
ICP 6-- Changes in Control and Portfolio Transfers	O	<p>Requirements for FSA approval of changes in control and portfolio transfers are comprehensive. The FSA demonstrated that it followed the requirements of the legislation and guidelines in the examples reviewed.</p>
ICP 7- Corporate Governance	LO	<p>There are extensive requirements in general company law and insurance legislation, backed by wide-ranging material in the FSA's Guidelines. The coverage of group issues in the Guidelines is particularly developed. The FSA undertakes supervision work, mainly off-site, on individual insurers and on a thematic basis, notably on the governance of major groups; and has required insurers to improve governance when necessary.</p> <p>There are some gaps in relation to the detailed requirements of the ICP, including on boards' resources. While it is carrying out effective supervision, the FSA lacks a systematic risk-based process for assessing all aspects of governance, including appropriate on-site evaluation, for application to all insurers.</p>

Table 1. Japan: Summary of Observance with the ICPs (continued)

ICP 8-- Risk Management and Internal Controls	LO	<p>The FSA's Guidelines set out extensive expectations on risk management and controls. The coverage of group issues is particularly developed, although there is no requirement on IAIGs to undergo an independent assessment of the coherence, completeness, and effectiveness of the internal controls system. The FSA undertakes some supervision work, notably on internal audit. There are expectations in the Guidelines on each of the control functions and these are particularly clear in relation to the group level.</p> <p>The FSA would benefit from much clearer requirements on control functions including on independence, adequacy of resources, and appropriate reporting lines. The introduction of the ESR provides an opportunity for strengthening current requirements. The FSA would benefit from a systematic risk-based process for assessing all aspects of risk management and controls at all insurers.</p>
ICP 9-- Supervisory Review and Reporting	PO	<p>Prudential supervision is based on thematic issues where a number of insurers are subject to analysis (but far from all insurers). The FSA's supervision is mainly reactive to risk that has crystalized into a problem for an insurer. Regular supervisory risk assessment is not undertaken as part of a supervisory cycle. Supervision plans are not prepared for individual insurers.</p> <p>It is current practice that, on-site inspections are not part of routine supervision. On-site inspections are used more as an investigation tool to understand the root cause of risks that have crystalized with the findings used to identify required improvements. There is a small team in the Insurance Prudence Monitoring Office (IPMO) which conducts analysis of reported information, including the operation of an Early Warning System (EWS) which covers all insurers. The Monitoring Section for each sector analyses the impact of key risks. When an issue with an insurer is identified from this off-site monitoring it is followed up by the team which is allocated to that insurer.</p> <p>Ultimately, the approach to supervision appears to be designed to fit the available resources. As detailed in relation to ICP 2, resourcing at the FSA appears limited compared with peer supervisors. Addressing the recommendations in relation to this ICP and a number of others will require a significant increase in resources.</p>
ICP 10-- Preventive Measures, Corrective Measures and Sanctions	O	<p>The FSA has an escalating series of preventative measures and corrective measures which it applies in practice.</p> <p>It has an extensive list of possible sanctions which are applied in practice.</p>

Table 1. Japan: Summary of Observance with the ICPs (continued)

ICP 12-- Exit from the Market and Resolution	PO	<p>Insurers have a path to voluntary exit from the market subject to oversight and approval by the FSA. The issues in this assessment arise from the approach to insurer resolution. The assessment focuses on the CRA and SMRPFI which appears to be the best path to resolution of an insurer. The IBA does not provide a practical avenue for resolution other than for SASTIs and smaller insurers due to the lack of powers to modify the rights of non-policyholder creditors.</p> <p>It is also notable that the trigger point for resolution under the CRA and SMRPFI is when there is a likelihood that the insurer will be unable to pay debts or will become insolvent. This trigger point is not ideal as it means that losses are likely already crystalized for policyholders and/or other creditors.</p> <p>Under the CRA and SMRPFI, the FSA may state an opinion to the court concerning reorganization. Creditors with claims over a certain amount, including policyholders, can file a petition to start resolution process before the FSA makes an application to a court to begin the process, then the court must notify the FSA of the filing. The FSA has no decision-making role. Under the CRA and SMRPFI, the FSA is clearly an influential stakeholder in a resolution process but is not in a decision-making position.</p> <p>Policyholder protection is in place through legislative provisions and the existence of the policyholder protection corporations. Policyholder protection corporation funding has been stable for over two decades. There should be a review of the funding levels and caps on member contributions. There is a possible public subsidy to the resolution of a life insurer with no provision for reimbursement of public funds which is a provision of the IBA that has been renewed every 5 years by the Diet, most recently in 2022. The existence of this possible public subsidy to the resolution of a life insurer is problematic as reforms of resolution frameworks post-GFC are meant to limit reliance on public funding.</p> <p>Resolution planning is not required for any insurers. Given the possible subsidy of resolution of life insurers as mentioned above, it seems at odds that large life insurers would not be required to evaluate prospectively their specific operations and risks in possible resolution scenarios and to put in place procedures for use during a resolution.</p> <p>There is no evidence of a requirement to consider the ability of the group-wide management information system to produce timely information in a resolution.</p>
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Table 1. Japan: Summary of Observance with the ICPs (continued)

ICP 13-- Reinsurance and Other Forms of Risk Transfer	LO	<p>The Guidelines contain requirements for insurers to meet in putting together their reinsurance programs and managing risk in relation to reinsurance. However, there are a few omissions. The FSA does not explicitly differentiate reinsurance arrangements based on the quality of supervision in the jurisdiction. The focus is on credit ratings. The FSA does not explicitly require consideration of liquidity risk in relation to reinsurance programs and does not explicitly require the approach to liquidity risk management to consider liquidity risk in relation to reinsurance programs.</p> <p>Supervision of reinsurance arrangements is focused on large non-life insurers and mid-tier non-life insurers. Some risk assessment at the individual insurer level would be useful in targeting supervision resources where there are likely to be material concerns with insurer's reinsurance arrangements.</p>
ICP 14-- Valuation	PO	<p>At the time of the assessment, a valuation approach relation to the SMR is applied. Valuation of assets and liabilities are based on J-GAAP except for valuation of policy reserves and investment reserves which is provided for in the IBA.</p> <p>Assets and liabilities are measured on a consistent basis to an extent but there are exceptions. Assets and liabilities are not valued on an economic basis. The discounting of future cash flows is based on an assumption of a single rate rather than a yield curve. The risk-adjusted present value of cash flows is only incorporated in policy reserves to a limited extent based on limited liability adequacy testing. For non-life insurance, the extraordinary contingency reserve is a profit smoothing tool and as such does not have an economic basis.</p> <p>Policy reserves do not include an explicit MOCE. It is also not clear that embedded options and guarantees are taken into account in the determination of policy reserves.</p> <p>The FSA will introduce the ESR from fiscal year, 2025. Economic valuation underpins this new approach, and it is likely to address the shortcomings noted in this assessment.</p>
ICP 15-- Investment	LO	<p>Insurers are required to invest in accordance with specified investments set out in the OEIBA. There are no explicit requirements related to insurers ensuring assets are sufficiently secure and held in an appropriate location for their availability.</p> <p>Supervisory review of how insurers manage their assets is not regularly undertaken other than through the regular review of ORSA for the five largest life insurers and three largest non-life insurers. Due to this lack of regular oversight of investment management, this item cannot be considered "Observed." This matter relates to the issues raised in relation to ICP 9 and the way the FSA conducts supervision.</p>

Table 1. Japan: Summary of Observance with the ICPs (continued)

ICP 16-- Enterprise Risk Management for Solvency Purposes	LO	<p>ICP 16 is a complex principle with many detailed requirements particularly in relation to ComFrame. The FSA undertook a concerted effort to incorporate ComFrame requirements into the Guidelines in 2020. This effort has largely been very successful with few requirements of ICP 16 not explicitly reflected in the Guidelines.</p> <p>Three omissions compared to ICP 16 were noted. There is inadequate supervisory review of the requirements of ERM. There was one thematic review in 2016 of ORSA which did not include the participation of all insurers and thereafter review was targeted only those assessed at lower levels in the ERM assessment exercise. The largest groups' ORSA reports are reviewed annually, and it seems many insurer's ORSA reports are filed and not systematically reviewed. There has been no on-site verification that ERM processes reported in ORSA reports are implemented and operating as described. This lack of consistent supervisory review of the implementation of ERM across a range of insurers is a concern and has contributed to the assessment of "Largely Observed."</p>
ICP 17-- Capital Adequacy	LO	<p>The SMR is a risk-based solvency requirement which meets most of the requirements of ICP 17. However, there are some shortcomings. One key issue is that there is not a coherent total balance sheet approach in the design of the SMR. The SMR is calibrated at a level that solvency control levels do not provide any constraint to the operations of insurers. Insurers are operating at close to 1000 percent SMR ratios with the first solvency control level at 200 percent, the level at which margin equates to risk.¹ The likely ESR calibration results are in an ESR of around 200 percent (margin equates to risk at ESR of 100 percent). This is indicative that the SMR is not calibrated at a sufficient level so that in adversity the insurer's obligations will continue to be met as they fall due.</p> <p>The lowest solvency control level is 0 percent. This is too low for an MCR as it only allows the strongest intervention—suspension of business and possible resolution—when losses have crystalized for creditors including policyholders.</p> <p>In fiscal year 2025, the FSA will introduce the economic value-based solvency regulation including the introduction of ESR. The regulation is being developed in an open and transparent process. The introduction of ESR is likely to address the issues raised in this assessment.</p>
<p>¹ In the SMR formula, the denominator is total risk divided by 2 so a 200% SMR is needed for margin to equal risk.</p>		

Table 1. Japan: Summary of Observance with the ICPs (continued)

ICP 18 - Intermediaries	LO	<p>There is an extensive framework of requirements on intermediaries, covering registration (i.e., licensing) and supervision as well as regulatory standards. Delegation by the FSA of much work to the LFBs has brought supervision closer to markets and enabled the FSA to focus on areas of supervisory concern, in cooperation with the LFBs. There are some areas where the approach could be more aligned to the ICP standards: governance requirements and requirements on agents to disclose the basis of their remuneration. The FSA could also increase its supervisory work on intermediaries, which is mainly reactive. There is scope for the FSA, with LFB support, to undertake more proactive supervisory work on insurers' oversight of agents, potentially also on agents directly and on brokers. This additional work would require increased resources.</p>
ICP 19-- Conduct of Business	LO	<p>There are extensive provisions, especially in the FSA's Guidelines, on all aspects of business conduct, covering insurers, agents, and brokers. The FSA's product approval work, integrated approach to supervision of insurers and intermediaries, and its extensive framework of supervisory viewpoints in the Guidelines equips the FSA to identify and respond effectively to conduct issues. Supervision work is, however, in practice mainly focused on addressing significant concerns over past misconduct, often following reports by insurers themselves. Wide-ranging and effective thematic work has been undertaken in recent years. However, market-wide intelligence gathering, and risk assessment could be developed. The FSA could also develop related processes for proactive supervision of controls over conduct issues, corporate culture, and the effectiveness of compliance functions.</p>
ICP 20-- Public Disclosure	LO	<p>Insurers are required to make disclosures in line requirements in the IBA and OEIBA. The Guidelines provide some elaboration of these requirements. These requirements meet ICP 20 disclosure requirements. However, supervisory oversight of disclosure could be improved. Disclosure standards are only assessed in relation to the large insurance companies that are less likely to fail to meet supervisory disclosure standards and in fact make voluntary disclosures in excess of supervisory requirements. There is some checking of compliance with disclosure requirements for small-to-medium companies through analysis related to the EWS. Checking of compliance with disclosure requirements should be addressed more systematically in relation to all individual insurers. This would be made possible if the recommendations in relation to ICP 9 are introduced and supervisory plans are developed for each insurer.</p>

Table 1. Japan: Summary of Observance with the ICPs (continued)

ICP 21-- Countering Fraud in Insurance	LO	Insurance fraud has been a long-standing challenge in Japan, although insurers' controls had been regarded as strong. Fraud is becoming a larger concern and controls and culture at some insurers may need to be improved. The FSA had already been responding to significant fraud by the own sales staff of some life insurers. However, as in other areas of its supervisory work, the FSA's approach has been mainly reactive. It does not focus systematically on fraud risk and insurers' controls in risk assessment and proactive supervisory work. It would need significantly increased resources to do so effectively.
ICP 22-- Anti- Money Laundering and Combating the Financing of Terrorism	O	There is an extensive framework of legislation and detailed guidelines issued by the FSA, much of it applying to financial institutions generally but also material specific to insurance. The FSA has developed an understanding of risks in the insurance sector, a system of risk assessment based on detailed reporting and a program of supervisory work proportionate to the risks in insurance business. Coordination with other agencies has been strengthened and the insurance sector is included in the national plan to raise standards.
ICP 23-- Group- wide Supervision	LO	The FSA has a well-developed approach to group supervision which has been extended in recent years to apply ComFrame requirements to IAIGs. However, there are some areas where the FSA could develop the approach further. It should include not only holding companies and subsidiaries but also minority interests within the scope of group supervision, where necessary. It is not collecting detailed information of such entities, as required under ComFrame standards. Collection, analysis and making appropriate responses to such information would be likely to require commitment of resources not currently available to the FSA.

Table 1. Japan: Summary of Observance with the ICPs (concluded)

ICP 24 - Macroprudential Supervision	PO	<p>The FSA has made significant strides forward in its macroprudential supervision since previous FSAPs. It obtains adequate data, performs macroprudential analysis, and uses the results of its macroprudential supervision to inform supervision of individual insurers.</p> <p>One issue is that macroprudential supervision does not include all major insurers in Japan. One major insurer is not included in macroprudential supervision as it is not supervised by the FSA.</p> <p>There are no assessment criteria for assessing the systemic risk of individual insurers and therefore insurers are not subject to a systemic risk assessment. While the FSA conducts monitoring of individual insurers through its holistic framework monitoring of each insurer's liquidity risk management, individual insurer's own stress testing of macroeconomic exposure and insurer determined risk limits with respect to interconnectedness, this does not constitute a systemic risk assessment.</p> <p>The aggregated data published by the FSA in its annual report is highly summarized profitability and solvency data. It does not include detailed breakdown of sources of revenues by business line, costs, details of asset holdings, details of technical provisions that are disclosed by many other supervisors. There is no one place to find data about the Japanese insurance sector as in other major insurance markets.</p>
ICP 25-- Supervisory Cooperation and Coordination	O	<p>The FSA has a well-developed framework for cross-border cooperation, focusing mainly on the supervisory colleges which it leads for Japanese IAIGs and the large number of colleges for foreign-owned IAIGs in which it participates as an involved supervisor. The framework for cross-border crisis management is less developed. Further development of cross-border supervision and even a return to regular in-person college meetings may be hampered by the FSA's low level of resources and (except for the Japanese IAIGs) the limitations of its current supervisory model.</p>

Table 2. Japan: Summary of Observance Level

Category	Number of CPs
Observed (O)	6
Largely observed (LO)	12
Partly observed (PO)	6
Not observed (NO)	0
Total	24

Source: IMF staff.

E. Recommendations

Insurance Core Principle	Recommendations
ICP 1-- Objectives, Powers and Responsibilities of the Supervisor	<ul style="list-style-type: none"> The FSA and ministries responsible for the supervision of insurance activities of cooperatives (kyosai) should increase cooperation on regulatory initiatives and supervisory practices, prioritizing coordination between the FSA and MAFF on the regulation and supervision of the largest institutions conducting insurance activities, including the application of fully risk-based solvency requirements in the medium term, they should periodically review the need for changes to the organization of regulatory and supervisory responsibilities for kyosai business.
ICP 2-- Supervisor	<ul style="list-style-type: none"> The Government of Japan should delegate to the Commissioner of the FSA the licensing powers currently reserved to the Minister of State for Financial Services. The government should also review (taking into account constitutional constraints) whether it can provide for increased freedom for the FSA to determine its expenditure budget and to finance itself independently of other parts of the government. The FSA should take steps to allocate to insurance sector supervision, over an appropriate timeframe and taking account of its overall budgetary resources, significant additional financial and human resources to support skills, and infrastructure as necessary. The FSA should build on existing high levels of disclosure about its strategic objectives and insurance sector supervisory work by publishing more information about the insurance sector itself rather than relying on industry publication of aggregate data.
ICP 5-- Suitability of Persons	<ul style="list-style-type: none"> The FSA should ensure that competence and integrity requirements (with appropriate definitions) apply to all persons within the scope of the ICP. The FSA should develop supervisory processes to assess, on risk-based principles, whether insurers are meeting their responsibilities on suitability of persons in practice.
ICP 7- Corporate Governance	<ul style="list-style-type: none"> The FSA should address the gaps in requirements identified in this assessment and amend its guidelines or initiate changes in legislation as appropriate. The FSA should review the Tokyo Stock Exchange's Code of Corporate Governance for provisions that should be included in its Guidelines (and applicable to all insurers) or in legislation, including standards of independence expected of outside directors. The FSA should establish risk-based tools and procedures for regular in-depth assessment of corporate governance, including board effectiveness, developing appropriate on-site monitoring tools such as interviews with board members.
ICP 8-- Risk Management and Internal Controls	<ul style="list-style-type: none"> The FSA should revise its Guidelines (or consider initiating changes to law or regulations) to set explicit and comprehensive expectations on the establishment and adequacy of all control functions within the ICP scope.

Insurance Core Principle	Recommendations
	<ul style="list-style-type: none"> • The FSA should establish risk-based tools and procedures for regular in-depth assessment of risk management and controls, including control functions, developing appropriate on-site monitoring tools such as interviews with board members and key persons in control functions.
ICP 9-- Supervisory Review and Reporting	<ul style="list-style-type: none"> • As part of the economic value-based solvency regulation introduction, the FSA should ensure that the frequency and audit of regulatory reporting is appropriate for the new framework. • Supervisory plans should be developed by the FSA for each insurer based on their risk profile detailing a cycle of supervision that involves supervisory activities, leading to revised risk assessment and to revisions of the supervisory plan as necessary. • A systematic approach to risk assessment of each insurer should be the foundation of supervisory plans of the FSA. The risk assessment should consider inherent risks, the quality of governance, risk management and controls and the possible impact of a failure of the insurer. • On-site inspections should be instituted as part of the regular FSA supervisory process, which will require an increase in staff resources as discussed in the context of ICP 2 and should generally be less intensive than the current practice under which inspections are used essentially as an enforcement tool.
ICP 10-- Preventive Measures, Corrective Measures and Sanctions	<ul style="list-style-type: none"> • The FSA will have to revise the Early Warning System (EWS) for the introduction of ESR which will use market valuation, and update methodologies and assumptions where relevant to reflect changes in insurer portfolios and market environment. • The FSA should publish more details of its EWS in order to encourage insurers to enhance their risk management processes to address a wide range of circumstances.
ICP 12-- Exit from the Market and Resolution	<ul style="list-style-type: none"> • Japanese authorities should carefully review the resolution framework and process of resolution for insurers to ensure clarity on the operations and procedures for resolution of insurers, insurance groups and IAIGs. In doing so, Japanese authorities should address any gaps where necessary, using the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions (FSB KAs) in particular the FSB KA's Assessment Methodology for the Insurance Sector as a best practice reference while also addressing: <ul style="list-style-type: none"> ○ The disconnect between J-GAAP or IFRS accounting and valuation under the soon to be introduced economic value-based solvency regulation which will require a clear trigger point for resolution to be determined in light of the revised regulatory requirements. ○ The increasing complexity of Japanese IAIGs with a focus on increasing foreign business.
ICP 13-- Reinsurance and Other Forms of Risk Transfer	<ul style="list-style-type: none"> • Supervisory guidelines should be updated by the FSA to require insurers to consider the impact of supervision in the reinsurer's jurisdiction and should be updated so that liquidity risk considerations in relation to reinsurance are explicitly required by insurers.

Insurance Core Principle	Recommendations
	<ul style="list-style-type: none"> As part of addressing ICP 9 recommendations to implement individual insurer supervision and risk assessment, the FSA should consider the importance of reinsurance arrangements for all insurers and direct supervisory resources to focus more on reinsurance arrangements of reinsurers that may be more vulnerable to issues with their reinsurance programs.
ICP 14-- Valuation	<ul style="list-style-type: none"> As planned, the FSA should introduce the economic value-based solvency regulation and ensure that all the requirements of ICP 14 are met.
ICP 15-- Investment	<ul style="list-style-type: none"> As part of revisions to the approach to supervision, the FSA should ensure that asset management practices at insurers are subject to review based on a risk assessment of the activities of individual insurers.
ICP 16-- Enterprise Risk Management for Solvency Purposes	<ul style="list-style-type: none"> As part of revisions to the approach to supervision, the FSA should ensure that risk management at insurers are subject to review based on a risk assessment of the activities of individual insurers.
ICP 17-- Capital Adequacy	<ul style="list-style-type: none"> As planned, the FSA should introduce the ESR in FY 2025 and ensure that all of the requirements of ICP 17 are met.
ICP 18 - Intermediaries	<ul style="list-style-type: none"> The FSA should review the limited areas where their approach does not clearly meet ICP standards (governance and some disclosure requirements) and make changes to existing Guidelines. The FSA should develop a process for risk-based supervisory work on agents and brokers (notwithstanding their current limited market share), focusing (for direct supervision) on larger entities and/or those assessed as higher risk; and (in indirect supervision) on insurance companies' monitoring of their agents.
ICP 19-- Conduct of Business	<ul style="list-style-type: none"> The FSA should strengthen assessment of conduct risks, market wide and at insurers and intermediaries, through enhanced market intelligence and supervisory work, including on-site supervision as appropriate.
ICP 20-- Public Disclosure	<ul style="list-style-type: none"> Supervisory assessment of insurers' disclosures should be addressed more systematically in relation to all individual insurers.
ICP 21-- Countering Fraud in Insurance	<ul style="list-style-type: none"> The FSA should establish risk-based tools and procedures for regular in-depth assessment of insurers' fraud risks and controls (potentially as part of a wider reform of supervision practices as recommended in the assessment of ICP 9 and other ICPs in this report). The FSA should develop specialist expertise in insurance fraud (in the context of an increase in staff resources as recommended in the assessment of ICP 2 and elsewhere in this report).

Insurance Core Principle	Recommendations
	<ul style="list-style-type: none"> The FSA (in cooperation with law enforcement agencies as necessary) and industry bodies should develop a strategy and action plan for addressing fraud risk which may imperil confidence in insurance.
ICP 23-- Group-wide Supervision	<ul style="list-style-type: none"> The FSA should have appropriate policies to include within the scope of group-wide supervision entities not currently captured (such as minority interests) where necessary to obtain a group-wide overview of risk. The FSA should strengthen the collection of information on significant individual entities within insurance groups building on its existing close collaboration with involved supervisors.
ICP 24 - Macroprudential Supervision	<ul style="list-style-type: none"> The FSA should coordinate with other ministries as relevant, for the purpose of macroprudential supervision to ensure all major entities conducting insurance activities are included in macroprudential supervision. The FSA should create a methodical approach to assessing the systemic risk of individual insurers, starting with assessment criteria and then regular exercises to assess systemic risk of individual insurers. The FSA should reconsider its approach to publication of data and requirements applicable to insurers with a view to publishing data on all insurers and granular aggregate data on the insurance sector to encourage research, analysis, and market discipline.

F. Authorities' Responses to the Assessment

46. The FSA would like to express our sincere gratitude to the IMF mission team for the efforts they have devoted to complete the assessment of compliance with Insurance Core Principles (ICP). We greatly appreciate their conducting the assessment in a fair, thorough and professional manner throughout the process.

47. Since the last Detailed Assessment of the ICP was conducted in 2012, there have been a number of changes surrounding the FSA's insurance supervision. The FSA has strengthened its supervisory framework for insurers' governance and enterprise risk management while also emphasizing group-wide supervision. Especially, the FSA has made significant steps towards the introduction of the Economic value-based Solvency Regulation, and also has incorporated elements of ComFrame and the Holistic Framework by the IAIS into our supervisory framework.

48. The FSA acknowledges the importance of upgrading our risk-based supervisory framework, which would require more resources. The FSA has strived to ensure policyholder protection and financial stability through a wide-range of thematic supervisory programs, including on governance, risk management, conduct risks and financial soundness. The FSA has acted swiftly and rigorously whenever any company-specific or sector-wide issues are identified. Nevertheless, we

agree that the risk-based supervisory framework could be enhanced, with more focus on monitoring individual insurers. We also agree with the importance of more “proactive” supervisory approaches, recognizing that achieving this would require more resources, as highlighted throughout this Detailed Assessment.

49. The FSA believes that the existing legislative and institutional arrangements already provide a solid foundation to address the abovementioned challenges. The Insurance Business Act and other key legislations provide the FSA with a wide range of powers and tools, and the Supervisory Guidelines function as a flexible and effective tool to set supervisory expectations. Our view is that coordination among authorities as well as the FSA’s resources could be strengthened under the existing institutional arrangements. We believe that taking an effective and pragmatic approach is extremely important when tackling the complex and wide-ranging challenges of enhancing our supervisory framework.

50. The FSA will continue to update our supervisory framework, so that we could respond even more proactively to challenges surrounding the insurance sector in Japan. One of the most immediate and important steps is the effective introduction of the Economic value-based Solvency Regulation, which will have significant implications for our risk-based supervisory approach. There are other areas where we could review our supervisory approach, building upon the findings in this Detailed Assessment. We will make sure to take steady steps to upgrade our supervisory framework, while being cognizant that prioritization is key given limited resources.

DETAILED ASSESSMENT

ICP 1	<p>Objectives, Powers, and Responsibilities of the Supervisor</p> <p>Each authority responsible for insurance supervision, its powers and the objectives of insurance supervision are clearly defined.</p>
Description	<p><i>Insurance authorities and their objectives</i></p> <p>Legislation identifies the FSA as the principal regulator of insurance and assigns to it responsibilities for: (i) ensuring the stability of the financial system in Japan, (ii) protecting depositors, insurance policyholders and securities investors, etc., and (iii) ensuring smooth finance functions (Article 3(1) of the Law on the Establishment of the FSA, (LEFSA)). The FSA is also required to assist the work of the Cabinet on policies related to its responsibilities (Article 3 (2) of the LEFSA).</p> <p>The LEFSA requires the FSA to address: (i) matters related to the planning of the financial system; (ii) matters related to supervision, including on-site inspection, of financial institutions including insurers (and insurance holding companies); (iii) matters related to the planning of a system regarding international business conducted by financial institutions; and (iv) matters related to international cooperation concerning the affairs for which the FSA is responsible (Article 4 of the LEFSA).</p> <p>These objectives of the FSA are mirrored in the purposes of the Insurance Business Act (IBA) which are to protect policyholders etc. by ensuring the sound and appropriate operation of insurance business etc., contributing to the stability of the lives of the people and the sound development of the national economy (Article 1 of the IBA). However, the IBA gives powers for insurance supervision to the Prime Minister. While most are delegated to the FSA under Article 313 of the IBA and Article 46 of the Cabinet Office Order for Enforcement of the IBA, those related to licensing and cancellation of a license are retained by the Prime Minister but delegated in practice to the Minister of State for Financial Services – see ICP 2.</p> <p>The FSA issues a strategic plan and other material making statements on how it interprets its objectives. Since a review and reform of its approach to supervision in recent years, it has sought to balance financial system stability and safety and soundness concerns with the need to develop financial intermediation, contributing to economic growth (FSA’s supervisory approaches: Replacing checklists with engagement, June 2018 and FSA’s Approaches to Prudential Supervision, March 2019).</p> <p>In a recent strategic plan, it required insurers to build sustainable business models and develop products meeting changes in customer needs; and stated that in cooperation with foreign authorities, it would encourage insurers to make steady progress in clarifying strategies and enhance group-wide governance in light of their recent overseas expansion</p>

to benefit from overseas economic growth (The FSA Strategic Priorities, July 2022-June 2023).

Legislation also identifies certain government ministries as supervisors of the insurance activities of cooperative organizations. Such insurance activities (kyosai), although targeted mainly at the members of the cooperative, falls within the scope of an insurance policy as defined in Article 2 (i) of the Insurance Act 2008, but is exempt from insurance business defined in Article 2 of the IBA and regulated under dedicated legislation.

For example, the insurance activities undertaken by the National Mutual Insurance Federation of Agricultural Cooperatives (Zenkyoren), one of the largest institutions conducting insurance activities in Japan, is supervised by the Ministry of Agriculture, Forestry, and Fisheries (MAFF) under the Agricultural Cooperatives Act. Other kyosai organizations are supervised by the Ministry of Health, Labor, and Welfare and the Ministry of Economy, Trade and Industry. The legislation on kyosai is similar to the IBA and ministries issue regulatory materials and supervise kyosai organizations. They communicate with the FSA on policy matters.

This assessment focuses on the insurance activities that are regulated by the IBA and supervised by the FSA.

Under Article 313(2) of the IBA and Articles 48 and 49 of the Cabinet Office Order for Enforcement of the IBA, the FSA has delegated certain powers to the Local Finance Bureaus (LFBs) of the Ministry of Finance (MOF), which are located in Japan's prefectures. The powers cover:

- Regulation and supervision of Small Amount and Short Term Insurers (SASTIs) (120 firms at end-March 2023 with total written premiums in the financial year 2022 of JPY 134.6 billion, less than 0.5 percent of the industry total); they can write only short-term (under one year for life, two years for non-life), small amount products (amount insured less than up to JPY 10 million depending on the product) and with a cap on total annual GWPs; SASTIs are subject to lower minimum capital than insurers, may operate as composites but are not covered by the Policyholder Protection Corporations.
- All insurance agents: full powers, including registration and enforcement, are delegated to the LFBs under 49 (1) of the Cabinet Office Order for Enforcement of the IBA.
- Insurance brokers: full powers, including registration and enforcement, are delegated to the LFBs under 49 (2) of the Cabinet Office Order for Enforcement of the IBA.

However, for both SASTIs and agents, the FSA retains certain enforcement powers (Articles 48(1) and 49(1) of the Cabinet Office Order for Enforcement of the IBA). It also has powers to order an agent or broker to submit reports or data and undertake inspections (Article 305 of the IBA). The power to issue an order to improve business operations (Article 306) is, however, delegated to LFBs. The FSA retains staff to support

the LFBs with supervision of SASTIs and intermediaries. It cooperates actively with LFBs in regulatory and supervisory work (see ICP 18).

The FSA also works with the Bank of Japan (BOJ), the Prime Minister and the Minister of Finance on financial stability issues through its membership of official bodies:

- the Council for Cooperation on Financial Stability, where it meets with the BOJ (usually the FSA Commissioner and the Deputy Governors of the BOJ); and
- the Financial Crisis Response Council which advises the Prime Minister on systemic risks at the point of a financial institution's failure (chaired by the PM, it comprises the Minister of Finance, the Minister for State for Financial Services, the Commissioner of the FSA, the Governor of the BOJ, and the Chief Cabinet Secretary).

Powers

The overall regulatory framework consists of a hierarchy of different instruments, some falling to the Government of Japan to issue and others to the FSA.

- Primary legislation such as the IBA is approved by the Cabinet and passed by the Diet, i.e., Parliament; the FSA has the authority to draft laws and Cabinet Orders (see below) which are relevant to insurance supervision. Laws provide powers to ministries, agencies etc. to issue secondary forms of legislation.
- Orders for enforcement of laws that are approved and issued by the Cabinet; the IBA sets out the areas of regulation for which such orders may be issued. The Order for Enforcement of the IBA sets out a number of important provisions, including delegation to LFBs.
- Ordinances for enforcement of laws which may be issued by ministries or by the FSA, again in areas specified in law and which usually set out detailed requirements (many of those relevant to ICP observance are set out in the Ordinance for Enforcement of the IBA (OEIBA), also referred to, for example in the English language version of the FSA's Guidelines, as a "regulation").
- Guidelines, which may be issued by the FSA. The FSA's Comprehensive Guidelines for Supervision of Insurance Companies (Guidelines) set out expectations on a wide range of issues, including many that are the subject of ICP standards. Some of the guidelines take the form of issues to be addressed by supervisors ("points of view"). The FSA considers the guidelines to be binding on insurers and in discussions for the purposes of this assessment, insurers noted that they take the same view.
- Regulatory notices which may be issued by ministries or by the FSA and which concern matters of detail.

In addition, the FSA issues "no action letters" in response to inquiries from insurers intermediaries and non-insurance companies, for example on how a new product or service may be affected by the regulatory framework. The FSA has issued rules on its

	<p>approach and procedures for companies to follow are set out in FSA's guidelines (III-1-9-3). Answers to inquiries are posted to the FSA's website.</p> <p>Under the IBA and the OEIBA (and excepting the powers reserved to the Prime Minister/Minister of State for Financial Services), the Commissioner of the FSA has a broad range of authority, including to request information (Articles 128 and 271-27 of the IBA); to issue orders for business suspension and business improvement and to take corrective actions generally (Articles 132 and 271-29); to conduct inspections and off-site monitoring; and to approve insurance products. It has powers to issue regulatory material including ordinances and guidelines.</p> <p>The FSA has no powers to waive or modify its requirements in their application to individual insurers or intermediaries. It lacks an explicit power to apply requirements to an individual insurer or intermediary, for example to impose additional solvency margin requirements.</p> <p>The FSA has powers to undertake group supervision (it has adopted the direct approach, applying consolidated solvency requirements, for example, since 2012). There are requirements that insurance holding companies (IHCs) be licensed. The FSA has extensive supervisory powers, including to require reports from the IHC and its subsidiaries, the insurer's subsidiaries, major shareholders and outsourcing service providers; and to conduct on-site inspections. The FSA's general powers over insurers apply also to IHCs; for example, the FSA may request an IHC to submit a business improvement plan (Articles 271-29 of the IBA).</p> <p><i>Review and request for amendments to laws relating to insurance etc.</i></p> <p>The FSA has requested the government to enact amendments to the IBA, which have been passed by the Diet. Recent, relatively minor changes were made to the IBA, but there have not been major revisions in recent years.</p>
Assessment	Largely Observed
Comments	<p>The FSA is clearly identified as the principal insurance sector authority and is empowered to issue certain regulatory requirements and to supervise insurers and intermediaries including groups. Responsibilities retained by Minister of State for Financial Services of Japan, including decisions on licensing, are also clearly established as are arrangements to empower the Local Finance Bureaus by delegation of FSA responsibilities. The FSA focuses mainly on the statutory objectives emphasizing policyholder protection and financial stability. However, its aim of balancing these objectives with meeting the needs for development of the insurance sector, with wider economic benefits, could give rise to conflicts.</p> <p>This assessment covers FSA's responsibilities only. The separate institutional and regulatory arrangements for the insurance activities of cooperatives (kyosai), accounting for some 15 percent of total premium income and including one of the largest institutions</p>

	<p>conducting insurance activities in the country, are also well-established. However, they could give rise to differences in approach (including on solvency requirements) and in levels of protection for policyholders that are not justified by differences in the markets. They also hamper effective macroprudential supervision covering the whole sector. Further, while there is ad hoc cooperation in practice, there are currently no standing arrangements for coordination and information-sharing between the FSA and responsible ministries, even on supervision of the largest institutions conducting insurance business. It is understood that by contrast, responsibilities for supervision of banking business within cooperative organizations are shared between the FSA and relevant ministries.</p> <p>It is recommended that the FSA and ministries responsible for the supervision of insurance activities of cooperative organizations (kyosai) should increase cooperation on regulatory initiatives and supervisory practices, prioritizing coordination between the FSA and MAFF on the regulation and supervision of the largest institutions conducting insurance, including the application of fully risk-based solvency requirements; and they should periodically review the need for unification of insurance sector responsibilities.</p>
ICP 2	<p>Supervisor</p> <p>The supervisor is operationally independent, accountable and transparent in the exercise of its responsibilities and powers and has adequate resources to discharge its responsibilities.</p>
Description	<p><i>Independence from undue political interference</i></p> <p>The FSA is established as an external agency of the Cabinet Office (Article 49 of the Act for Establishment of the Cabinet Office and Article 1 of the LEFSA). It is accountable to the Diet (Parliament), which can and does request that FSA staff attend and answer questions, for example when the Diet is conducting examinations or investigations or is considering draft legislation which the FSA has submitted. The FSA does not, however, send an annual report to the Diet, although it does publish details of its activities, including in an annual report. Nor does it appear annually at the Diet for a general review of its work.</p> <p>The insurance regulatory and supervisory powers set out in the IBA are assigned to the Prime Minister (PM), as the head of the Cabinet Office, but these powers are generally delegated to the Commissioner of the FSA under Article 313 (1) of the IBA. However, Article 46 of the OEIBA provides that certain powers are retained by the PM:</p> <ul style="list-style-type: none"> • powers to grant and to revoke licenses to carry on insurance business license under Articles 3, 185 (foreign insurers) and 219 of the IBA; • powers to approve the establishment of an Insurance Policyholders Protection Corporation under Article 265-9 of the IBA; and • authorization of an insurance holding company (IHC) and revocation of the authorization under Article 271-18 and Article 271-30 of the IBA.

These powers of the PM related to licensing are in practice delegated to the Minister of State for Financial Services (an office currently held by the Minister of Finance) under the Financial Services Agency Document Approval Rules. The Minister takes licensing decisions (see ICP 4) based on proposals submitted by the FSA. The FSA's experience is that it can and does decline to take proposals to the Minister when it considers that they do not meet the licensing conditions (applications are then invariably withdrawn); and that the Minister accepts FSA recommendations to grant or withdraw a license.

The FSA is almost entirely funded by the government and its overall budget, including insurance sector work, is set by law as part of the general government budgeting process (a more independent funding model may not be possible under the Constitutional framework). The FSA makes a bid for and generally secures the budget it considers necessary to fulfil its responsibilities (JPY 23.19 billion in FY 2023, an increase of JPY 560 million from the previous year). The total number of staff covered by this budget has been increasing and stood at 1649, an increase of 15 from the previous year.

Independence from undue industry interference

The FSA consults with the insurance sector on new regulatory proposals etc. and makes extensive use of advisory groups involving industry as well as academic and other outside representatives (for example in planning the new economic value-based solvency regulation – see ICP 17). However, the FSA is responsible for decisions on the use of regulatory and supervisory powers where not reserved to the minister. There are no industry representatives involved in the governance of the FSA, which does not have a board or governing body. Senior management are not generally drawn from the industry.

Legal protection

As an agency within the Government of Japan, the FSA is subject to the National Public Service Act and rules made by the National Personnel Authority. The effect of these is to protect current and former staff of the FSA against lawsuits, where they have taken actions in good faith and legally. The FSA itself can be sued but cannot be held liable unless it exercised power illegally, in which case the legislation provides for redress to the affected party. In the past five years, The FSA does not have experience of legal action being brought against it or a member of staff based on the exercise of its powers against any insurer.

Appointment and dismissal of governing body

The FSA Commissioner and staff are all national public officials subject to the National Public Service Act. In the absence of a board or other form of governing body, the key appointments are the Commissioner and senior officials. The Prime Minister has the authority to appoint the Commissioner and staff in the ranks of department head or higher ("designated position"), while the Commissioner appoints officials in the ranks of section chiefs and lower (Article 55 (1) of the National Public Service Act). The Commissioner is not appointed for a fixed term.

As public officials, all FSA staff, including the Commissioner, may not against their will be demoted, placed on administrative leave or dismissed, unless for specified causes, which include: (i) unsatisfactory performance of duties; (ii) mental or physical disorders; (iii) lack of other qualifications required for the position; or (iv) the individual has become redundant following a reorganization that eliminates the individual's post (Articles 75 and 78 of National Public Service Act).

Other than as part of the regular rotation of FSA staff at senior (and many other) levels within the FSA or wider Government of Japan, no Commissioner or other staff member in a designated position has been transferred or dismissed by the Prime Minister in recent years.

Accountability and organization of the FSA

The FSA is accountable to the Diet and other stakeholders. It publishes extensive material on its strategic plans (covering all its responsibilities, including insurance, and typically over a one-year period) which includes a report on key outcomes of its supervisory activities as well as its work plan for the year ahead. In respect to insurance sector work, it publishes annually a full Insurance Monitoring Report that sets out the issues and challenges facing the sector and how it has addressed these (as well as key findings) in its supervision work. Information on its use of key powers (corrective actions and sanctions) is published in a spreadsheet available on its website.

The organizational structure of the FSA is clearly defined as are decision-making responsibilities. The Act on the Establishment of the Cabinet Office, the Order and Ordinance for Organization of the FSA and FSA Organization Rules stipulate in detail the allocation of departments and bureaus, management posts, and operations and responsibilities of these departments and bureaus. Where these orders are issued by the Cabinet Office, the FSA provides input and they are regularly reviewed.

Application of requirements consistently

Decision-making within the FSA relies on the appropriate and timely escalation of proposed decisions to management, including to the Head of the Insurance Business Division and senior management of the Supervision Bureau. There is cooperation and coordination within teams but no formal structures such as committees dedicated to ensuring the appropriate inputs into decisions and fostering consistency. There is no risk committee, for example, or other body overseeing the allocation of resources to key risks, although in practice the FSA focuses much of its work on cybersecurity and other issues spanning sectors regulated by the FSA – the Risk Analysis Division then has a key role in organizing the work. There is no formal quality assurance function charged with ex post reviews of how decisions have been taken in practice and the quality and consistency of supervisory judgments.

Rights of appeal

There are rights of appeal against administrative actions taken by the FSA (or by the Minister) in respect of insurers, intermediaries, and individuals. Such parties may seek administrative review under Article 2 of the Administrative Appeal Act or a lawsuit for revocation of administrative actions under Article 8 of the Administrative Case Litigation Act. There are no procedures within the FSA providing for independent review of decisions. In the past five years, no appeal has been made under the provisions of the Administrative Case Litigation Act for revocation of an FSA (or ministerial) decision.

Any decision subject to appeal, for example a decision to remove a license, is not subject to an automatic stay of execution pending resolution of the appeal (Article 25 (1) of the Administrative Complaint Review Act and Article 25 (1) of the Administrative Case Litigation Act).

Protection of confidentiality

The National Public Service Act requires the FSA and its current and former staff to protect the confidentiality of information and prescribes penalties, including dismissal and imprisonment, for wrongful disclosure FSA (Articles 100 (1) and 109 of the National Public Service Act). The FSA has procedures to protect confidential information in practice, including by denying requests to release such information other than when required by law, or when requested by another supervisor who has a legitimate interest and the ability to protect its confidentiality (see ICP 3).

There have been no cases in recent years where FSA has failed to protect confidential information.

Transparency

The FSA publishes materials on its activities. All regulatory material including primary legislation, Orders and Ordinances etc. is available on Government of Japan and/or FSA websites and in the Official Gazette, as are the FSA's other materials, including the key Guidelines relating to insurance. "No action letters" issued to individual insurers etc. (see ICP 1) are also published by the FSA.

The FSA is required to consult on draft requirements (Article 39 of the Administrative Procedure Act) and does so in practice. Draft legislation etc. is published on the FSA website. Major initiatives such as the recent reform of its supervisory approach and the planned introduction of the ESR (see ICP 17) are the subject of extensive consultation with stakeholders, sometimes including dedicated advisory groups.

Comprehensive information on the insurance sector itself, including the insurance activities of cooperatives (kyosai business), the context for regulation and supervision, is not readily available on the FSA website or elsewhere. Information on the relevant sector (life, general, SASTI and kyosai) can be found on the separate trade association websites. The FSA website includes lists of licensed insurers and IHCs, and certain aggregate statistics on life and non-life sector are published in the Annual Report.

Resources

The FSA has three bureaus: the Strategy Development and Management Bureau (609 staff in June 2023), the Policy and Markets Bureau (190) and the Supervisory Bureau (387). (Article 2 of the FSA Organization Order). Most insurance sector work is carried out in the Insurance Business Division within the Supervisory Bureau, but some other work is done in the International Affairs Office and Risk Analysis Division (within the Strategy Development and Management Bureau) and Planning and Management Division (within the Policy and Markets Bureau). The Insurance Business Division organization and resource allocation is show in the Table.

Overall resources allocated to insurance sector regulation and supervision comprise 88 in the Insurance Business Division and around 40 staff in other roles within the FSA. There are also an estimated 50 staff involved in insurance sector work at the Local Finance Bureaus (see ICP 1) and some allocation of resources to banks (where they act as insurance agents) in the Banking Business Divisions. There are small numbers of staff at the ministries supervising kyosai organizations.

The organization and resourcing of the Insurance Business Division, which leads on supervision and policy development for prudential and business conduct issues but excluding Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) work, are described in the Table below. Resources are focused on off-site monitoring, including product approval work, and resources available for on-site inspections are limited (see ICP 9). Staff are sourced mainly from within the FSA. Regular rotations of staff, a feature of civil service staff management, applies to FSA staff, although some now remain in post for longer than the normal two years.

As it does not use external experts, the FSA must develop specialist expertise itself (it provides training and study opportunities) or through recruitment. It has been able to recruit qualified actuaries (there were nine at the time of this assessment), but they cannot always be used flexibly within insurance supervision where they are expected, as many are, to return to the industry after a period at the FSA. The IT resources supporting insurance supervision were reported as adequate and there are planned enhancements to FSA-wide systems that will facilitate the management and analysis of regulatory data.

	<p style="text-align: center;">Organization and Resourcing of FSA’s Insurance Business Division</p> <p>JAPAN FSA - Insurance Business Division</p> <p>The number of employees at each office is shown in (). Moreover, Some offices employ part-time staff responsible for general affairs.</p> <p>Source: FSA.</p> <p><i>Outsourcing</i></p> <p>There is no provision in the IBA for outsourcing of supervisory work and the FSA does not, for example, engage consultants or advisors to carry out supervisory tasks.</p>
<p>Assessment</p>	<p>Partly Observed</p>
<p>Comments</p>	<p>Although it is an agency within the Government of Japan, with the benefits of close cooperation with as well as accountability to the Diet and Cabinet, the delegation of most powers to the Commissioner gives the FSA a high degree of operational independence and protection from undue political interference. Nonetheless, the reservation to a minister of key licensing powers and the FSA’s dependence on the central government budgeting process expose it to potential interference, even if the assessment identified no evidence of any such interference in practice. In relation to the insurance sector, the FSA balances openness and accountability, including due consultation on proposed requirements, with independent decision-taking. Although it is generally operating with a high degree of transparency there is scope for FSA to publish more information on the insurance sector.</p> <p>Insurance sector resources are low in relation to those available to other insurance supervisors facing comparable tasks (a large insurance sector with significant numbers of IAIGs), particularly given the strategic challenges in the sector, as set out in the FSA’s</p>

	<p>Insurance Monitoring Report, and regulatory change such as the introduction of the ESR. Analysis and discussions for this assessment highlighted areas where the FSA's work, for example monitoring of insurers (off-site and on-site) and closer engagement with the overseas operations of Japanese groups, is constrained by low levels of resource. Regular rotations of staff, especially in more senior positions, despite its advantages in terms of career development, also appears to constrain effective supervision, including the development of specialist expertise.</p> <p>The FSA has been growing staff numbers gradually over recent years in line with the overall growth of the FSA. It plans to bid for several more in the next budget process. However, an even more significant change in the level of resources now appears necessary, particularly in the Insurance Business Division for frontline supervision work, if FSA is to meet its objectives and improve its level of observance of the ICPs.</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> • the Government of Japan should delegate to the Commissioner of the FSA the licensing powers currently reserved to the Minister of State for Financial Services; the government should also review (taking into account constitutional constraints) whether it can provide for increased freedom for the FSA to determine its expenditure budget and to finance itself independently of other parts of the government; • the FSA should take steps to allocate to insurance sector supervision, over an appropriate timeframe and taking account of its overall budgetary resources, significant additional financial and human resources to support skills, and infrastructure as necessary; and • the FSA should build on existing high levels of disclosure about its strategic objectives and insurance sector supervisory work by publishing more information about the insurance sector itself rather than relying on industry publication of aggregate data.
ICP 3	<p>Information Sharing and Confidentiality Requirements</p> <p>The supervisor obtains information from, and shares information with, relevant supervisors and authorities subject to confidentiality, purpose and use requirements.</p>
Description	<p>The FSA has powers to request other supervisory agencies, domestic and foreign, to provide information, where deemed necessary cooperation to carry out its functions. The FSA has signed the IAIS Multilateral Memorandum of Understanding (MoU) and has also concluded bilateral MoUs ("Exchanges of letters") with several foreign supervisory authorities. Signatories to such frameworks have confirmed the objectives of information exchange and provisions on the protection of confidentiality. For example, in an Exchange of Letters with the German regulatory authority dated 2019, the FSA commits to exchange of confidential information subject to confidentiality, purpose and use requirements.</p> <p>In practice, the FSA now relies on the MoU to provide the basis for exchange of</p>

	<p>information with other signatories and is not actively developing new bilateral agreements.</p> <p>However, the existence of any form of agreement on information exchange is not a prerequisite for the FSA to exchange of information.</p> <p><i>Requests by the FSA</i></p> <p>Article 5 of the LEFSA empowers the FSA to request other agencies to “submit materials, provide explanations, and provide other necessary cooperation”. In practice, the FSA makes requests to relevant supervisors and other authorities to provide information, including information necessary for the supervision of cross-border insurance groups (through supervisory colleges and bilaterally).</p> <p>Where the FSA receives information in response to such requests to other agencies, its policy is to use the information only as requested and not for other purposes, except that where it proposes to use information for other purposes or communicate it to other parties, it will obtain prior consent from the agency that provided the information.</p> <p>If the FSA were to be required to disclose such confidential information to a third party, its policy would require it to notify and seek prior consent from the relevant supervisor or, where consent is not given, to take all available actions to counter the request for disclosure of information from a third party. In practice, the FSA has not disclosed any confidential information received from other supervisors.</p> <p><i>Requests to the FSA</i></p> <p>Article 4 (24) of the LEFSA empowers the FSA to provide information to other parties in the context of its responsibilities for matters concerning international cooperation pertaining to affairs. The scope of the provision is drawn widely and not limited to specific types of agency (or specific “gateways”) or purposes of sharing information, as is the case on some other jurisdictions.</p> <p>Most exchanges take place within the framework provided by the MoU or in the context of supervisory colleges (see ICP 25). If there is a request to the FSA from an authority which is not party to an agreement, it will exchange information only after confirming the purpose of the request (reverting to the requesting agency for more information if necessary), the need for information and whether the requesting authority has taken appropriate measures to protect confidential information. The law does not require strict reciprocity and this issue has not arisen in practice.</p> <p>Requests for information are usually handled by the relevant supervisory area, with support as required from the International Affairs Office of the FSA and transmitted to the requesting party using appropriate channels. There are no specific internal procedures for handling such requests, but the approval of FSA senior management for sharing confidential information is sought where necessary on an ad hoc basis.</p> <p><i>Practices</i></p>
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	<p>The FSA's supervisory guidelines include summary material on exchange of information and wider cooperation with foreign supervisory authorities in respect of group supervision. They require FSA to provide information to foreign authorities that contributes to their supervision of insurance groups and proactively promote exchange of opinions with them. For example, in the case of insurance groups where FSA is the group-wide supervisor, they require FSA supervisors proactively to exchange information on financial soundness and appropriateness of business operations (Guidelines VII-5-2).</p> <p>Many of the requests for exchange of information made to or by the FSA arise from its role as group-wide supervisor of insurance groups (many others relate to information required about persons known to FSA from their employment in key positions at Japanese insurers). The FSA staff identified cases when they have shared specifically confidential information about an insurer, in one case with the home supervisor of a foreign-owned insurer in connection with a concern that led to the issuance of a business Improvement order (see ICP 10). The FSA has exchanged information and views with other supervisors through its supervisory colleges, covering the business and financial condition of the group and crisis management arrangements.</p> <p>However, during consideration of licensing applications from foreign insurers, the FSA does not always proactively exchange information with the relevant foreign insurance supervisors, although it does use its membership of supervisory colleges to do so, where applicable (see ICP 4).</p> <p>In the case of exchanges with domestic agencies, the FSA can and does exchange with the BOJ, the National Police Agency, the Japan Financial Intelligence Center (JAFIC), the Financial Intelligence Unit in Japan, and the ministries responsible for supervising the insurance business of cooperative organizations.</p>
Assessment	Observed
Comments	The FSA has widely drawn powers to exchange information with other agencies and exchanges (and protects) confidential information in practice, with domestic and foreign authorities. However, there is a scope for the FSA to exchange information more proactively with home supervisors in the case of consideration of applications for new licenses from foreign-owned insurers.
ICP 4	<p>Licensing</p> <p>A legal entity which intends to engage in insurance activities must be licensed before it can operate within a jurisdiction. The requirements and procedures for licensing must be clear, objective and public, and be consistently applied.</p>
Description	<p><i>Definition of insurance for the purposes of licensing insurers</i></p> <p>There is a definition of life insurance business (Article 3(4) of the IBA) and a definition of</p>

	<p>non-life insurance business (Article 3(5) of the IBA). The same entity cannot obtain both a life insurance business license and a non-life insurance business license (Article 3(3) of the IBA).</p> <p>A person who has conducted Insurance Business without obtaining the license shall be punished by imprisonment with work for not more than three years or a fine of not more than three million yen, or both (Paragraph 1 of Article 315 of the IBA).</p> <p>Cases where unlicensed insurance business are conducted are brought to the attention of the FSA through complaints from the general public. In such cases, a hearing would be required for the person or persons involved in the suspected unlicensed insurance business. If a person is found to be conducting insurance business without a license the first action is for the FSA to demand correction by demanding they stop their operation. Then information would be shared with law enforcement.</p> <p><i>Exceptions to the requirement for a license to conduct insurance business</i></p> <p>Even though an entity is conducting business that meets the definition of insurance business it may be exempted from obtaining a license under the IBA if:</p> <ul style="list-style-type: none"> • There are special provisions in other laws (for example, <i>kyosai</i> mentioned in relation to ICP 1). • Activities conducted by the specified organization only for its members (for example companies providing insurance-like fringe benefits to employees, the FSA could not provide concrete examples). • Businesses with fewer than 1000 counterparties (however a license is required if a policy amount exceeds half-a-million JPY if the policyholder is an individual or ten million JPY if the policyholder is a corporation). <p><i>Licensing insurers</i></p> <p>An insurer can be a Stock Company or a Mutual Company which has set up the following certain governance structures (Article 5-2 of the IBA). Foreign insurers can be established as either subsidiaries where the requirements of Article 3 of the IBA apply or as branches (Article 185 of the IBA).</p> <p>Licensing criteria stipulated include (Paragraph 1 of Article 5 of the IBA):</p> <ul style="list-style-type: none"> • The applicant has a sufficient financial basis to perform the business of an insurer soundly and efficiently; • The applicant has good prospects for income and expenditure (future business plan) pertaining to the business; • The applicant has, in light of personnel and structure the knowledge and experience necessary to be able to carry out the insurance business appropriately, fairly and efficiently, and sufficient social credibility;
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- The contents of the insurance contract are consistent with policyholder protection; and,
- Calculation procedures for insurance premiums and technical provisions are reasonable and proper, based on actuarial science.

Life insurers have to demonstrate in their business plans that they will be profitable before the end of the tenth year of business. Non-life insurers have to demonstrate they are expected to be profitable before the end of their fifth year of business. Article 10-2 of the OEIBA sets out these requirements.

The applicant has to demonstrate adequate capital to the FSA (Article 4(1) of the IBA) and this must not be less than one billion yen (Article 6 of the IBA and Article 2-2 of the Cabinet Office Order for Enforcement of the IBA).

Through the FSA review of licensing, the applicant must demonstrate its ability to meet governance, suitability of persons, risk management and internal controls that apply to an operating insurer. These requirements are not explicitly set out in licensing requirements.

Decisions on licensing insurers are retained by the Minister of State for Financial Services (i.e., not delegated to the Commissioner of the FSA), however the Prime Minister may retain decision making in exceptional and important cases. See ICP 2 for further discussion.

Article 246 of the OEIBA stipulates that the FSA shall endeavor to make licensing decision in 120 days.

Practically, licensing decisions are largely made within the FSA. There is an extensive pre-application engagement with prospective applicants where aspects of the application are improved before formal submission. In practice, applicants do not submit applications that are not likely to succeed.

When an applicant contacts the FSA wishing to apply for an insurance license they are put in contact with the relevant section: Life Insurance Section for life insurance applications and the Non-Life Insurance Section for non-life insurance. There are extensive discussions with a focus on ensuring the viability of the applicant as per the requirements of the OEIBA. There is also an assessment that the applicant will be able to meet all of the requirements set out in the Guidelines relevant for the operation of the company including governance, risk management and internal controls. The knowledge of board members is also a key focus. The application is improved through the engagement with the FSA until it is ready to be submitted in a form that is likely to be approved. If the FSA would not recommend the application goes forward, they will inform the applicant and as a result the application would not be submitted. The process pre-application involves not just review of documentation but multiple hearings (approximately two-hour meetings) with senior executives of the applicant.

There are a number of officials involved in the licensing decision internally. The license application will not go forward unless supported by the Head of the Insurance Business

	<p>Division. The application is then reviewed by the Director-General of the Supervision Bureau. This is where most of the challenge occurs to the staff who prepare the recommendation for the license and ultimately the Director-General of the Supervision Bureau is most influential in making the decision to approve an application. Finally, the Commissioner of the FSA must be satisfied that the application can go forward to the Minister of State for Financial Services (currently also the Minister of Finance). The approval of the application at the Ministerial level is always relatively straightforward due to all the prior work of the FSA.</p> <p>There is no official rejection of applications because of all the pre-application process.</p> <p>There were no examples where license conditions were imposed. The FSA has made it a priority to engage in dialogue with the applicant so that the application could be approved without conditions.</p> <p><i>Publication of a list of licensed insurers</i></p> <p>The FSA publishes a list of licensed insurers by type of license at: https://www.fsa.go.jp/en/regulated/licensed/index.html.</p> <p><i>Foreign insurer applications and cross-border business</i></p> <p>The process of licensing a branch of a foreign insurer requires the home supervisor to provide a certificate that the establishment of the foreign insurer was carried out legally and that it is lawfully transacting insurance business in its home country. The FSA consults with home supervisors as necessary.</p> <p>Foreign insurers are not allowed to conduct business on a cross-border basis in Japan, they must be licensed as a subsidiary or branch. However, persons seeking insurance can apply to the FSA to obtain permission to obtain insurance cover from a foreign insurer. Applications are rare, about one per year, usually commercial insurance of the size and nature that may not be covered by Japanese insurers.</p>
Assessment	Observed
Comments	<p>The IBA and OEIBA contain extensive requirements for licensing of insurers. One concern noted under ICP 2 is that the decision to grant licenses to carry on insurance business are not delegated to the Commissioner of the FSA. That is not a matter for assessment under ICP 4 but is an issue raised under ICP 2.</p> <p>The FSA's process of working with applicants to ensure official applications for licenses are likely to be approved is an extensive process and a pragmatic approach. It means that in most cases the practical decision making about granting licenses is being made by the FSA.</p>

ICP 5	Suitability of Persons <p>The supervisor requires Board Members, Senior Management, Key Persons in Control Functions and Significant Owners of an insurer to be and remain suitable to fulfil their respective roles.</p>
Description	<p><i>Scope</i></p> <p>High level eligibility criteria are set out in the IBA (Article 8-2 (1)), covering separately (see ICP 7 for general features of the corporate governance framework):</p> <ul style="list-style-type: none"> • directors engaged in day-to-day business of an insurer (or, as applicable to the form of governance, a director and executive officer engaged in day-to-day business); • a corporate auditor of an insurer (or audit and supervisory committee member, where applicable); and • an audit committee member. <p>They are required to have “knowledge and experience”, as applicable, to carry out business management of an insurer or to supervise the execution of duties of directors of an insurer in an appropriate, fair and efficient manner as well as “social credibility”.</p> <p>The Guidelines elaborate briefly on the requirements, highlighting (as part of a range of supervisory viewpoints addressing insurers’ governance) that directors etc. should have knowledge and experience appropriate to their tasks (for example, Guidelines II-1-2-1 (2) (xi) A).</p> <p>FSA has not set out more detailed expectations of what would be appropriate knowledge and experience, taking the view that this will depend on the nature of the role and the nature, scale and complexity of the insurer’s business. The Guidelines do nonetheless set the expectation that the qualifications required for directors engaging in the ordinary business of an insurer (and executive officers) and auditors are “extremely high” (Guidelines II-1-2).</p> <p>The FSA interprets the requirement for social credibility to refer to absence of involvement in criminal activities, including no convictions etc. in Japan or elsewhere (see for example, Guidelines II-1-2-1 (2) (xi) B). The IBA also includes a prohibition on the appointment as director of persons who have been subject to bankruptcy proceedings (Article 8-2 (2)). Other provisions prohibit directors who have committed crimes.</p> <p>In addition, there are eligibility requirements on the “responsible actuary” whom insurers are required to appoint. The person must be a regular member of The Institute of Actuaries of Japan with necessary knowledge and a minimum number of years of experience of working in a field involving actuarial science (Article 120 (2) of the IBA, Article 78 of the OEIBA).</p> <p>There are no explicit suitability requirements applying to all members of senior management. Executive Officers are subject to the eligibility requirements mentioned</p>

above but only (in the IBA and Guidelines) in companies adopting one of the three approaches to corporate governance (the “three committees” model).

Nor are key persons in control functions included within scope of eligibility requirements explicitly, other than the responsible actuary (if in practice that person is acting as a key person in the actuarial function – see ICP 8). Some key persons in control functions may in practice be covered by the requirements on Executive Officers.

Major shareholders

The IBA defines such shareholders as entities with 20 percent or more of the voting rights of an insurer (held directly or indirectly or held jointly with others, or as an individual holding 15 percent or more of the voting rights as well as significant influence over the insurer (Article 2 (13) of the IBA).

Those intending to become a major shareholder must obtain authorization from the FSA (Article 271-10 (1) of the IBA). The criteria FSA must use include whether they would impair sound and appropriate business operation of an insurer, considering their acquisition funding, the purpose of their shareholdings or their financial conditions (and whether they fully understand the public nature of insurance business, and whether they have sufficient social credibility (Article 271 -11 (1) of the IBA, Article 209 of the OEIBA).

Persons must notify the FSA when they become a major shareholder or cease to hold voting rights that equal or exceed the threshold for falling within the definition of major shareholder, etc. (Article 271-32 (1) of the IBA). The requirement also applies explicitly to insurance holding companies (Article 271-32 (2) of the IBA).

In addition, when a major shareholder no longer conforms to the standards for authorization, the FSA can order it to take necessary measures for conforming to the standards (Article 271-14 of the IBA) and to rescind the authorization (Article 271-16 of the IBA).

FSA’s Guidelines III-2-11 sets out guidance on how supervisors should assess major shareholders at the time of a notification to take a shareholding and on a continuing basis. They include aspects relating to the financial soundness of the shareholder.

Assessment of suitability

Insurers are required to notify the FSA when any person has assumed or departed from certain positions (broadly those also covered by Article 8-2 (1) of the IBA – see above) (Article 85-1(2) of the OEIBA).

As part of supervision, the FSA checks the eligibility of such persons and of all directors, senior management and key persons in control functions and major shareholders as part of its off-site monitoring. Where the notification requirement does not apply, the FSA expects to be informed by insurers of new appointments.

The FSA carries out background checks on nominated persons, using its access to databases of past administrative actions, criminal records etc. It may call for a hearing (see

ICP 9) with a nominated person, especially where it considers that the person within the scope of the eligibility requirements in the IBA and Guidelines may not meet the eligibility requirements (Guidelines II-1-3-6(2)).

The FSA may take action for violation of Article 8-2 of the IBA, for example by issuing a business improvement order under Article 132 of the IBA (see ICP 10), which may cite shortcomings of a relevant person. Where a violation has been identified, the FSA may issue a business suspension order or require dismissal of a director etc. as well as be able to withdraw the license (Article 133 of the IBA, Guidelines II-1-3).

In practice, the FSA has taken actions, usually involving hearings and discussions that have led to directors etc. not being appointed, i.e., without the need for use of powers. For example, they have had cases where insurers and SASTIs sought to appoint directors or CEOs with limited or no relevant experience or, in one case, where the person had been found unsuitable at a different insurer in Japan. In respect to that other insurer, the FSA had issued a business Improvement order (details of which were published in July 2022) where a supervisory issue with the company was identified as having been caused in part by the failings of the CEO and other senior management. These actions have invariably led to the relevant person being dismissed (in the latter case before the Improvement Order was issued) or not appointed by the insurer.

Obligation on insurers to assess suitability and identify unsuitable persons

There is no explicit requirement in law or regulations on insurers to assess suitability. However, the FSA's Guidelines note, in the context of discussing supervisory actions (Guidelines II-1-3 (6) (iii)) note that insurers should take responsibility for considering the qualifications of individual directors, executive officers, auditors, audit committee members, and members of the audit and supervisory committee, taking into account the viewpoints set out in the Guidelines.

There is no explicit requirement in law or regulations on insurers to notify the FSA of circumstances that may materially adversely affect the suitability of its directors etc. However, there is a general obligation on insurers to notify FSA of adverse events that have occurred to the insurer or its subsidiary company (Article 85(1), item 27, of the OEIBA). The FSA has received such notifications in practice.

The FSA may check through supervision work that insurers are assessing suitability on an ongoing basis and making notifications to the FSA, but this is likely to occur only where they have identified an issue with a particular appointment.

Exchanges with other authorities

The FSA exchanges information with relevant authorities where necessary, for example when a candidate for a director of an insurer has experience working for a foreign insurer. As noted under the assessment of ICP 3, the FSA has in practice exchanged information about individuals with other authorities.

	<p><i>Groups, including ComFrame requirements</i></p> <p>There are limited legal or regulatory requirements on suitability of persons in positions with group-wide responsibilities.</p> <p>Directors, executive officers or auditors of an insurance holding company must not have been bankrupted (Article 271-19-2 of the IBA). In addition, the Guidelines (Section VII-2-2-1(i)) on Group-wide Governance) states that the representative director, directors, the representative executive officer, executive officers, auditors and managers of the management company of insurance groups must have the knowledge and experience necessary for performing their respective roles in light of the scale, complexity, internationality and the risks held by the insurance group.</p> <p>As in the case of the requirements applying to insurance companies, key persons in control functions (other than the responsible actuary) are not explicitly covered by these requirements and FSA has not specified what would amount to appropriate knowledge and experience for these purposes. Again, the FSA assesses persons in the context of the role and nature of the insurance group.</p>
Assessment	Partly Observed
Comments	<p>The legislation covers many of those persons within the scope of the ICP requirements and FSA receives and responds to notifications of new appointments. It focuses especially on the senior executive positions, regularly holding hearings with nominated persons and taking action where the person is considered unsuitable. It assesses major shareholders appropriately. Actions taken by the FSA have included requiring the removal of unsuitable CEOs, using supervisory discussion, although powers are also available to the FSA.</p> <p>However, the scope of the suitability requirements is not comprehensive. They do not clearly cover all directors (for both competence and integrity requirements) nor all persons holding senior management positions, including all key persons in control functions. There is limited information on FSA's expectations of the knowledge and experience of persons within scope. While there are expectations in the Guidelines on insurers' responsibility for assessing suitability (of persons within the scope of IBA requirements), the FSA has inadequate resources to conduct regular effective supervision to ensure that insurers are meeting their responsibilities in practice.</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> • the FSA ensure that competence and integrity requirements apply to all persons within the scope of the ICP; and • the FSA develop supervisory processes to assess, on risk-based principles, whether insurers are meeting their responsibilities on suitability of persons in practice.

<p>ICP 6</p>	<p>Changes of Control and Portfolio Transfers</p> <p>The supervisor assesses and decides on proposals:</p> <ul style="list-style-type: none"> • to acquire significant ownership of, or an interest in, an insurer that results in a person (legal or natural), directly or indirectly, alone or with an associate, exercising control over the insurer; and • for portfolio transfers.
<p>Description</p>	<p><i>Definition of major shareholder</i></p> <p>Article 2 Paragraphs 13 and 14 and the IBA define a Major Shareholder as an entity which has 20 percent or more of the voting rights of an insurer or an entity holding 15 percent or more of the voting rights accompanied with significant influence over an insurer. According to Article 2-2 of the IBA “Holding of the voting rights” includes both direct shareholding and indirect shareholding and voting rights of shareholders who hold an insurer’s voting rights jointly are combined.</p> <p><i>Supervisory approval of major shareholder</i></p> <p>A person who intends to become a major shareholder of an insurer requires authorization from the FSA (Article 271-10 (1) of the IBA). In approving a major shareholder, the FSA will consider the following criteria: (i) the sound and appropriate operation of the business of the insurer is unlikely to be impaired in light of the acquisition funds, purpose of holding and financial position of the applicant; and</p> <p>(ii) the applicant has sufficient understanding of the public nature of the insurance business and has sufficient social credibility (Article 271-11 of the IBA, Article 209 of the OEIBA).</p> <p>Guideline III-2-11-1 provides some elaboration on how the FSA will assess these criteria. An example of the approval of a major shareholder reviewed by assessors demonstrated the FSA consideration of the criteria set out in the Guideline.</p> <p>Guideline III-2-11-2 provides matters to be considered in supervision post-approval of major shareholders. This requires major shareholders to submit details about their financial position and business relationship with the insurer. The power for the FSA to require these reports is contained in Article 271-12 of the IBA. The IBA also gives the FSA the power to conduct on-site inspections of major shareholders (Article 271-13), and the ability to require a major shareholder to submit a business improvement plan (Article 271-15 of the IBA, Article 210-2 of the OEIBA). If the FSA finds that a Major Shareholder no longer satisfies the requirements set by the IBA, the FSA may order the Major Shareholder to take necessary measures to satisfy the requirements (Article 271-14 of the IBA) and may cancel the authorization granted (Article 271-16 of the IBA).</p>

	<p>When a shareholder becomes or ceases to be insurer's major shareholder, or becomes or ceases to be a holder of more than 50 percent of the voting rights of an insurer, it must notify the FSA (Article 271-32(1) of the IBA).</p> <p><i>Insurance Holding Companies</i></p> <p>A company which seeks to become a holding company whose subsidiary companies include an insurer, or a person who seeks to incorporate such a holding company through any of the following transactions or actions must obtain authorization in advance (Article 271-18 of the IBA). As for other licensing requirements, the power for authorization is not delegated to the Commission of the FSA but is delegated from the Prime Minister to the Minister of State for Financial Services (a role currently held by the Minister of Finance). The application must be assessed against the following standards:</p> <ul style="list-style-type: none"> • the applicant and subsidiary companies have good prospects for income and expenditure of the business; and • in view of its personnel structure, the applicant has the knowledge and experience that will enable the applicant to perform the business management of an insurer that is or is planned to become its subsidiary company appropriately and fairly and has sufficient social credibility (Article 271-19 of the IBA; Article 210-3 of the OEIBA). <p>An example of an insurance holding company application was reviewed. Files showed extensive review of projections and trends in past years of underlying businesses and a significant analysis of the structure and governance of the applicant.</p> <p>Suitability requirements are prescribed for directors of insurance holding companies – refer to ICP 5.</p> <p>The FSA also has the authority to require insurance holding companies to submit reports or materials (Article 271-27 of the IBA), conduct on-site inspections (Article 271-28 of the IBA), and require the submission business improvement plans (Article 271-29 of the IBA). In addition, the FSA has the authority to revoke an authorization, including in cases where the holding company has violated laws and regulations, the articles of association, or a disciplinary action (Article 271-30 of the IBA).</p> <p>When a shareholder becomes or ceases to be an insurance holding company, it must notify the FSA (Article 271-32(2) of the IBA).</p> <p><i>Shareholders with more than 5 percent voting rights</i></p> <p>An entity holding more than 5 percent of the voting rights of an insurer or insurance holding company must notify the FSA (Article 271-3 (1) of the IBA; Article 205 of the OEIBA).</p> <p><i>Changing status from mutual to stock company</i></p> <p>If an insurer changes its corporate status from mutual to stock company or from stock company to mutual, it must be approved by the FSA. (Article 80 and 96-10 of the IBA)</p>
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	<p>The criteria for approval of the change include:</p> <ul style="list-style-type: none"> • whether the insurer after changing its corporate status has the financial foundation sufficient to operate soundly and effectively; • whether the change will not harm rights of policyholders; and, • whether the change will not negatively affect the sound business operation of the insurer (Articles 80 and 96-10 of the IBA, Articles 41 and 46 of the OEIBA) <p>No examples of recent changes in status of insurers were available for review but given the processes observed for major shareholders and holding companies it is clear the FSA follows procedures set out in the IBA and OEIBA for such approvals.</p> <p><i>Transfers of insurance contracts</i></p> <p>An insurer may transfer insurance contracts to another insurer (Article 135(1) of the IBA). The FSA approval is needed in order to transfer insurance contracts (Article 139 of the IBA and Article 90 of the OEIBA). In determining whether such application is to be approved, the FSA will consider the following conditions (Article 90-2 of the OEIBA):</p> <ul style="list-style-type: none"> • that the purpose of the transfer of insurance contracts and the selection criteria for Transferred Contracts are not likely create a negative impact on protection of policyholders; • that the Policy Reserves are based on relevant actuarial methods after the transfer of insurance contracts; • relevant policyholder dividend reserves are set aside appropriately after the transfer of insurance contracts; • that the transferor insurer and the transferee insurer are expected to have an appropriate level of solvency after the transfer of insurance contracts; and • in cases where the transferor insurer distributes surplus to the affected policyholders, that such distribution will be made properly. <p>Transfers of insurance contracts are not a usual process in Japan. The only example that was able to be provided for discussion was the transfer of a SASTI's insurance contracts within a group. The process of the decision involving the FSA and relevant LFB appeared comprehensive and focused on policyholder protection.</p>
Assessment	Observed
Comments	Requirements for FSA approval of changes in control and portfolio transfers are comprehensive. The FSA demonstrated that it followed the requirements of the legislation and guidelines in the examples reviewed.

	<p>One issue that is not a matter for assessment is that there is a global trend towards structuring of reinsurance transactions for life insurers effectively as transfers of business. Given individual reinsurance transactions do not require the FSA approval, the FSA may wish to consider how it will address this global trend if it begins to occur in Japan in any material way.</p>
ICP 7	<p>Corporate Governance</p> <p>The supervisor requires insurers to establish and implement a corporate governance framework which provides for sound and prudent management and oversight of the insurer's business and adequately recognizes and protects the interests of policyholders.</p>
Description	<p><i>Framework of key requirements</i></p> <p>The main governance requirements on insurers are set out in the IBA and the OEIBA. There is also extensive material in the FSA's Guidelines, focusing on insurers generally and separately on groups. Insurers (including mutuals) are subject to requirements in general company law (the Companies Act).</p> <p>Insurers listed on the Tokyo Stock Exchange (TSE) are also subject to the TSE's Corporate Governance Code (CGC), most recently revised in 2021, which does not set binding requirements but to which listed entities must have regard on a "comply or explain" basis. The Code is mostly principles-based but includes detailed requirements, for example that at least one-third of the directors of companies be independent (two directors minimum for companies not listed on the main market). Unlisted insurers such as mutuals have regard to the CGC and report compliance on a voluntary basis.</p> <p>The FSA's Supervisory Guidelines set out an expectation that listed insurers make efforts to establish a control environment for governance of a level required by the CGC (Guidelines II-1-2). However, the FSA is not responsible for monitoring compliance with or enforcing the CGC.</p> <p>Governance requirements generally apply at the solo company level and to the group, including the IHC, where applicable.</p> <p>The requirements on insurers reflect and have regard to the different approaches to corporate organization set out in the Companies Act. All companies have a board of directors but approaches to oversight vary.</p> <ul style="list-style-type: none"> • Companies may have a corporate auditor (Kansayaku) or board of auditors; under a system unique to Japan, the Kansayaku audit the performance of duties by directors and management and have investigation powers by law; at least half of Kansayaku, who are appointed at the general shareholders meeting, must be external to the company and there must be at least one full-time Kansayaku. (Companies Act Articles 390-395). • They may adopt a "Three Committees" approach, where Nomination, Audit and

	<p>Remuneration Committees take oversight roles. Such companies must appoint one or more executive officers from directors or non-directors and delegate business administration to them (Companies Act Article 402).</p> <ul style="list-style-type: none"> • They may establish a Supervisory Committee (also known as Audit and Supervisory Committee) and, as with the Kansayaku model, appoint a representative director etc. (Companies Act Articles 399-2). <p>Most insurers in practice adopt the first approach. Companies must also appoint external auditors, which may be referred to as financial auditors to distinguish them from auditors under the first model described above.</p> <p><i>Board role and responsibilities</i></p> <p>The Companies Act sets out basic provisions on the authority and operations of boards (Articles 362-373). The IBA (Article 53-14) and the OEIBA (Article 23-8) require the board to:</p> <ul style="list-style-type: none"> • make decisions on the development of systems that ensure that directors and management execute their duties efficiently in accordance with laws and regulations, and on the appropriateness of business operations; and • supervise the execution of duties by executive directors. <p>The Guidelines (Section II) set out expectations by type of corporate organization, including that, for companies with a corporate auditor/board of auditors (Kansayaku), the board actively participates in the decision-making process regarding the execution of business and in the supervision of the execution of business by directors. The responsibilities of the corporate auditor/board of auditors are also set out in the FSA Guidelines (II-1-2-1-(3)).</p> <p>The CGC requires the board of directors (regardless of form of corporate organization) to perform effective oversight of the management and directors from an independent and objective standpoint and to establish appropriate internal control and risk management systems (Principle 4.3).</p> <p>In relation to corporate culture, business objectives and strategies of the insurer, the CGC sets an expectation that the board view the establishment of corporate goals and setting strategic direction as part of its roles and responsibilities.</p> <p>The FSA's Guidelines similarly set an expectation that boards articulate a corporate management policy based on the insurer's aims and a corporate management plan (Guidelines II-1-2-1). Supervisors are to focus on whether the board:</p> <ul style="list-style-type: none"> • cultivates corporate culture that emphasizes the importance of governance (Guidelines II-1-2-1-(2) (ix)); and • has presented the purpose of implementing enterprise risk management and established the risk management policy, taking into account the strategic goals of the company (Guidelines II-3-4-2-(1)).
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There are some requirements in general companies legislation on boards' internal governance practices (Articles 348 and 369 of the Companies Act and Article 53-14 of the IBA). However, there are no explicit requirements on the adequacy of resources to enable the Board to discharge its duties (ICP 7.3).

Board composition and requirements on individual board members

The IBA requires that directors have knowledge and experience to conduct management of an insurer appropriately, fairly and efficiently, and have sufficient social credibility (Article 8-2) (see ICP 5). There are restrictions on their serving concurrently in other posts.

The CGC (Principle 4.11) includes provisions on composition, balance of skills etc.: the board should be well balanced in knowledge, experience and skills in order to fulfill its roles and responsibilities, and it should be constituted in a manner to achieve both diversity and appropriate size. It should evaluate its effectiveness.

There are legislative provisions on directors' fiduciary duties to their company (Articles 53 and 53-15 of the IBA, Articles of 330 and 355 of the Companies Act). They are prohibited from making management decisions that would undermine the interests of the company and are restricted from using their positions to gain personal advantage or in ways that would cause detriment to the company (Articles 53-15 of the IBA and Article 356 of the Companies Act). Principle 4.5 of the CGC has similar provisions.

However, there are no explicit requirements on "exercise of independent judgment" (ICP 7.4) by all directors. (The CGC has relevant requirements, but as noted above, these are applied by the TSE only to listed companies.)

Remuneration requirements

Remuneration for directors is fixed by a resolution at a meeting of shareholders or member representative meeting (for mutuals) (Article 53-15 of the IBA, Article 361 of the Companies Act).

The Guidelines (Section II-5-3) set out detailed expectations on compensation for an internationally operating financial institution? Supervisors focus on whether a compensation committee has been established as well as an appropriate control environment to ensure the appropriate design and operation of the compensation structure; and whether the compensation committee, etc. has confirmed that the overall level of compensation will not have a material impact on the future adequacy of the financial soundness.

Insurers are also expected to disclose information on the control environment and the design of the compensation structure (Guidelines II-5-3-2(3)).

Oversight of financial reporting and the external audit

There are extensive requirements on the preparation and publication of financial reports. Insurers must prepare business reports for each year (if they have subsidiaries etc. on a consolidated basis) and submit them to the FSA (Articles 110 and 271-24 of the IBA).

These reports include financial statements including balance sheets and profit and loss statements (Articles 59 and 210-10 of the OEIBA). Financial statements must be audited by the external auditors (Article 54-4 of the IBA and Article 436 of the Companies Act.).

These requirements are not expressed explicitly in terms of the duties of the board of directors. The FSA's Guidelines do, however, set out an expectation that directors recognize the importance of effective external audits and periodically check whether audits are effectively functioning (Guidelines II-1-2-1(6) for companies with boards of auditors, although the same requirement applies to insurers using other models).

Timely and effective communications with the supervisor on governance

Insurers are subject to various notification requirements (including a general obligation to notify FSA of adverse events (Article 85(1), item 27, of the OEIBA) and FSA, in practice, expects them to communicate openly about all important matters including governance. For example, the FSA requests large insurance companies to submit their management meeting materials in a timely manner. However, there are no explicit requirements on the insurer's Board to have systems and controls to ensure appropriate, timely and effective communications with the supervisor on the governance of the insurer (ICP 7.9).

Role of senior management

There are extensive expectations in the Guidelines on the role of executive officers of a company with a nominating committee, etc. (Guidelines II-1-2-2-(3)). They include an expectation that such officers make decisions on business execution in accordance with the policy decided by the board of directors. There are general requirements on managers Supervisory Guidelines (II-1-2 (4)).

Supervisory work

The FSA carries out a range of supervisory work on governance, some of it also referred to in other parts of this assessment (ICPs 5, 8 and 9):

- they collect information about boards of directors and management committees from reviews of regularly-received papers and minutes, in the case of the larger insurers; they evaluate, for example, whether outside directors appear to be making full contributions at the board meetings (governance issues may also be discussed in the context of reviews of ORSAs – see ICP 16);
- they hold hearings with nominees for director or CEO roles and review suitability in the context of wider governance (see ICP 5); they also hold meetings at the level of the senior management of the FSA with CEOs of the major insurance groups annually; and
- they conduct thematic work on governance issues: in the case of the major groups, including IAIGs, they undertook a major exercise to assess the challenges of maintaining effective governance over international operations (the summary results were published in an Insurance Monitoring Report dedicated to work on IAIGs published in 2020 and findings continue to be followed up by supervisors).

They have required insurers to make improvements in governance, because of adverse findings (for example when they have identified weaknesses in corporate culture – see also the example described under ICP 5 above) or in response to the work on group governance issues (for example, they required corrective action of one group found not to be adequately coordinating with overseas subsidiaries).

However, the FSA does not have a systematic risk-based process for assessing all aspects of governance at all insurers, with the emphasis on the larger insurers and groups and including appropriate on-site evaluation (see also ICP 9). For example, supervisory staff do not regularly visit the offices of insurers or interview members of the board of directors to assess the effectiveness of the board (and/or board of auditors and committees) in overseeing executive management and controlling risk.

Groups including IAIGs

There are extensive requirements and supervisory expectations applying to groups, including (but not specifically) to IAIGs.

Both insurers themselves and IHCs are required to manage the business operations of an insurance group to which they belong (Article 106-2 of the IBA, Article 58-3 of the OEIBA and for IHCs, Article 271-21 of the IBA and Article 210-6-3 of the OEIBA).

“Managing business operations” in these provisions refers to such matters as ensuring the formulation and proper implementation of basic management policies; coordination in the event of a conflict of interests among group companies, development of systems to ensure that insurers and groups execute duties efficiently in accordance with laws and regulations; addressing matters that contribute to ensuring sound and appropriate operation of business of an insurance company group or an IHC group.

The Guidelines also require that the board of the management company (the company responsible for group-wide management, usually the IHC, where applicable) has:

- specified in documentation the group structure and the mutual relationship between group companies in order to help understand the group structure and identify risks and enhance risk management (Guidelines VII-2-2 (1) (ii));
- developed an appropriate control environment for governance to enable more effective supervision of the business management of the entire insurance group based on full understanding of the group-wide structure and the businesses and risks of group companies (Guidelines VII-2-2 (1) (iii)); and
- clarified the line of command and the control environment for reporting between group companies and the management company (Guidelines VII-2-2 (1) (ii)).

The Guidelines also require the board of directors, etc. of the management company, when setting group-wide goals and business strategy to pay attention, for example, to risks, laws etc. in relevant foreign jurisdictions and to fair treatment of customers, taking into account the profits and goals of group companies (Guidelines VII-2-2-(1) (iv)).

	As mentioned above, the FSA's supervisory work on IAIGs has included extensive work on group governance issues, which has also been discussed in supervisory college meetings.
Assessment	Largely Observed
Comments	<p>There are extensive requirements in general company law and insurance legislation, backed by wide-ranging material in the FSA's Guidelines. The coverage of group issues in the Guidelines is particularly developed, reflecting the recent systematic implementation of ComFrame requirements, although the material applies to all groups. The FSA undertakes supervision work, mainly off-site, on individual supervisors and on a thematic basis, notably on the governance of major groups; and has required insurers to improve governance when necessary.</p> <p>There are some gaps in relation to the detailed requirements of the ICP: on boards' powers and resources; on the exercise of independent judgment by all directors; on the insurer's board having systems and controls to ensure appropriate, timely and effective communications with the supervisor on governance; and on the role and responsibilities of senior management applying to all insurers. In some cases, for example standards of independence, the FSA has regard to material in the Corporate Governance Code, although this applies only to listed insurers and is not enforced by FSA. While it is carrying out effective supervision, the FSA lacks a systematic risk-based process for assessing all aspects of governance, including appropriate on-site evaluation, for application to all insurers.</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> • the FSA address the gaps in requirements identified in this assessment and amend its guidelines or initiate changes in legislation as appropriate; • the FSA review the Tokyo Stock Exchange's Code of Corporate Governance for provisions that should be included in its Guidelines (and applicable to all insurers) or in legislation, including standards of independence expected of outside directors; and • the FSA establish risk-based tools and procedures for regular in-depth assessment of corporate governance, including board effectiveness, developing appropriate on-site monitoring tools such as interviews with board members.
ICP 8	<p>Risk Management and Internal Controls</p> <p>The supervisor requires an insurer to have, as part of its overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters and internal audit.</p>
Description	<p><i>Risk management framework and risk appetite</i></p> <p>There are no requirements in legislation. However, the FSA's Guidelines (Sections II on Governance and III on the Control Environment for Enterprise Risk Management and VII</p>

on groups) set out expectations on how risks should be managed and issues to be reviewed in supervision. Key expectations are that:

- senior management of insurers conduct appropriate risk management based on their risks in accordance with a risk management policy and implement measures based on policy determined by the board of directors (Guidelines II-1); and
- insurers establish a risk management policy, including monitoring systems and management practices, for all material risks, based on their risk profiles and strategic objectives and develop and embed in the business an enterprise-wide policy on quantitative and qualitative risk tolerance (Guidelines II-3-4-1).

The Guidelines also refer to materials in the TSE Corporate Governance Code, although this applies only to listed insurers (see ICP 7).

Additional specific requirements apply in the context of the insurer's Own Risk and Solvency Self-Assessment (ORSA) (see ICP 16).

Internal controls

There are no explicit requirements in legislation on internal controls and the FSA relies on its Guidelines to set out expectations. These highlight the need for governance arrangements that provide for risk management and systems to ensure an appropriate exercise of internal controls for governance to be effective.

Boards and senior management of insurers should establish effective systems of internal controls, including an internal audit division independent from audited divisions etc. (Guideline II-1). Legislation does, however, establish different models of corporate governance aimed at ensuring effective oversight of the management and controls of the insurer (see ICP 7).

Control functions— general

There are limited requirements on control functions, especially at the level of individual insurers. There are clear requirements on internal audit, in relation to the independence of the function as well as reporting lines (Guideline II-1-2-1 (2) (x) applicable to companies adopting the corporate auditor/board of auditors model of governance – see ICP 7)). The Board of Directors is expected to develop a system that enables control functions to discharge their duties, for example by providing them with necessary information (Guideline II-1-2). There is a requirement on a responsible actuary (see below).

Risk management function

There is no explicit expectation, applicable to all insurers, that they should establish an independent risk management function with appropriate responsibilities as well as adequate resourcing etc. (ICP 8.3 and 8.4). However, there is an expectation that insurers clearly define "a section that implements enterprise risk management" according to the characteristics, scale, and complexity of risks; and that the head of that section report on risk management to relevant senior management and the board of directors (Guidelines

II-3-6-2-- which is focused on controls related to reporting in the context of ERM). The FSA regards this as creating an expectation for an independent risk management function.

There are also expectations on boards of directors fully to recognize that disregarding the “risk management section” may have a serious impact on corporate earnings etc.; and a requirement for supervisors to assess whether the director in charge of risk management has in-depth knowledge and understanding of methods of measuring, monitoring and managing risks (Guidelines II-1-2-1 (2) (vi) applicable to companies adopting the corporate auditor/board of auditors model).

Compliance function

There are no explicit regulatory requirements or expectations in FSA’s Guidelines for a compliance function. However, in setting out expectations on an insurer’s approach to ensuring compliance with laws and regulations etc. and FSA’s supervisory approach, the Guidelines list as an area for consideration whether a “supervising section for compliance” has been established as a structure to unify management of legal issues such as compliance, etc.; and whether its functions are fully performed etc. (Guidelines II-4-1). The FSA regards this as creating an expectation for an independent compliance function.

Actuarial function/responsible actuary

Article 120 of the IBA and Article 78 of the OEIBA require insurers to appoint a responsible actuary and assign key roles in actuarial matters such as the calculation of insurance premiums. Article 121 of the IBA and Articles 77, 79-2 and 80 of the OEIBA set out more detailed requirements distinguishing between issues where the participation of the actuary is required such as the methods of calculation of insurance premiums, policy reserves and policy dividends or surplus to be distributed to members; and those requiring verification by an actuary.

The Board of Directors is expected to develop a system that enables the responsible actuary to discharge their duties, for example by providing them with necessary information (Guideline II-1-2).

Internal audit function

There are no explicit regulatory requirements on an internal audit function. However, the FSA’s Guidelines set out an expectation that insurance companies establish an internal audit division independent from the business and reporting to the representative director and the board of directors (Guidelines II-1).

Supervisors assess whether, for example, an internal audit section has been established, and whether it is sufficiently staffed and equipped to conduct effective audits; has developed efficient and effective internal audit plans based on risk; makes timely reports; and checks on remediation actions in response to its recommendations. There are various detailed expectations of internal audit set out in the Guidelines in respect of issues such as control over payments and IT security.

	<p><i>Supervision work</i></p> <p>The FSA undertakes some supervision work specifically on risk management and control functions. It does expect insurers and groups to have in place adequate risk management and controls (on the model of three lines of defense). It checks, where necessary, whether insurers have adequate control functions. Supervisors conduct hearings regularly with internal auditors and react to identified problems, with a priority on meetings with the major groups. The recent and ongoing supervisory work on major group governance (see ICP 7) included aspects of controls, highlighting, for example, a need for progress on developing effective group internal audit work.</p> <p>However, as in the case of governance requirements (see ICP 7), the FSA does not have a systematic risk-based process for assessing all aspects of risk management and controls at all insurers, with the emphasis on the larger insurers and groups and including appropriate on-site evaluation (see also ICP 9). For example, supervisory staff do not regularly visit the offices of insurers or interview members of the board of directors to assess the effectiveness of risk management and controls or to interview senior staff in control functions (except for internal audit).</p> <p><i>Outsourcing</i></p> <p>The IBA requires that when an insurer has outsourced a business operation to a third-party, it bears an obligation to carry out management and oversight of the outsourcing service provider to ensure the accurate execution of the outsourced business operations (Article 100-2 of the IBA, Article 53-11 of the OEIBA). The FSA's Guidelines task supervisors with a set of detailed issues to consider, including whether insurers manage and oversee outsourcing service providers effectively, including whether the insurer has comprehensively reviewed the risks related to outsourcing (Guidelines II-5-1).</p> <p><i>Groups and ComFrame requirements</i></p> <p>The main requirements and expectations in the FSA's Guidelines apply at group (including IAIG) as well as solo insurer level. The IBA requires an insurer to manage its group, including establishing policies for risk management (Article 106-2 of the IBA, Article 58-3 of the OEIBA). IHCs are subject to similar requirements to manage the group, which includes formulating policies on group risk management and ensuring their appropriate implementation (Article 271-21 of the IBA).</p> <p>The separate section of the Guidelines on groups (Section VII) includes supervisory material on group-wide risk management. This covers:</p> <ul style="list-style-type: none"> • the need for the board of directors, etc. of the management company to develop an appropriate control environment for governance to enable effective supervision of the management of the entire insurance group (Guidelines VII-2-2 (1)); • the need for groups to develop and foster a group-wide risk culture, e.g., by setting and disseminating the group management principles, providing various training
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	<p>programs and establishing an appropriate compensation system for employees. (Guidelines VII-3-2 (8));</p> <ul style="list-style-type: none"> • the expectation that groups will review the group risk management framework at least annually and when necessary, such as when strategic objectives change; and that they conduct periodic internal or external independent evaluations of the group-wide risk management system (Guidelines VII-3-2 (6)); • the need to develop an appropriate control environment regarding regulatory compliance and risk management with respect to intra-group transactions (Guidelines VII-3-2 (9)); and • requirements on the control environment for group outsourcing (Guidelines VII-4-2). <p>There is no requirement on IAIGs to undergo an independent assessment of the coherence, completeness and effectiveness of the internal controls system (CF8.2b), although insurers are expected individually to undertake an external audit by an accounting auditor at least annually for the effectiveness of their internal control environment (Guidelines II-1-2-1 (6) (ii)).</p> <p>In respect to group level control functions, all insurance groups are expected to:</p> <ul style="list-style-type: none"> • define the role of the “division in charge of group-wide enterprise risk management” in accordance with the business and risk profile of the group etc. and specify the division of roles among group companies and relevant divisions; supervisors are to assess whether the risk management division secures checks and controls over group companies (Guidelines VII-3-3-3); FSA regards this as creating an expectation for a group risk management function; • establish a division in charge of overseeing compliance-related matters (a “compliance oversight division”) at the management company in order to ensure that the status of compliance of the group and group companies is appropriately managed” (Guidelines VII-4-1); FSA regards this as creating an expectation for a group compliance function; • manage actuarial matters on a group-wide basis via a group-wide actuarial function (Guidelines VII-2-2(4)); supervisors are to assess whether, for example, the function reports to the board of directors of the management company on group-wide actuarial matters; conducts evaluations of methodologies on a group-wide basis and at individual group companies; highlights problems on actuarial matters at group companies and is appropriately involved in evaluating compliance with solvency and related requirements for the group and group companies; and • ensure that the internal audit division of the management company evaluates the control environment for internal audit within the group, reports to the board and in practice highlights issues etc.; and cooperates with internal audit divisions within the group (VII-2-2 (3)).
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Assessment	Largely Observed
Comments	<p>The FSA's Guidelines set out extensive expectations on risk management and controls. The coverage of group issues is particularly developed, reflecting the recent systematic implementation of ComFrame requirements, although there is no requirement on IAIGs to undergo an independent assessment of the coherence, completeness, and effectiveness of the internal controls system (CF8.2b). The FSA undertakes some supervision work, notably on internal audit (including regular meetings with the senior staff).</p> <p>There are expectations in the Guidelines on each of the control functions and these are relatively clear in relation to the actuarial function (although the "responsible actuary" approach falls short of a full control function) and internal audit at the level of individual companies; and generally for all control functions at the group level. In practice, the larger insurers (and maybe others) have established control functions at the company and group level, although different approaches are applied in practice.</p> <p>The FSA would benefit from much clearer requirements (maybe set out in legislation rather than only in the Guidelines) on control functions covering their establishment and the requirements for independence, adequacy of resources and appropriate reporting lines (ICP 8.3). The objectives would be to emphasize to all insurers that these functions must be not just sections on an organogram but effective control functions as envisaged by the ICP; and to provide a sound basis for FSA's supervisory and enforcement work.</p> <p>The introduction of the ESR (see ICP 17) provides an opportunity for clarifying and, where necessary, strengthening current requirements, including on creating a strong independent actuarial function. As in the case of governance, the FSA would benefit from a systematic risk-based process for assessing all aspects of risk management and controls at all insurers, with the emphasis on the larger insurers and groups and including appropriate on-site evaluation.</p> <p>It is recommended that FSA:</p> <ul style="list-style-type: none"> • revise its Guidelines (or consider initiating changes to law or regulations) to set explicit and comprehensive expectations on the establishment and adequacy of all control functions within the ICP scope; and • establish risk-based tools and procedures for regular in-depth assessment of risk management and controls, including control functions, developing appropriate on-site monitoring tools such as interviews with board members and key persons in control functions.

ICP 9	<p>Supervisory Review and Reporting</p> <p>The supervisor uses off-site monitoring and on-site inspections to: examine the business of each insurer; evaluate its financial condition, conduct of business, corporate governance framework and overall risk profile; and assess its compliance with relevant legislation and supervisory requirements. The supervisor obtains the necessary information to conduct effective supervision of insurers and evaluate the insurance market.</p>
Description	<p><i>Regulatory reporting</i></p> <p>Article 110 and 128 of the IBA provides for the power for the FSA to require reports from insurance companies. Article 129 provides for the power to conduct on-site inspections.</p> <p>Insurers are required to submit a financial regulatory report in a predetermined format semi-annually (Article 110 of the IBA). The FSA also requires insurers to submit reports on risk information on a regular basis. ORSA reports are required annually (more detail is provided under ICP 16) and three annual written opinions from the responsible actuary (see ICP 14 for more detail). There are also annual business reports and risk reports required with the matters to be included specified in Article 59 of the OEIBA.</p> <p>Specified disclosed descriptions of the business structure and activities of the insurers pursuant to Article 111 of the IBA and Article 59(2) of the OEIBA, which are made available to the public, are also reported to the FSA and are a source of supervisory information. See ICP 20 for further elaboration.</p> <p><i>Approach to Supervision – the Guidelines</i></p> <p>There are the Comprehensive Guidelines for Supervision for Insurance Companies (the Guidelines), which provide a framework for continuous monitoring and supervision of insurance companies. The core concept of the Guidelines is to carry out monitoring through assessment of reporting and dialogue with senior management when issues are identified through reporting or through media reports and other market intelligence. The Guidelines establish basic ideas of supervision outlining the approach and philosophy of supervision of the FSA. The Guidelines also set out detailed expectations relevant to a number of ICPs and the FSA’s main supervisory focus in relation to those elements. In that sense, the Guidelines provide both supervisory requirements (see for example in relation to ICP 8 and ICP 16) and the main supervisory focus of the FSA in relation to these matters. The Guidelines are published on the FSA website and as such are available to all insurers and other interested parties. The last major update to the Guidelines occurred in 2020 to implement ComFrame and the IAIS Holistic Framework for systemic risk in the insurance sector. The FSA provided the assessors with a mapping of ComFrame requirements to the Guidelines which shows that in most cases the ComFrame requirements have been implemented via the Guidelines.</p> <p><i>Off-site monitoring</i></p>

There is a small team of 16 people in the Insurance Prudence Monitoring Office (IPMO) which conducts analysis of reported information, including the operation of an Early Warning System (EWS).

A market risk dashboard is also produced by the IPMO on a quarterly basis which looks at impacts created by potential market price movements. If any insurers are flagged as likely to have a less than 200 percent SMR as a result of such market movements, the insurer is flagged to the relevant team within the Life Insurance Section or the Non-Life Insurance Section of the Insurance Business Division (IBD). The IPMO conducts other monitoring such as consideration of actuarial reports, consideration of ORSA reports and monitoring insurers' disclosure practices.

The Life Insurance Section (12 staff) and Non-Life Insurance Section (13 staff) of IBD are each divided into five Sections. There are three sections in the Life Insurance Section to which all the life insurers are allocated (7 total staff) and three sections in the Non-Life Insurance Section (7 total staff) to which non-life insurers are allocated (see ICP 2 Description for a full organization chart of IBD). The Life Insurance Section and Non-Life Insurance Section also have an Agents and Brokers Section and a Monitoring Section. The Agents and Brokers Section's activities with the LFBs are detailed under ICP 18. The Monitoring Section for each sector analyses the impact of key risks such as Reinsurance and Natural Disasters for Non-Life Insurance and foreign currency-denominated insurance products and insurance for disabled people as themes for Life Insurance.

When an issue arises with an insurer it is one of the six sections with allocated insurers that is tasked with following up the issue. These supervision sections cover both market conduct and prudential matters. However, in terms of their observed workload, it mostly comes from market conduct issues. Market conduct supervision is covered under ICP 19. The discussion below focuses on prudential supervision.

Prudential supervision focuses on off-site monitoring through the work of the IPMO with additional focus on eight large insurers through the holistic framework monitoring (see below).

The FSA's prudential supervision is not focused on individual insurers as a matter of course but if Issues are identified through off-site monitoring, then off-site monitoring and hearings are conducted in relation to that insurer. The primary focus of prudential supervision is through thematic reviews.

Thematic reviews start with identifying a pool of insurers that may be affected by an issue, for example, implementation of ORSA in 2016. The FSA will start a thematic review with a questionnaire sent to insurers likely to be affected by a market-wide issue that has been identified. Based on the answers received, some insurers will be identified to be invited to the FSA for hearings. Hearings are typically a two-hour interview with a senior officer of an insurer. Multiple hearings may be requested for an insurer depending on the issue.

On-site inspections

If significant issues are found, then on-site inspections are ordered. An on-site inspection is a significant commitment of resources with the inspections lasting three to four months and a significant number of inspectors assigned. In one case example cited during the assessment discussions, a chief inspector and 17 staff were used in an on-site inspection that went for a little over four months. All cases discussed involved market conduct issues and assessors were informed that no on-site inspection for prudential matters has been undertaken for about 10 years.

At the conclusion of an on-site inspection, a detailed report is presented to the chief executive of the insurer soon after the conclusion. The insurer is expected to respond to the issues raised. This may take some time. In one case reviewed, an on-site inspection report was issued in June 2021 and the insurer responded in July 2023. As detailed in ICP 10, the FSA may move to issue a business improvement order as the next stage if issues are not sufficiently resolved.

On-site inspection is not carried out as part of a cycle of supervision. On-site inspections are part of escalating measures when a problem is identified and will be discussed more in ICP 10. The combination of off-site analysis and on-site inspection that is intended to be used to gather information to inform risk analysis is not carried out by the FSA. Prudential supervision is largely reactive, based on off-site analysis by the IPMO and only handed off to supervisors responsible for individual insurers when a problem is identified. Those supervisors are not regularly undertaking proactive supervision according to an insurer-specific supervisory plan. Some of the small to medium insurers do not regularly have interactions with FSA supervisors and may go a number of years without interactions about prudential matters.

Holistic Framework Monitoring

An exception to this is the five large life insurers/insurance groups and three large non-life insurers/insurance groups that are subject to monitoring for the Holistic Framework (more details about this under ICP 24). These eight insurers include the four IAIGs. These companies are subject to more extensive monitoring. In addition to inclusion in the EWS and market risk analysis, they are subject to enhanced monitoring across the subjects of liquidity risk management, macroeconomic exposure (both outward and inward risks) and interconnectedness. Issues identified in this process with individual insurers are followed up with those insurers. Most likely issues identified will be followed up through the hearing process.

ESR-based stress testing is also part of Macroprudential Surveillance. The shock applied is based on the Lehman Brothers failure scenario. Where post-stress ESR is below 100 percent, the FSA follows up to understand what management actions would be taken. In effect, for these eight insurers, ESR is being used in supervision in a type of parallel run. Internal ESR is also obtained and analyzed and compared to the new regulatory ESR. Other measures covering credit risk, liquidity risk, use of repos, size of unrealized gains/losses on derivatives, foreign bond holding exposure and foreign currency liquidity

	<p>positions are all analyzed for these eight individual insurers. While all of this analysis is carried out individually, it is not pulled together in a comprehensive risk assessment for an insurer or group.</p> <p>The results of this enhanced monitoring for IAIGs are shared with other supervisors through supervisory college meetings.</p> <p><i>Supervisory Plans</i></p> <p>Supervisory plans for the Life Insurance Section, Non-life insurance Section and the IPMO are set out at the sector level. Thematic monitoring is often only carried in relation to the IAIGs and other large insurers but some mid-size insurers are sometimes included in certain themes. These thematic reviews will sometimes identify issues that require further follow-up with insurers. This may result in escalating measures as described in relation to ICP 10.</p> <p><i>Supervision of outsourced business operations</i></p> <p>Article 100-2 of the IBA and Article 53-11 of the OEIBA require that when an insurer has outsourced its business operations to a third-party entity, it has an obligation to carry out management and oversight of the outsourcing service provider to ensure the accurate execution of the outsourced business operations. The Guidelines build further on this in Guideline II-5-1 that requires insurers to develop a system regarding the management and oversight of outsourcing service providers.</p> <p>The FSA reviews outsourced activities through irregular hearings with insurance companies if an issue is identified. Outsourcing arrangements are not routinely reviewed as part of a cycle of supervision. This is an outcome of the approach to supervision that is planned at the sector level rather than at the individual insurer level.</p> <p><i>Audit</i></p> <p>Audits are only required for general purpose financial statements – see Article 53-22 of the IBA and Article 396 of the Companies Act. Other information provided in regulatory reports is not subject to audit.</p> <p><i>Reporting of reference ICS</i></p> <p>The reference ICS is reported by Japanese insurers and discussed in supervisory colleges for the four IAIGs.</p>
Assessment	Partly Observed
Comments	Reporting requirements are comprehensive. It is notable that financial regulatory reports which include a calculation of the SMR are only required semi-annually through legislation, although the FSA does request quarterly key financial data including an SMR calculation. While this is not a matter affecting observance, the frequency of reporting is

an issue that requires attention on the introduction of ESR. At least a statutory requirement for quarterly reporting would be desirable.

Audit of regulatory reports could be expanded and must be considered in light of the introduction of ESR.

Supervision is mainly reactive to risk that has crystalized into a problem for an insurer. Where FSA's supervision is forward looking it relies on EWS, which has some limitations under the current framework. Risk-based supervision is about proactively identifying risks and building a supervisory plan for an insurer based on its net risk of failure or significant compliance issues and the size and importance of the insurer. These elements cannot be seen in practice at the FSA. The lack of such a risk assessment does not meet the requirements of ICP 9.2 and CF 9.2a in relation to the four IAIGs. This focus on supervision at the sector level means that ICP 9.3 is not met either as outsourcing arrangements are not routinely reviewed.

On-site inspections are part of escalating measures for insurers that are operating outside the FSA's own risk tolerance. However, on-site inspections are not part of routine supervision. On-site inspections are used more as an investigation tool to understand the root cause of risks that have crystalized with the findings used to require improvements. As such the type of on-site inspections contemplated by ICP 9.6 are not carried out.

While it may be argued that the process of hearings where senior management are interviewed for about two hours at the FSA premises may cover parts of the same ground as an on-site inspection, an on-site inspection process is so much more, involving discussions with operational staff, review of systems, review of case files and assessment of whether governance processes, internal control procedures and risk management practices are actually implemented.

There is no individual supervision plan for each insurer. Prudential supervision is based on thematic issues where a number of insurers are subject to analysis (but far from all insurers). An example of this is the 2016 review of the implementation of ORSA. Issues found with individual companies were followed up but comprehensive review of ORSA was not carried out subsequently for many insurers. ORSA reports are reviewed for the 8 largest insurers as part of the Holistic Framework monitoring.

Ultimately, the approach to supervision appears to be designed to fit the available resources. As detailed in relation to ICP 2, resourcing at the FSA appears limited compared with peer supervisors. Addressing the recommendations in relation to this ICP and a number of others will require a significant increase in resources.

The recommendations set out below require reconsideration of the FSA's approach to insurance supervision. Each insurer (or at least all but the smallest) should have a supervisory plan for a year or longer. That supervisory plan should detail a cycle of supervision that involves supervisory activities, leading to revised risk assessment, leading to revisions of the supervisory plan as necessary. Supervisory activities should include a

	<p>mix of off-site monitoring and on-site inspections. Insurers should be allocated to different categories based on their risk and impact of failure. For each category, there should be a policy on balancing both off-site monitoring and on-site inspection to ensure proper risk-based supervision, taking into account the insurers' characteristics.</p> <p>Recommendations:</p> <ul style="list-style-type: none"> • As part of the economic value-based solvency regulation introduction, the FSA should ensure that the frequency and audit of regulatory reporting is appropriate for the new framework. • Supervisory plans should be developed by the FSA for each insurer based on their risk profile detailing a cycle of supervision that involves supervisory activities, leading to revised risk assessment, leading to revisions of the supervisory plan as necessary. • A systematic approach to risk assessment of each insurer should be the foundation of supervisory plans of the FSA. The risk assessment should consider inherent risks, the quality of governance, risk management and controls and the possible impact of a failure of the insurer. • On-site inspections should be instituted as part of the regular FSA supervisory process, which will require and increase in staff resources as discussed in the context of ICP 2 and should generally be less intensive than the current practice under which inspections are used essentially as an enforcement tool.
<p>ICP 10</p>	<p>Preventive Measures, Corrective Measures and Sanctions</p> <p>The supervisor:</p> <ul style="list-style-type: none"> • requires and enforces preventive and corrective measures; and • imposes sanctions, <p>which are timely, necessary to achieve the objectives of insurance supervision, and based on clear, objective, consistent, and publicly disclosed general criteria.</p>
<p>Description</p>	<p><i>Actions against individuals or entities that conduct unlicensed insurance activities</i></p> <p>FSA has powers to take action against a person who has operated an insurance business without a license through punishment by imprisonment with work for not more than 3 years or a fine of not more than three million JPY or both (Article 315 of the IBA)</p> <p>If the FSA finds a person who is conducting unlicensed insurance business, then it will issue a written warning and also require correction. The FSA can require hearings. The FSA would also communicate with other investigating authorities.</p> <p><i>Preventative measures and Corrective Measures</i></p> <p>The first step the FSA takes when it identifies concerns about an insurer is to require senior officers to attend a hearing, which is usually about a two-hour meeting as described in ICP 9. If after these hearings, the FSA still has concerns it can request the</p>

insurer or insurance holding company to submit a report under Article 271-27 of the IBA. If the report does not satisfactorily address the FSA's concerns, then it will require an on-site inspection to understand the underlying reason for the insurer's problems. Such on-site inspections are significant undertakings lasting three to four months and involving a team of ten or more FSA staff. There is a Monitoring and Inspections Section within the Insurance Business Division who will form the core of an on-site inspection team but other FSA staff within the IBD or elsewhere in the FSA may also be involved. At the conclusion of an on-site inspection a detailed report is issued to the chief executive of the insurer. The insurer will be required to respond to the report in writing.

If the response does not satisfy the FSA's concerns, then it can issue a business improvement order that requires a plan to be provided to the FSA for how the insurer will address the identified issue. The supervisors then ensure the plan is met.

Ladder of Intervention based on the Solvency Margin Ratio

As detailed under ICP 17, there are specific measures to be taken as the SMR declines below 200 percent with other thresholders at 100 percent and 0 percent.

Early Warning System (EWS) and Market Risk dashboard

The FSA calculate the indicators needed in the framework of the EWS based on data collected from insurance companies.

In total there are four components of the EWS:

- (1) Profitability: Fundamental profit index
- (2) Stability: Impact of changes in securities prices
- (3) Credit risk: Status of concentration of large borrowers
- (4) Cash flow: Ratio

The FSA publishes minimal information about the EWS in the Guidelines.

With regard to an insurer that is deemed to need improvement for each indicator, the FSA conducts hearings regarding the cause of problems and improvement measures.

If necessary, the FSA may encourage early improvement by ordering a report and conducting on-site inspections or may issue a business improvement order.

In addition, the FSA prepares a market risk dashboard on a quarterly basis to estimate the impact of market risks related to interest rates, exchange rates, stock prices, and credit spreads on SMR.

Sanctions

	Penalties	Person to whom applicable
Imprisonment with work for not more than 3 years; Or A fine of not	Article 315	
	No. 1	A person who has conducted Insurance Business without a license;
	No. 2	A person who has had another person conduct Insurance Business by name lending;
	No. 3	A person who has committed an act of providing false

	more than 3 million JPY; Or cumulative imposition		information to the settlor with regard to the acceptance of a trust;	
		No. 4	Person who has not delivered the report on the status of trust property, etc.	
		No. 5	Persons who do not deliver investment reports, etc.	
		No. 6	A person who has been registered for Low-Cost, Short-Term Insurance Business by wrongful means;	
		No. 7	A person who has had another person engage in Low-Cost, Short-Term Insurance Business by means of	
		No. 8	A person who has made a false statement to the policyholder or the insured, or has failed to disclose important matters included in the contract clauses of an insurance contract that would affect the judgment of the policyholder or the insured;	
		No. 9	Any person who has made Compensation for Loss, etc. under the Specified Insurance Contract;	
	Imprisonment for a term not exceeding two years; Or A fine of not more than 3 million JPY; Or cumulative imposition	Article 315-- (2)		
		No. 1	A person who has carried out the Establishment, etc. of an Insurance Holding Company without authorization;	
		No. 2	A Specified Holding Company that continued to be a Holding Company beyond the Last Day of the Grace Period;	
		No. 3	A person who, in violation of the measures required for the establishment, etc. of an Insurance Holding Company without authorization, etc., has remained as a Holding Company;	
		No. 4	A person who has carried out the Establishment, etc. of a Small Amount and Short-Term Insurance Holding Company	
		No. 5	A Specified Small Amount and Short-Term Insurance Holding Company that continued to be a Holding Company beyond the Last Day of the Grace Period	
		No. 6	A person who, in violation of measures required of a Small Amount and Short-Term Insurance Holding Company, etc. without authorization, etc., has remained as a Holding Company;	
		Article 316		
No. 1		A person who has violated any of the conditions attached to the Insurance business license;		
No. 2		A person who has violated an order for suspension of all or part of its business;		
No. 3	A person who has violated an order of suspension of business pertaining to approval of amendments to contract conditions;			
No. 4	A person who has violated the prohibition of business pertaining to a Foreign Insurer that has not established a branch office, etc. in Japan;			

	<table border="1"> <tr> <td>No. 5</td> <td>A person who has violated the conditions attached to the license of a foreign life insurance business to a foreign insurer;</td> </tr> <tr> <td>No. 6</td> <td>A person who started Insurance Business, etc. before making notification of deposit money;</td> </tr> <tr> <td>No. 7</td> <td>A person who has carried out business in violation of the provisions on suspension of business due to a disposition ordering business and property management by an insurance administrator;</td> </tr> </table> <p><i>Measures applicable to holding companies and IAIGs</i></p> <p>Articles 128, 132 and 271-27 to 271-30 apply to an insurer or an insurance holding company that is the management company of an insurance group.</p>	No. 5	A person who has violated the conditions attached to the license of a foreign life insurance business to a foreign insurer;	No. 6	A person who started Insurance Business, etc. before making notification of deposit money;	No. 7	A person who has carried out business in violation of the provisions on suspension of business due to a disposition ordering business and property management by an insurance administrator;
No. 5	A person who has violated the conditions attached to the license of a foreign life insurance business to a foreign insurer;						
No. 6	A person who started Insurance Business, etc. before making notification of deposit money;						
No. 7	A person who has carried out business in violation of the provisions on suspension of business due to a disposition ordering business and property management by an insurance administrator;						
Assessment	Observed						
Comments	<p>The FSA has an escalating series of preventative measures and corrective measures which it applies in practice.</p> <p>It has an extensive list of possible sanctions which are applied in practice.</p> <p>The EWS in its current form has some limitations which can be addressed in its redesign to accommodate the introduction of ESR. Furthermore, publication of more details of the EWS will be helpful to insurers in enhancing their risk management processes to address a wide range of circumstances.</p> <p>Recommendation:</p> <ul style="list-style-type: none"> • The FSA will have to be revise the EWS for the introduction of ESR which will use market valuation, and update methodologies and assumptions where relevant to reflect changes in insurer portfolios and market environment. • The FSA should publish more details of its EWS in order to encourage insurers to enhance their risk management processes to address a wide range of circumstances. 						
ICP 12	<p>Exit from the Market and Resolution</p> <p>Legislation provides requirements for:</p> <p>the voluntary exit of insurers from the market; and</p> <p>the resolution of insurers that are no longer viable or are likely to be no longer viable, and have no reasonable prospect of returning to viability.</p>						
Description	<p><i>Legislative framework for insurer exit from the market</i></p> <p>There are 4 pieces of legislation that provide paths to insurer resolution. There is the IBA through which a resolution is conducted under the supervision of the FSA. There are</p>						

procedures under the Corporate Reorganization Act (CRA) which is applied to insurers structured as stock companies. There is the Act on Special Measures for the Reorganization Proceedings of Financial Institutions (SMRPFI) which is applied to insurers that are structured as mutual companies. Procedures for resolution under the CRA and SMRPFI are conducted under the supervision of the courts. There is also the Deposit Insurance Act (DIA) where in the case of systemic risk, orderly resolution measures would be used.

Exit from the market under the IBA

Under the IBA, the FSA may use a range of powers to ensure the exit of an insurer. The conditions that must be met for the FSA to proceed are:

1. That it will be difficult for the insurer to continue undertaking insurance business in light of the status of its business or solvency or
2. When the operation of the business is extremely inappropriate such that continuation is likely to result in insufficient protection of policyholders (Article 241 of IBA).

When the FSA has reached this conclusion, it may suspend the whole or a part of an insurer's business, require a merger, seek an agreement on the transfer of insurance contracts, take any other necessary measures, or may make a disposition ordering the administration of business and property by an insurance administrator. This can occur where the insurer has liabilities in excess of assets. These powers were used in the 1997 life insurance crisis.

The purpose of the second set of criteria is to allow the FSA to take action against an insurer that is impairing confidence in the insurance sector and is contrary to the public interest.

Exit from the market under the SMRPFI

Under the SMRPFI, the FSA may file a petition for commencement of reorganization proceedings against an insurer, insurance holding company, small amount and short-term insurer if a fact constituting grounds for commencement of bankruptcy proceedings is likely to occur. Bankruptcy proceedings are likely to occur to a corporation due to insolvency (liabilities exceeding assets) – Article 16 of the Bankruptcy Act. The insurer in question could also make a petition to the court for reorganization proceedings as could a creditor such as a corporate debt holder or a policyholder. The court then decides whether to commence reorganization proceedings and about the appointment of a receiver.

Exit from the market under the CRA

Proceedings under the CRA are similar to the SMRPFI. The FSA can file a petition for reorganization proceedings to the court and so can the insurer in question or any party with a claim on the insurer. Then it is the court's decision to commence reorganization proceedings and appoint a receiver. The receiver develops a reorganization plan which is

subject to approval by a stakeholders meeting. The court then considers and approves the proposed reorganization plan. It is notable that under the CRA, general claims can be reduced in the reorganization plan. This contrasts with the IBA process where the only claims for which rights can be limited are those related to insurance contracts (i.e., policyholders). The FSA has chosen the CRA / SMRPFI process over IBA process in all the resolution cases after the revision of SMRPFI in 2000 enabled the application of the process to insurers.

Where the court finds it necessary, it may request the administrative agency (such as the FSA) with jurisdiction over the business of the reorganization company to state its opinions on the reorganization proceedings of insurer or the reorganization company, and the administrative agency may state its opinions on the reorganization proceedings to the court (Article 8 (3 & 4) of the CRA and Article 174 of the SMRPFI). With regard to a proposed reorganization plan that specifies matters that require permission, authorization, license or any other disposition by an administrative agency, the court shall hear the opinion of such administrative agency on such matters (Article 187 of the CRA and Article 280 of the SMRPFI). When a proposed reorganization plan is approved, the court must make an order of confirmation or disconfirmation of the reorganization plan. One of the requirements for an order of confirmation of the reorganization plan is that in the case of a reorganization plan that specifies matters that require permission, confirmation, license or any other disposition by an administrative agency, it does not contradict, in material respects, the opinion of the administrative agency concerned under the provisions of Article 187 of the CRA or Article 280 of the SMRPFI (see also Article 199(1 & 2), of the CRA and Article 290 SRMPFI).

Policyholder protection under CRA and SMRPFI

Under the CRA and the SMRPFI, the rights of each creditor can be amended based on a reorganization plan (Article 168 (1) of the CRA and Article 260(1) of the SMRPFI). In this modification of rights, a fair and equitable difference must be provided with respect to the content of the reorganization plan between persons that hold different types of rights, so losses are distributed in accordance with the order of priority of claims (Article 168 (3) of the CRA and Article 260(3) of SMRPFI). Policyholders are protected by using the financial assistance system of the policyholder protection corporations to guarantee, in principle, up to 90 percent of the policy reserve at the time of failure (Article 270-3 (2) of the IBA, Article 50-5(1) of the Order on Special Measures for the Protection of Policyholders).

Orderly resolution under the DIA

The Orderly Resolution provisions of the Deposit Insurance Act (DIA) could be applied to insurers (and broadly to non-banks) when the Prime Minister finds that significant disruption is likely to occur in the Japanese financial market or other part of the financial system unless measures are taken for orderly resolution. If the insurer is still solvent, the Deposit Insurance Corporation of Japan (DICJ) would inject capital (to meet capital

requirements) and get preferred stock (without voting rights). If the insurer is insolvent or likely to become insolvent, the DICJ can transfer systemically important assets and liabilities (most likely to a bridge institution). In practice, there are no cases of insurers using the DIA and it is unlikely that it will ever be used for the resolution of an insurer.

Policyholder protection mechanism

There are two policyholder protection corporations. There is the Life Insurance Policyholders Protection Corporation (LIPPC) and the Non-Life Insurance Policyholder Protection Corporation (NIPPC). When reorganization proceedings are chosen under the CRA or SMRPF, a reorganization plan is approved and decided by finding another insurer (a relief insurer) willing to take over the insurance liabilities and financial assistance by the relevant policyholder protection corporation can be provided if necessary in the process of executing the reorganization plan (Article 259 of the IBA). If no relief insurer can be identified, then the relevant policyholder protection corporation will set up a subsidiary to accept the insurance contracts of the failed insurer.

A relief insurer may petition a Protection Corporation, jointly with the failed insurer, to provide financial assistance for the transfer of insurance contracts (Article 266 (1) of the IBA). The failed insurer and the relief insurer must obtain the authorization of the FSA for the transfer of insurance contracts by the time the application for financial assistance is made (Article 268 (1) of the IBA). The FSA may approve a transfer of insurance contracts only if certain conditions are met, such as contributing to the protection of policyholders (Article 268(3) of the IBA).

The level of indemnification of holders of insurance contracts provided by policyholder protection corporations varies by contract type (Article 50-5 of the Order on Special Measures for the Protection of Policyholders).

Types of covered contracts	Coverage ratio
Life insurance contracts	90 percent
Sickness and injury insurance policy;	90 percent
Automobile insurance contracts, personal non-life insurance contracts;	80 percent
Automobile Liability Insurance Contract, Earthquake Insurance Contract	100 percent

The amount of assistance provided by a policyholder protection corporation is the amount required to make up the shortfall in assets after a reduction of the insurance liabilities (see table above) plus an amount for the costs of transferring and administering the transferred insurance contracts (Article 270-3(2) of the IBA).

The Life Insurance Policyholders Protection Corporation (LIPPC) is funded to a limit of 400 billion JPY.¹ This is a pre-funded amount that is currently managed by LIPPC. If the assets of the LIPPC are not sufficient then it can borrow up to 460 billion JPY from financial institutions with a government guarantee. This amount is post-funded. That is, member contributions are required to repay the loan. Maximum member contributions are 33 billion JPY per year. So, if the full amount of the loan was required to be drawn down it would take approximately 14 years for the members of the LIPPC to pay down the debt and a further period of approximately 12 years to reestablish the pre-funded amount. The pre-funded amount and post-funded amount were determined in 1998 and have not been updated since. This amount has been determined as appropriate as it assumes multiple failures and based on repeated dialogue the view is that regulation has been strengthened and failures are less likely. The increasing value of insurance contracts since 1998 does not seem to have been a key consideration.

If these sources of funding are insufficient, then in extremely limited circumstances the Government of Japan may fund an amount equivalent to all or part of the relevant costs (Article 259 and subsequent articles of the IBA; Article 1-2-14 of the Supplementary Provisions of the IBA). The limited circumstances are based on whether members of the LIPPC would face deteriorating financial positions due to costs of taking on the obligation to fund policyholder protection making it difficult to maintain the credibility of the insurance industry. Such a situation could cause extremely serious problems in the day-to-day living of a number of people in Japan or cause extremely serious problems for financial markets. If such a risk is found, the government may subsidize the LIPPC with an amount equivalent to all or part of the relevant costs within the scope of the amount set forth in the budget (Article 259 and subsequent articles of the IBA; Article 1-2-14 of the Supplementary Provisions of the IBA). Note there is no recourse for the government to be compensated for this subsidy. This would be a direct taxpayer subsidy. This provision in the IBA is subject to renewal every 5 years.

The last decision to renew the potential subsidy was on March 31, 2022 (Article 1-2-14 of the Supplementary Provisions of the IBA). The proposal to extend the subsidy was made after consultation with the life insurance industry. During debate in the Diet prior to the decision, the Minister of State for Financial Services provided the following rationale for the decision to extend the subsidy: "The business conditions of life insurance companies are stable at present. On the other hand, the business environment surrounding life insurance companies is expected to remain severe due to the further decrease in the birthrate and aging population, the decrease in the number of policyholders in the future, the continuation of the low interest rate environment, and the deterioration in the profitability of various investments. Under these circumstances, the Government of Japan believes that it is necessary to extend government subsidies in order to appropriately

¹ For a comparison point, the 9th largest life insurer has total assets of nearly 12 trillion JPY and net assets of 356 billion JPY. The largest domestic life insurer has total assets of 75.6 trillion JPY and net assets of 6.8 trillion JPY.

	<p>protect policyholders under any circumstances and maintain the credibility of the insurance industry.”</p> <p>The NIPPC is funded by members to a limit of 50 billion JPY – a pre-funded amount. It may also issue debt up to a limit of 50 billion JPY – a post funded amount. Contributions from members are capped at 5 billion JPY per year. A failure that drew down the entire pre-funded amount would take 10 years to replenish and a further 10 years to pay off debts if the post-funded amount through loans was required. There is no government guarantee for this debt unlike the LIPPC. The amounts of pre-funding and post-funding were established in 1998 and have not been revised.</p> <p>The most recent failures handled by the NIPPC were in 2000 and 2001. The contributions required were relatively small compared to the excess of liabilities over assets, a function of guaranteeing only 80 percent of reserves in the case of most products.</p> <p>In both cases, without failures to administer, staffing is minimal and activities are focused on managing the pre-funded amount prudently. Staffing can be built up if a failure occurs through access to member resources including temporary transfer of staff. The Chair of both organizations is a rotating role and the Chair provides additional staffing support. However, institutional memory of how to deal with a failure has dissipated in the two decades since major failures. Insurance failure simulation exercises have not been undertaken.</p> <p><i>Resolution planning</i></p> <p>Resolution planning is not required for any insurers. A decision was made that resolution planning was not required by 4 IAIGs as it is not seen that they perform any critical functions. This decision seems at odds with the decision to extend possible government subsidy of a resolution of a life insurer.</p>
Assessment	Partly Observed
Comments	<p>Insurers have a path to voluntary exit from the market subject to oversight and approval by the FSA.</p> <p>This assessment must focus on the CRA and SMRPFI as it appears to be the best path to resolution of an insurer. The IBA does not provide a practical avenue for resolution other than for SASTIs and smaller insurers due to lack of powers to modify the rights of non-policyholder creditors,</p> <p>It is also notable that the trigger point for resolution under the CRA and SMRPFI is when there is a risk that a debtor (in this instance an insurer) will be unable to pay debts or will become insolvent which fits with the FSA ladder of intervention on solvency grounds where the strongest measures will be taken at below 0 percent SMR (see ICP 10 and ICP 17 for more detail). This trigger point is not ideal as it means that losses that are likely already crystalized for policyholders and/or other creditors. In other jurisdictions, breach</p>

of a Minimum Capital Requirement (MCR) as defined in ICP 17 would be the point at which resolution proceedings could be triggered where there are still excess assets over liabilities. While the trigger point is clear, its efficacy in providing policyholder protection is questionable and as such it is not consistent with ICP 12.6 when read in conjunction with ICP 12.2 that requires a framework for resolution that protects policyholders.

Policyholder protection is in place through legislative provisions and the existence of the policyholder protection corporations. Policyholder protection corporation funding has been stable for over two decades. There should be a review of the funding levels and caps on member contributions given the size and complexity of insurers two decades since the decision was made and the market conditions they currently face as well as the likely medium-term evolution of those conditions. Criteria for adequate funding should be determined with a particular focus on the funding of the LIPPC given that public subsidy may be activated if the LIPPC total funding is inadequate.

ComFrame 12.2b that requires minimizing reliance on public funding is not met given the explicit possible government subsidy for a life insurance resolution.

Resolution planning is not required for any insurers. Given the statement by the Minister of State for Financial Services when the Diet debated the extension to the possible subsidy of life insurance, it seems at odds that large life insurers would not be required to evaluate prospectively their specific operations and risks in possible resolution scenarios and to put in place procedures for use during a resolution. This means that the requirements of ICP 12.3 are not met. For the one IAIG with predominantly life insurance business, a resolution plan should be required given the reasons used for justifying the continuation of the state subsidy for life insurer resolution. For this reason, the requirements of ComFrame CF12.3a and CF12.3b are not met.

There is no evidence of a requirement to consider the ability of the group-wide management information system to produce timely information in a resolution. While the FSA does not believe that the resolution of an insurer has the same immediacy of data needs as a bank resolution, they still have not undertaken analysis of the requirements in the resolution of an IAIG given the complexity of foreign business and interconnectedness created through reinsurance contracts and other internal transactions. Such an analysis should be undertaken in IAIG resolution planning and in FSA supervision of resolution planning.

Under the CRA and SMRPFI, the FSA may state opinions to the court concerning reorganization. The FSA has no decision-making role. However, the court cannot approve a reorganization plan that specifies matters that require permission, confirmation, license, or any other disposition the FSA, if the plan contradicts the opinion of the FSA in material respects. Under the CRA and SMRPFI, the FSA is clearly an influential stakeholder in a resolution process but is not in a decision-making position. This situation does not appear to be consistent with ICP12.5 that requires clarity in the role of various authorities.

	<p>In the extensive list of powers in relation to IAIG resolution expected under CF12.7a, there is only one power not available. That is the power to stay rights of the reinsurers of the ceding insurer in resolution to terminate, or not reinstate, coverage relating to periods after the commencement of resolution. These powers exist in relation to all insurers not just IAIGs and so are consistent with the requirements of ICP 12.7.</p> <p>Given the length of time since major failures from 1998 through to the early 2000s, institutional knowledge of how to address such failures has dissipated at both FSA and at the policyholder protection corporations. While it is not a matter for observance of ICP 12, it would be useful to conduct simulation exercises to assist in designing and updating procedures to handle practical aspects of failure such as public communication (including social media), setting up or gaining control of insurer systems to process policyholder claims, assessing the value of assets available and assessing the appropriate trigger for resolution and assessing circumstances in which the subsidy to the LIPPC may be invoked including ministerial or government approval processes.</p> <p>Recommendation:</p> <p>Japanese authorities should carefully review the resolution framework and process of resolution for insurers to ensure clarity on the operations and procedures for resolution of insurers, insurance groups and IAIGs. In doing so, Japanese authorities should address any gaps where necessary using the FSB’s Key Attributes of Effective Resolution Regimes for Financial Institutions (FSB KAs) in particular the FSB KA’s Assessment Methodology for the Insurance Sector as a best practice reference² while also addressing:</p> <ul style="list-style-type: none"> • The disconnect between J-GAAP or IFRS accounting and valuation under the soon to be introduced economic value-based solvency regulation which will require a clear trigger point for resolution to be determined in light of the revised regulatory requirements; and • The increasing complexity of Japanese IAIGs with a focus on increasing foreign business.
ICP 13	<p>Reinsurance and Other Forms of Risk Transfer</p> <p>The supervisor requires the insurer to manage effectively its use of reinsurance and other forms of risk transfer. The supervisor takes into account the nature of reinsurance business when supervising reinsurers based in its jurisdiction.</p>
Description	<p><i>Effective Internal Controls for Reinsurance</i></p> <p>The Supervisory Guidelines II-3-10 “Risk Management for Reinsurance” which is a component of II-3 “Control Environment for Enterprise Risk Management” require the</p>
<p>² See also the ‘Technical Note on Financial Safety Net and Crisis Readiness.</p>	

	<p>management of reinsurance risk as part of the overall risk management strategy and capital management strategy.</p> <p>The Guidelines also require ceding insurers to:</p> <p>1: Formulate an appropriate holding limit for insurance risk and a reinsurance policy; and</p> <p>2: Underwriting risk exceeding the holding limit must be covered by arranged reinsurance.</p> <p>Reinsurance programs for the three large non-life insurers and mid-tier insurers are reviewed soon after the renewal season which occurs in April for Japanese insurers. The supervisory review of reinsurance programs is focused on flood and typhoon damage. The supervisory review varies in intensity from year to year based on available resources to undertake a review. The focus of the review is not necessarily what is put in place but management discussions about the program. Management committee minutes are obtained to understand these discussions.</p> <p><i>Economic impact of reinsurance risk transfer</i></p> <p>Programs put in place in April are compared to strategies that are usually determined in February. There is enough information made available by insurers to understand the economic impact of insurance risk transfer. Most insurers operate well in excess of minimum SMR, so the FSA doesn't focus its supervision on the economic impact rather the risk management and control processes used.</p> <p><i>Supervision performed in the jurisdiction of the reinsurer</i></p> <p>The FSA does not have any requirements to consider the supervision performed in the jurisdiction of the reinsurer.</p> <p><i>Reinsurance impact on liquidity management</i></p> <p>The Guidelines II-3-10 on risk management for reinsurance do not directly address liquidity risk. The Guidelines II-3-12 Control Environment for Management Liquidity Risk does not reference liquidity issues in relation to reinsurance.</p> <p><i>Use of Insurance-Linked Securities</i></p> <p>Guidelines VII.3.6. 2 address the use of ILS at the group level. In practice, the use of ILS in the Japanese insurance market is immaterial.</p>
Assessment	Largely Observed
Comments	<p>Supervision of reinsurance arrangements is focused on large non-life insurers and mid-tier non-life insurers. This is understandable from a market impact point of view; however often smaller insurers are more dependent on more concentrated reinsurance arrangements and some risk assessment at the individual insurer level would be useful in targeting supervision resources where there are likely to be material concerns.</p> <p>The FSA does not differentiate reinsurance arrangements based on the quality of</p>

	<p>supervision in the jurisdiction. The focus is on credit ratings. This means that the requirements of Standard ICP 13.4 are not met.</p> <p>The FSA does not explicitly require consideration of liquidity risk in relation to reinsurance programs and does not explicitly require the approach to liquidity risk management to consider liquidity risk considerations in relation to reinsurance programs. As such, Standard ICP13.5 is not fully met.</p> <p>Recommendations:</p> <p>Supervisory guidelines should be updated by the FSA to require insurers to consider the impact of supervision in the reinsurer’s jurisdiction and should be updated so that liquidity risk considerations in relation to reinsurance are explicitly required by insurers.</p> <p>As part of addressing ICP 9 recommendations to implement individual insurer supervision and risk assessment, the FSA should consider the importance of reinsurance arrangements for all insurers and direct supervisory resources to focus more on reinsurance arrangements of reinsurers that may be more vulnerable to issues with their reinsurance programs.</p>
ICP 14	<p>Valuation</p> <p>The supervisor establishes requirements for the valuation of assets and liabilities for solvency purposes.</p>
Description	<p><i>Recognition, derecognition of assets and liabilities</i></p> <p>The rules applicable for recognition and derecognition of assets and liabilities come from Japanese Generally Accepted Accounting Principles (J-GAAP). Recognition of insurance liabilities occurs when an insurer is on risk for the contract, that is the contractual start of the coverage period. Any premiums received prior to this period are booked as a premium received liability.</p> <p>Valuation of assets and liabilities are based on J-GAAP except for valuation of policy reserves and investment reserves which is provided for in the IBA.</p> <p><i>Valuation of assets</i></p> <p>Securities are valued based on accounting standards for financial instruments with the following providing a summary:</p> <ul style="list-style-type: none"> • Trading securities: Market value through profit and loss • Held-to-maturity securities: Amortized cost • Equity securities issued by subsidiaries: Acquisition cost • Other securities: Market value through comprehensive income

An exception to the above classifications is that assets backing long term liabilities (Debt Securities Earmarked for Policy Reserves – DSR) are allowed to be valued at amortized cost even though they might otherwise be valued at market value. Use of amortized cost is subject to the following conditions:

1. Policies for appropriate risk management have been established
2. A system to comply with the policies
3. Subdivisions prescribed in the policies have been established and managed.
4. The effectiveness of duration matching is assessed and periodically verified.

The valuation of DSR is conducted in accordance with the *Temporary Treatment of accounting and Auditing Concerning Debt Securities Earmarked for Policy Reserve in Insurance Industry* issued by the Japanese Institute of Certified Public Accountants.

Insurers must maintain a Price Fluctuation Reserve in accordance with Article 115 of the IBA for trading securities. Insurers may apply for exemption from this requirement. The reserve must only be reduced where there is excess of losses on trading of securities. Article 65 of the OEIBA sets out the securities for which the Price Fluctuation Reserve is established which include domestic and foreign shares, JPY denominated bond certificates, assets denominated in foreign currencies and gold bullion. Article 66 provides a formula for determining the amounts to reserve.

Valuation of Policy Reserves

Article 116 of the IBA requires policy reserves to be accumulated by insurers from insurance premiums and investment income to ensure the payment of future insurance claims. Policy reserves are valued using the locked-in method, in which the calculation assumptions (accident rate and assumed interest rate) estimated at the time of contracting are fixed.

Through Article 69(1) of the OEIBA, policy reserves of life insurance companies are divided into the following four categories according to their function:

Insurance Premium Reserve: A reserve that has been set aside for future payments of insurance claims, pensions and benefits. The amount is actuarially calculated using assumed interest rates and other key assumptions such as assumed mortality rates

- **Outstanding Insurance Premiums:** The amount of premiums written that corresponds to the liability for unexpired premiums
- **Refund Reserve:** An amount set aside for possible refunds when the insurance contract provides for the refund of the whole or a part of the amount of insurance premiums or profits obtained by investing money received as insurance premiums and
- **Contingency Reserve:** Reserve that has been set aside to cover extraordinary risks in excess of the amount that the Insurance Premium Reserve and Outstanding Insurance Premiums covering insurance risk, insurance risk of third-sector insurance, scheduled

	<p>interest rate risk, minimum guaranteed risk - Note that the contingency reserve is considered part of the Solvency Margin (capital resources) for the purposes of the SMR.</p> <p>The calculation method for premium is broadly divided into the <i>Level Premium System</i> and the <i>Zillmer quota</i>. In general, the <i>Level Premium System</i>, is used to determine Policy Reserves. The <i>Zillmer quota</i> is used when the company is unable to use the <i>Level Premium System</i>, for example, when the insurer has just been established (Article 69(4)(iv) of OEIBA).</p> <p>For individual insurance policies contracted on or after April 1996, if it is recognized that there is a concern that there will be an underfunding in the future at the current funding level due to a decrease in interest rates or other reasons, an additional insurance premium reserve needs to be accumulated for the amount equivalent to the shortfall (Article 69(5) of the OEIBA). The analysis required is similar to an impairment test, called an income and expenditure analysis and is conducted during a 10-year analysis period. If a shortfall is expected to occur within the first five years of the analysis period, an additional policy reserve is required to be recorded. Therefore, any shortfall arising from the analysis period of more than five years is not currently reflected in the valuation of liabilities, and additional policy reserves are posted as appropriate over time.</p> <p>The calculation of the insurance premium reserve is based on set actuarial assumptions set out in Notice of the Ministry of Finance No. 48. Notable are the set assumptions on interest rates:</p> <ul style="list-style-type: none"> • 2.75 percent per annum for Contracts before March 31, 1999 • 2.00 percent per annum for Contracts from April 1, 1999 through March 31, 2001 • 1.50 percent per annum for Contracts from April 1, 2001 through March 31, 2013 • 1.00 percent per annum for Contracts from April 1, 2013 through March 31, 2015. <p>For contracts on or after April 1, 2015, depending on contract type the single interest rate applied is the sum of 50 percent of each of the 20-year government bond and 10-year government bond or the 10-year government bond, with conservative haircuts.</p> <p>This means that a yield curve is not being used to value policy reserves, the valuation is based on a single discount rate.</p> <p>The addition to the insurance premium reserve has been required for a number of life insurers as evidenced during the assessment.</p> <p><i>Embedded options</i></p> <p>Non-life policy reserves are divided into four functional categories³ (Article 70 (1) of the OEIBA)</p>
<p>³ Usual reserving requirements do not apply to Earthquake Insurance on Dwelling Risks and Compulsory Automobile Liability Insurance (CALI).</p>	

Regular Policy Reserve: Total for each of the categories listed below:

- Insurance Premium Reserve: The amount calculated in accordance with actuarial methodology for future obligations under insurance contracts (akin to a claims reserve).
- Outstanding Insurance Premiums: The amount equivalent to the liability corresponding to the unexpired risk based on the insurance premiums.
- Extraordinary Contingency Reserve: The amount calculated based on insurance premiums received to cover losses arising from extraordinary disasters - Note that the extraordinary contingency reserve is considered part of the Solvency Margin (capital resources) for the purposes of the SMR.
- Refund Reserve: An amount set aside for possible refunds when the insurance contract provides for the refund of the whole or a part of the amount of insurance premiums or profits obtained by investing money received as insurance premiums and
- Policy Dividend Reserve: The amount of the policy dividend reserve and any other equivalent amount.

If the policy reserve set is likely to be insufficient to cover the performance of the future obligations, additional regular policy reserve and refund reserve must be set aside (Article 70(3) of the OEIBA).

The extraordinary contingency reserve is policy reserve that is set aside over multiple fiscal years and is drawn down in the fiscal year when a catastrophe occurs. A certain percentage of the annual premium income is set aside as reserve in accordance with the statement of calculation procedures. (Ministry of Finance Notification No. 232, Article 2, Paragraph 1). A reserve reversal standard is set on a per business line basis. The extraordinary contingency reserve is used to cover risks such as large natural catastrophes that do not occur every year. If the net loss ratio for a year is above the reversal standard, then the contingency reserve can be drawn down. This is a form of profit smoothing over time.

There is no indication that the valuation of policy reserves reflects the insurer's own credit standing with respect to the assumptions used.

Actuarial certification

Insurers are required to appoint a responsible actuary under Article 120 of the IBA and the appointment of the responsible actuary is a matter for the board.

There are three actuarial reports required: Opinion on the Status of Property, Opinion on Property Reserve and Opinion on Distribution of Surplus. Article 121(1) of the IBA specifies the last two items and The Opinion on Status of Property is specified by Article

	<p>121(1)(iii) and Article 79-2 of the OEIBA. Actuarial reports are provided to the Board and the FSA.</p> <p>The Opinion on Status of Property is a financial condition report and provides a forward-looking view on whether assets are sufficient under a variety of scenarios with a 10-year forward view. The Opinion on Policy Reserves sets out a liability adequacy test and in one example reviewed it provided recommendations for strengthening reserves in certain lines of business. All of these opinions appeared to be very process oriented according to legislation and actuarial practice standards with very little qualitative content that would provide context to the numerical results of the report.</p> <p><i>Supervision</i></p> <p>The FSA places reliance on the actuary to provide an independent view on the valuation of assets and liabilities.</p>
Assessment	Partly Observed
Comments	<p>Assets and liabilities are measured on a consistent basis to an extent by design but there are exceptions. The creation of the contingency reserve for life insurers that acknowledges current economic conditions over the next 5 years creates some inconsistency compared to assets backing policy reserves that are held at amortized cost. Therefore ICP 14.2 is not fully met.</p> <p>Assets and liabilities are not valued on an economic basis. The discounting of future cash flows is based on an assumption of a single rate rather than a yield curve. The potential addition to insurance premium reserves for life insurance acknowledges changed circumstances but only to a limited extent with only 5 years of projections taken into account. The risk-adjusted present value of cash flows is only incorporated in policy reserves to this limited extent. For non-life insurance, the extraordinary contingency reserve is a profit smoothing tool and as such does not have an economic basis. Therefore, the requirements of ICP 14.4, ICP 14.5 and ICP 14.8 are not met.</p> <p>Policy reserves do not include an explicit Margin over the Current Estimate (MOCE) as required by ICP 14.7 and ICP 14.9.</p> <p>As minimum guarantee risk is a component of the contingency reserve for life insurers, to some extent embedded options and guarantees are taken into account but this calculation is on the basis of set formulas and assumptions. Therefore, it is not clear that ICP 14.11 is fully met.</p> <p>The FSA will introduce the economic value-based solvency regulation from fiscal year, 2025. Economic valuation underpins this new approach, and it is likely to address the shortcomings noted in this assessment. A revised actuarial opinion will be required and the FSA should consider working with the Institute of Actuaries of Japan to provide more qualitative opinions in the reports that may be useful for Board Directors.</p>

	<p>Recommendation:</p> <p>As planned, the FSA should introduce the economic value-based solvency regulation and ensure that all the requirements of ICP 14 are met.</p>
ICP 15	<p>Investments</p> <p>The supervisor establishes regulatory investment requirements for solvency purposes in order for insurers to make appropriate investments taking account of the risks they face.</p>
Description	<p><i>Regulatory Requirements</i></p> <p>An insurer must invest assets as set out in the IBA (Article 97(2) & (3) and Article 47 of the OEIBA). Article 97(2) of the IBA states that an insurer must invest in assets that are specified in a Cabinet Office Order. The relevant Cabinet Officer Order is the OEIBA which is Article 47 provides a list of allowable investments including securities as defined in Article 2 of the Financial Instruments and Exchange Act, real property, gold bullion, loans, deposits, trusts, securities related derivatives as defined in Article 2(20) and Article 28(8)(iv) of the Financial Instruments and Exchange Act, financial directives as defined in Article 98(1) of the IBA and foreign exchange futures.</p> <p>In addition, in order to control investment concentration risk, the amount of assets with the single counterparty is limited. Article 97-2 of the IBA states that an insurer cannot invest assets in excess of the amount specified by a Cabinet Office Order. Article 48-3 and Article 48-5 of the OEIBA is that cabinet office order. It is possible for an insurer to exceed the limit if it applies to the FSA and under Supervisory Guideline III-2-6 the FSA will require a plan for the insurer to reduce its exposure and monitor that plan.</p> <p>The FSA specifies the requirements to be applied to the investment activities of insurers in Guidelines II-3-11 Control Environment for Asset Management Risks and II-3-12 Control Environment for Managing Liquidity Risks. There are extensive requirements related to each major type of investment and derivative transactions. Liquidity risk requirement (see ICP 16) requires insurers to take into account the liquidity of assets and consider limits on low liquidity assets.</p> <p>Guideline II-3-11-2(1) requires a control environment for managing asset risks that enables insurer management to understand the extent of risks from assets, including credit risks. That implies gaining an understanding of credit risk but does not explicitly require avoiding placing undue reliance on credit rating agencies. Guideline VII-3-7 of the guidelines requires group-wide management of asset risks.</p> <p>The FSA requires an annual ORSA report to be provided by an insurer (more details under ICP 16) and one items to be covered in the report (ORSA Report Items 6. (2) (iii)) which the FSA requires the management companies to describe is cases where the transferability of funds and capital was examined between group.</p>

	<p>Guideline II-3-8 requires insurers to understand and manage the status of the total assets and liabilities. This requires them to invest in a manner that is appropriate to the nature and duration of its liabilities.</p> <p>Requirements for diversification of assets are implied in the Supervisory Guidelines in relation to the creation of limits for market risk management.</p> <p>The FSA requires insurance companies to develop and implement appropriate investment policies for credit investment in low liquidity instruments and securitizations (Guideline II-3-11-2 (1) 10 and II-3-11-2 (3)).</p> <p><i>Supervisory approach</i></p> <p>In addition, the FSA monitors the status of their asset management such as the security and diversification of their portfolios through asset management hearing or ORSA report.</p>
Assessment	Largely Observed
Comments	<p>Insurers are required to invest in accordance with specified investments set out in the OEIBA.</p> <p>There are no explicit requirements related to insurers ensuring assets are sufficiently secure and held in an appropriate location for their availability, so ICP 15.2 is not fully met.</p> <p>How insurers manage their assets is not regularly reviewed other than through the regular review of ORSA for the five largest life insurers and three largest non-life insurers. It is this lack of regular oversight of investment management that means this item cannot be considered observed. This matter relates to the issues raised in relation to ICP 9 and the way the FSA conducts supervision.</p> <p>Recommendation:</p> <p>As part of revisions to the approach to supervision, the FSA should ensure that asset management practices at insurers are subject to review based on a risk assessment of the activities of individual insurers.</p>
ICP 16	<p>Enterprise Risk Management for Solvency Purposes</p> <p>The supervisor requires the insurer to establish within its risk management system an enterprise risk management (ERM) framework for solvency purposes to identify, measure, report and manage the insurer's risks in an ongoing and integrated manner.</p>
Description	<p><i>ERM Framework Requirements</i></p> <p>The FSA requires insurers and insurance groups to develop an ERM framework according to individual management strategies and characteristics of risks (Supervisory Guideline II-3 and VII-3). In particular, for insurers facing large-scale complex risks, it is important to not only appropriately manage various risks involved by each risk category, but also</p>

develop control environments for ERM to manage all risks in an integrated and enterprise-wide manner (Supervisory Guideline II-3-1).

In order that insurers manage risks in their ERM framework, the FSA requires them to (Supervisory Guideline II-3-2-2 (1), and II-3-2-2 (3)):

- take into account all risks that they recognize as material, including difficult quantifiable risks;
- examine causes and impacts of various risks; and
- analyze mutual relationships between the risks based on above examination.

Similarly, the Guideline VII-3-2(3) requires insurance groups to ensure that their group-wide ERM frameworks are as consistent as possible across the group and to be aware of any material differences in approach to ERM according to the laws and regulations in the jurisdictions where the group insurers operate.

Guideline VII-3-2(5) requires management companies of insurance groups to appropriately implement group-wide ERM according to their management strategies and characteristics of risks, including:

- identification of risks;
- risk profile;
- risk measurement;
- risk management policy development and review; and
- own risk and solvency assessment (ORSA).

However, unlike CF 16.1b there is no specified list of risks that must be covered in group-wide ERM.

Risk management in relation to Intra-Group Transactions

Guideline VII-3-2(9) require the management companies of insurance groups to develop appropriate control environments for compliance with laws and regulations, and risk management with respect to intra-group transactions.

Under Article 100-3 of the IBA, an insurer must not conduct intra-group transactions other than on an arms-length basis. There is an example where the FSA checked the appropriateness of an intragroup transaction based on the material of the management meeting, although there are no specific reporting requirements on intragroup transactions.

	<p>Guideline VII-3-2(9) requires the management companies of insurance groups to develop appropriate control environments for compliance with laws and regulations and risk management with respect to intra-group investment.</p> <p><i>Quantification of Risk and Stress Testing</i></p> <p>Guideline II-3-3-1 requires insurance companies periodically to measure risks with appropriate forward-looking quantitative methods, such as risk measurement models, stress testing, and scenario analysis, in order to assess the significance and the probability of occurrence of risks.</p> <p>The FSA also requires all insurers and insurance holding companies to describe and report on their risk profile, approach to risk measurement and internal stress testing in their annual ORSA reports.</p> <p>Guideline II-3-3-3 requires the management companies of insurance groups to implement stress testing, reverse stress testing, sensitivity testing and so on, according to their financial conditions and risks held by themselves, while taking into account market trends.</p> <p>In light of the Holistic Framework, the FSA requires major insurers in Japan, including IAIGs, to submit reports on the state of risk management by the insurers for macroeconomic exposures (for example, a result of stress tests based on in-depth scenarios considering a macroeconomic stress).</p> <p><i>Independent assessment of ERM Frameworks</i></p> <p>Guideline VII-3-2 (6) requires the management companies of insurance groups to periodically implement internal or external independent assessments of their group-wide ERM framework.</p> <p><i>Elements of ERM Frameworks</i></p> <p>Guideline II-3-4-1 requires insurers to develop:</p> <ul style="list-style-type: none"> • risk management policies, including monitoring systems and management practices, for all categories of material risk, according to their risk profiles and strategic objectives in line with management policies; and • quantitative and qualitative risk tolerance policies and incorporate these into daily operations. <p>In the ORSA report, the FSA also requires all insurers and insurance holding companies to describe and report their management strategy, risk culture, risk management policy and own risk and solvency assessment in the ORSA report.</p> <p><i>Risk Appetite Statement</i></p> <p>Guideline II-3-4-2 requires insurers to develop risk appetite policies and clearly set out how they manage the level of risks they are willing to assume and the risk limit that apply.</p>
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Guideline VII-3-2(7) requires the management companies of insurance groups to establish and maintain a process to communicate and disseminate their quantitative/qualitative risk appetite within the group and externally as necessary.

Asset-Liability Management (ALM) Policies

Guideline II-3-8-2 requires insurers to set strategic objectives regarding ALM, and to clarify their policies regarding risk tolerance in the strategic objectives. Furthermore, under Guideline II-3-4-2, insurers are required to consider the following perspectives when developing ALM policies:

- whether the policies are designed to ensure consistency among product design, pricing, and relevant asset management strategies; and
- in particular, whether asset management and insurance product benchmarks are appropriately set in accordance with financial objectives, such as ALM.

Asset Management (Investment) Policies

Guideline II-3-11-2 requires insurance companies to develop a framework to operate and manage asset management risks on a daily basis and to take into account market risk, credit risk, liquidity risk and other risks. Insurers are also required to have an appropriate investment policy for investments with low market liquidity or with a high possibility of reducing market liquidity in the event of market turmoil. Insurers are required to appropriately manage credit risks related to major counterparties.

The FSA also requires the appropriate management of credit risks of major counterparties, (Guideline II-3-11-2 (4)).

Guideline VII-3-7-2 requires the management companies of insurance groups to develop group-wide asset management policies, and for each group company to develop and apply asset management policies that are consistent with the group-wide policies. The FSA requires the management companies of insurance groups to develop a framework to appropriately manage the concentration risk of particular exposures, such as setting the risk appetite and investment limits. This does not include a counterparty risk appetite statement other than in relation to reinsurance at the group level in Guideline VII-3-6-2 (2). Therefore, ICP 16.6 is not fully met.

Underwriting Policy

The FSA requires insurance companies to develop:

- risk appetite policies, including insurance underwriting policies, that set out how they manage the level of risks they are willing to assume and the risk limit (Guideline II-3-4-2); and
- control environments to appropriately manage insurance underwriting risks (Guideline II-3-9-1).

	<p>ORSA Report items include a description and report insurer's risk appetite that qualitatively clarifies which type of business lines or risks that they focus on (ORSA Report Items 4. Risk Management Policy (Risk Appetite)).</p> <p>Guideline VII-3-5-2(1) requires the management companies of insurance groups to develop group-wide insurance underwriting policies, and each group company to establish and apply insurance underwriting regulations that are consistent with the group-wide policies.</p> <p>Guideline VII-3-5-2(4) requires the management company of an insurance group to validate the valuation of insurance liabilities and reinsurance recoverable assets and to report the validation results to the board of directors.</p> <p><i>Group-wide strategy for reinsurance</i></p> <p>The management companies of insurance groups are required to develop group-wide control environments for reinsurance risk management from the viewpoint of exercising practical and effective governance over group companies' reinsurance arrangements. Group companies are required to appropriately develop their reinsurance risk management in a way that is consistent with group-wide reinsurance risk management (Supervisory Guideline VII-3-6-1). Supervisory Guideline VII-3-6-2 requires group-wide reinsurance risk management to focus on the following monitoring points:</p> <ul style="list-style-type: none"> • correlation between group-wide risk amounts and risk appetite or capital management strategies; • group reinsurance strategy and practices of group companies; • laws, regulations and practices applicable to group companies; • limits on or risk appetites for the credit risk of counterparties involved in reinsurance transactions; • the use of alternative risk transfer methods, including risk transfer products; and • effectiveness of risk transfer through reinsurance under stress situations <p><i>Group-wide actuarial policy</i></p> <p>Guideline VII-2-2(4) requires the management companies of insurance groups to develop control environments in order to ensure appropriateness of actuarial matters in group companies.</p> <p>The FSA focuses on the following monitoring points regarding the group actuarial function:</p> <ul style="list-style-type: none"> • whether the management company has formulated a group-wide policy regarding actuarial matters;
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- whether the actuarial function conducts evaluation (in cooperation with divisions in charge within the group) regarding actuarial methodology on a group-wide basis and at individual group companies;
- whether the actuarial function reports to the board of the management company on matters related to group-wide actuarial matters and potential risks related thereto at least once a year and gives independent advice. The actuarial function should report problems and being involved in considering and implementing measures to correct the problems; and
- whether the actuarial function is appropriately involved in the evaluation of the fulfillment of the regulatory capital requirements applicable to the entire group and group companies.

While not using the exact language of ComFrame Standards CF16.7d and CF16.7e, the intent of the provisions appears to achieve the same outcome.

Liquidity Risk Management

Guideline II-3-12 requires insurance companies to develop policies and control environments for liquidity risk management including:

- classifying their funding conditions according to the degree of funding stress; and
- developing rules such as management, reporting, and settlement methods according to the classification approved by the board of directors.

ORSA reports must describe and report the status of liquidity risk and how it is managed.

Guidelines II-2-2-6 and II-3-12 require insurance companies to manage liquidity risks such as securing liquid assets, implementing liquidity stress tests, and establishing contingency plans in the event of a liquidity crisis, as necessary.

In light of the Holistic Framework, the FSA requires major insurers in Japan including IAIGs to submit reports on the state of their liquidity risk management. It is not clear from HF reporting that all of the reporting requirements of CF16.9d are met.

Guideline VII-3-8-2(4) requires the management companies of insurance groups to implement liquidity stress tests considering their holding status of liquid assets and the assets' availability to absorb losses under stress situations. Guideline VII-3-8-2 (5) requires insurers to maintain sufficient liquid assets to take into account feasible and appropriate haircuts discovered in liquidity stress testing.

Guideline VII-3-8-2(6) requires the management companies of insurance groups to develop and review, in a timely manner, group-wide countermeasures against a liquidity crisis.

Own Risk and Solvency Assessment (ORSA)

Guideline II-3-5-1 requires insurers to periodically perform own risk and solvency assessment under the responsibility of the board of directors in order to assess the

	<p>appropriateness of own risk management and the sufficiency of the current and future solvency positions according to the management strategies and characteristics of risks. In their own assessment, the FSA requires insurers to take into account the future economic conditions and other changes in external factors including reasonably predictable material relevant risks. There must also be an assessment of the quality and adequacy of capital.</p> <p>For Holistic Framework reporting purposes, the FSA requires major insurers in Japan, including IAIGs, to submit reports on the state of risk management for liquidity risks, macroeconomic exposures, and interconnectedness from the perspective of contributing to the advancement of their own risk management.</p> <p>In carrying out their ORSA, insurers are required to take into account the medium-to long-term (e.g., three to five years) business strategies in particular new business plans (Guideline II-3-5-2 (1)).</p> <p><i>Recovery Planning</i></p> <p>The FSA requires IAIGs and, as necessary, the management companies of insurance groups engaged in large and complex business activities including international activities to develop and submit recovery plans annually. They are also required to submit recovery plans when there are material changes in the business or group structure.</p> <p>The FSA also requires major insurers that are not IAIGs to engage in dialogue and describe stress scenarios and recovery options including setting trigger levels to take actions in their ORSA reports.</p> <p>The FSA requires insurers to describe the following items in the recovery plan:</p> <ul style="list-style-type: none"> • overview of recovery plan; • analysis of the structure of the insurance group; • triggers for activation of recovery plans; • stress scenario analysis; • analysis of recovery options; • communication strategy within the group and externally; and • Governance over recovery plans, including control environments and systems necessary to acquire and manage information necessary for recovery plans. <p>The FSA has issued reporting orders and received initial recovery plans from the management companies of IAIGs in December 2021 and the updated plans in December 2022.</p> <p><i>Supervisory Review of ERM</i></p> <p>After ERM requirements were included in the Guidelines in 2014, there was an ERM monitoring process based on reviewing ORSA reports submitted. A significant portion of the licensed life insurers and non-life insurers in Japan were included in this process.</p>
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	<p>The FSA conducted the assessment, in accordance with pre-defined assessment viewpoints, including “Risk Culture & Risk Governance,” “Risk Control and Capital Adequacy,” “Risk Profile & Risk Measurement” and “Application to Business Management”, and confirmed whether the necessary systems have been developed to implement ERM and whether ERM principles are fully adopted in insurance companies.</p> <p>A comprehensive assessment of the soundness and profitability was conducted, and the results of the ERM assessment on insurance companies were classified into Assessment Levels 1-5 depending on their maturity.</p> <p>Feedback on the assessment results was provided to each company through interviews with top management. Furthermore, in order to encourage each company to enhance its ERM, the FSA compiled and published the assessment results.</p> <p>In FY 2017, 26 small and medium-sized companies that were assessed relatively low in the ERM monitoring assessment levels conducted in FY 2016 were selected and intensively monitored from a prudential perspective. Further follow-up reviews were conducted in the following years. In addition, large insurers were monitored from the view point of sustainable business models.</p> <p>There was no on-site component to this assessment. It was a desk review of reported ORSAs. Activities related to ERM supervision since 2017 have only targeted those insurers at lower levels in the ERM assessment exercise and insurers are not supervised individually. However, for the eight large insurance groups ERM reports continue to be analyzed.</p>
Assessment	Largely Observed
Comments	<p>ICP 16 is a complex principle with many detailed requirements, particularly in relation to ComFrame. The FSA made a concerted effort to incorporate ComFrame requirements into the Guidelines in 2020. This effort has been very successful with few requirements of ICP 16 not explicitly reflected in the Guidelines. There is no requirement for IAIGs to have a counterparty risk appetite statement other than in relation to group reinsurance so the requirements of ICP 16.6 are not fully met. It is not clear that reporting under the holistic framework meets the detailed liquidity reporting requirements for IAIGs in CF16.9d.</p> <p>Supervisory review of the requirements of ICP 16 is inadequate. There was one thematic review in 2016 of ORSA and thereafter It has only targeted those insurers at lower levels in the ERM assessment exercise. The largest group ORSA’s are reviewed annually and it seems many insurer’s ORSAs are filed and not systematically reviewed. There has been no on-site verification that ERM processes reported in ORSA reports are implemented and operating as described. It is the lack of consistent review of the implementation of ERM across a range of insurers that is a concern and has contributed to the assessment of Largely Observed.</p> <p>Recommendation:</p> <p>As part of revisions to the approach to supervision, the FSA should ensure that risk</p>

	management at insurers are subject to review based on a risk assessment of the activities of individual insurers.												
ICP 17	<p>Capital Adequacy</p> <p>The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention.</p>												
Description	<p><i>Legislative Basis</i></p> <p>Insurance companies are required to have a sufficient amount of capital to maintain a Solvency Margin Ratio (SMR) at 200 percent or higher (Article 130 of the IBA, Article 86 of the Regulation for Enforcement of the IBA, Article 2 of the Order Providing for Classification, etc. prescribed in Article 132, Paragraph 2 of the IBA). In addition, insurance companies are required to have at least one billion yen in capital (Article 6, Paragraph 2 of the IBA).</p> <p><i>Capital Requirements</i></p> <p>The SMR is calculated as Total Solvency Margin / {(1/2) × Total Risks}</p> <p>The SMR is based on a capital requirement (Total Risk) calculated using a factor-based approach calibrated to different levels according to the risk. There are different calibration levels for Earthquake risk: 99.5 percent, Storm and flood damage risk: 98.6 percent, Mortality risk: 99 percent, and Investment risk: 95 percent.</p> <p>Total amount of risk for life business = $\sqrt{(R_1 + R_8)^2 + (R_2 + R_3 + R_7)^2} + R_4$</p> <p>Total amount of risk for non-life business = $\sqrt{(R_5 + R_8)^2 + (R_2 + R_3)^2} + R_4 + R_6$</p> <table border="1"> <thead> <tr> <th>Types of risks</th> <th>Examples / Overview of Risk Measurement Techniques</th> </tr> </thead> <tbody> <tr> <td>Insurance risk (Life) (R1)</td> <td>Insurance amount at risk* 0.6/1000 (mortality risk)</td> </tr> <tr> <td>Insurance risk (Non-life) (R5)</td> <td>Net earned premiums or net incurred claims * factor by business line</td> </tr> <tr> <td>Third sector insurance risk (R8);</td> <td>Accumulation Limit of Contingency Reserve * 1 (Catastrophe Death Risk.</td> </tr> <tr> <td>Assumed Interest Rate risk (R2)</td> <td>Expected loss from a return on investment below the assumed interest rate</td> </tr> <tr> <td>Asset Management Risk (R3)</td> <td></td> </tr> </tbody> </table>	Types of risks	Examples / Overview of Risk Measurement Techniques	Insurance risk (Life) (R1)	Insurance amount at risk* 0.6/1000 (mortality risk)	Insurance risk (Non-life) (R5)	Net earned premiums or net incurred claims * factor by business line	Third sector insurance risk (R8);	Accumulation Limit of Contingency Reserve * 1 (Catastrophe Death Risk.	Assumed Interest Rate risk (R2)	Expected loss from a return on investment below the assumed interest rate	Asset Management Risk (R3)	
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Price fluctuation risk	Book value of assets * 20 percent (domestic stocks), 1 percent (policy-reserve-matching bonds), etc.
Credit risk	Book value of assets * factor for each asset class
Subsidiaries and other risks	Book value of assets * factor for each subsidiary, business, and assets
Derivatives trading risk	Balance of transactions * factor for each type of transaction
Credit spread risk	Notional principal amount of reference debt * factor for each location of assets
Other risks	Policy reserve / claims reserve for ceded reinsurance * 1 percent (reinsurance risk), etc.
Minimum guarantees risk (R7)	Policy reserve after asset price declines - Policy reserve for minimum guarantees
Operational risk (R4)	Total amount of capital charge for risks other than Operational risk * 2 percent or 3 percent
Catastrophe risk (R6)	The larger of the net claim amounts calculated based on prescribed scenarios for earthquake and windstorm damage.

The price fluctuation risk factors are: Domestic stocks 20 percent, Foreign stocks 10 percent, Bonds denominated in Japanese yen 2 percent, Bonds and loans denominated in foreign currency 1 percent, Real estate 10 percent, Gold bullion 25 percent, Trading account securities 1 percent, Items including exchange risk 10 percent. These factors are calibrated at a 95 percent VaR over 1 year level. These price fluctuation risks are combined through application of correlation matrix.

Group-wide capital adequacy

Group capital requirements apply on consolidated basis using a similar method to how the SMR applies at solo level.

Internal models

There is a potential for the use of internal models for minimum guarantee risk (R7). No insurer has adopted an internal model for R7. There are 13 criteria for the use of an internal model for R7 but these criteria are not as extensive as expected by ICP 17. For instance, there is no use test.

There is also the potential for an insurer to apply an internal model to calculated catastrophe risk (R6). Two types of catastrophe models are allowed to be used – an

engineering model and a theoretical distributed accident occurrence model. Some basic criteria are established for the use of these internal models for R6 but again they are not nearly as extensive as contemplated by ICP 17. No insurer has adopted an internal model for R6.

Capital Resources

Total Solvency Margin or capital resources in the terminology of ICP 17 is made up of the following items:

Item	Description	Provisions
Stated capital or funds	The total amount recorded in the net asset section of the balance sheet, less the amount to be disbursed as the disposition of surplus and the amount recorded in the items of Valuation and Translation Adjustments.	OEIBA Article 86
Price fluctuation reserve	In cases where the amount of loss from sale and purchase of assets exceeds the amount of profit, this shall be allocated to the price fluctuation reserve.	
Contingency reserve	The amount calculated for covering risks which are expected to arise in the future, in order to secure performance of future obligations under insurance contracts covering: Insurance risk, Assumed Interest Rate risk, Minimum guarantees risk and third sector insurance risk	
Extraordinary contingency Reserve	The amount calculated based on insurance premiums received to compensate for losses arising from extraordinary disasters.	
General loan-loss reserves	Reserve to be set aside in advance for possible default on loans in the future	
Valuation difference on available-for-sale securities	90 percent inclusion in solvency margin based on risk factors for price fluctuation risks of domestic stocks	

Unrealized gains (losses) on land	85 percent inclusion in solvency margin to take into account risks such as price declines	
Excess of surrender value amount	Policy reserve (excluding contingency reserve) in excess of surrender value Out of the reserve for future payment of insurance claims the amount exceeding the amount equivalent to payment calculated on the assumption that insurance contracts held by the insured will be terminated with no insured event occurring	Ministry of Finance Notice No. 50 Article 1
Dividend reserve not allocated	Dividend reserve in excess of the amount allocated as policy dividends,	
Tax effect equivalent	Introduced to capture the tax burden reduction effect by reducing taxable income when risks occur.	
Part of refund reserve	Non-life insurers Refund reserve which is set aside in excess of the amount calculated in accordance with the method specified in the statement of calculation procedures for insurance premiums and policy reserves	
Debt capital instruments,	This is included in solvency margin since a claim arises when the condition that other creditors are paid in full is satisfied.	
Deductions	Deduction of shareholding in other financial institutions when it is recognized as intentional a means of raising capital to improve capital adequacy ratio vis-a-vis another insurer or its subsidiary specialized in banking and securities.	

There is no tiering of capital resources.

Total Balance Sheet Approach

From the above it can be noted that there are reserves in Solvency Margin (capital resources) that cover risks similar to that covered in the total risks calculation. There is a lack of clarity in the SMR framework about where risks are being addressed.

	<p><i>Solvency Control Levels</i></p> <p>Solvency control levels are set out in a Cabinet Office Order Providing for Categories Prescribed in Article 132(2) of the IBA. Assigned categories have prescribed actions that the FSA can take.</p> <p><i>Development of regulatory capital requirements</i></p> <p>The FSA is currently developing the ESR which will be introduced in fiscal year 2025 (a full description is in Box 1). The development of this new requirement demonstrates that the FSA develops capital requirements in a very open and transparent process not just for stakeholders in Japan but also for international stakeholders. There has been yearly field testing, consultations and hearings with public reports made available.</p>
Assessment	Largely Observed
Comments	<p>The SMR is a risk-based solvency requirement which meets most of the requirements of ICP 17. However, there are shortcomings in the way in which risk is measured, the calibration level of the SMR (not consistent across risks) and the impact of the valuation approach on measuring risk. Given the different calibration of risks, there is no appropriate overarching target criteria and hence ICP 17.8 is not met.</p> <p>One key issue is that there is not a coherent total balance sheet approach in the design of the SMR. There are some risks which are measured in total risks, in valuation through reserves but then those reserves are recognized as part of solvency margin (capital resources). This means that ICP 17.1 is not met.</p> <p>The SMR is calibrated at a level that solvency control levels do not provide any constraint to the operations of insurers. Insurers are operating at close to 1000 percent SMR ratios with the first solvency control level at 200 percent, the level at which margin equates to risk. The likely ESR calibration results in an ESR of around 200 percent (margin equates to risk at ESR of 100 percent). This is indicative that the SMR is not calibrated at a sufficient level so that in adversity the insurer's obligations will continue to be met as they fall due.</p> <p>The lowest solvency control level is 0 percent. This is too low for an MCR as it only allows the strongest intervention – suspension of business and possible resolution – when losses have crystalized for creditors including policyholders.</p> <p>There are no explicit criteria for assessment of the quality and suitability of capital resources with all capital resources assigned to the same level of quality and suitability through no tiering of capital resources. However, with the haircuts provided to some amounts and through the explanation of each item of solvency margin, some consideration as to quality and suitability can be seen but it is far from best practice. It is arguable as to the extent that ICP 17.11 is met but it is unarguable that this is an area that needs improvement and will be addressed through the introduction of ESR.</p> <p>In fiscal year 2025, the FSA will introduce the economic value-based solvency regulation.</p>

	<p>The regulation is being developed in an open and transparent process. The introduction of ESR is likely to address the issues raised in this assessment.</p> <p>Recommendation:</p> <p>As planned, the FSA should introduce ESR in fiscal year 2025 and ensure that all of the requirements of ICP 17 are met.</p>
ICP 18	<p>Intermediaries</p> <p>The supervisor sets and enforces requirements for the conduct of insurance intermediaries, in order that they conduct business in a professional and transparent manner.</p>
Description	<p><i>General framework</i></p> <p>There are provisions in the IBA and OEIBA on intermediary registration (the term used for licensing) and supervision. The FSA's Guidelines also set out expectations, separately for agents, who are supervised both directly by FSA and the LFBs and indirectly via the FSA's supervision of insurance companies who use agents; and brokers who are directly supervised by FSA and LFBs. Solicitation is the term applied in law to sales of insurance products. Other general financial service legislation such as the Financial Instruments and Exchange Act (FIEA) also provide rules relating to solicitation of insurance contracts.</p> <p>Agents may be individuals or legal entities (some have large national or regional networks) or banks and other financial institutions. Many sell insurance incidentally to business such as car dealing and real estate. Insurers are held liable for any damage caused by an agent to a policyholder (Article 283 of the IBA).</p> <p>As in other markets, brokers are required to act for customers rather than for insurers (Article 299 of the IBA).</p> <ul style="list-style-type: none"> • In life insurance, agents accounted for approximately 32 percent of the total sales on an annualized premium basis in FY 2022. Financial institutions acting as agents (mainly banks) accounted for 31 percent and direct sales by insurers 37 percent. There are around 34,000 agents and over 240,000 individual sales persons. • In non-life insurance, agents accounted for 90.5 percent of the total (primary insurance sales measured by net direct premiums, FY 2022), with direct sales by insurers accounting for approximately 8.6 percent and brokers 0.9 percent. There over 150,000 agencies and over 1.8million individual sales persons; and 55 broker companies with some 1,500 staff. <p>The FSA delegates responsibility for registration and supervision of agents and brokers to LFBs while retaining certain oversight and powers of intervention (see ICP 1). It has small numbers of staff (two for each of life and non-life insurance) dedicated to intermediary supervision and works closely with LFBs in practice. The LFBs, being present in the</p>

prefectures of Japan, are judged well-placed to register and supervise the large numbers of intermediaries in Japan with their geographic dispersion.

The ministries that supervise the insurance business of cooperatives (kyosai) are responsible for supervising the respective intermediaries, unless those intermediaries (or the kyosai organizations themselves) act as agents for insurers regulated by the FSA and LFBs.

Licensing

Insurance agents (referred to in the IBA as specified agents) and brokers must be registered by the FSA (Articles 276 and 286 of the IBA), although in practice registration (i.e., licensing) decisions are taken by the LFBs under the delegation arrangements. Article 279 sets out conditions of agent registration. Applications for registration are processed by the LFBs, who undertake much of the administrative work relating to intermediary supervision, receiving reports and notifications etc.

Supervision

Agents are subject to both direct and indirect supervision:

- Agents make reports directly to the LFBs (the reports can also be accessed by the FSA): larger agents (those with 15 or more affiliated insurers or with two affiliated insurers and at least JPY 1 billion in annual fee income) are subject to requirements to prepare and keep books and documents (Article 303 of the IBA) and to make a business report covering their transaction volume (number of contracts, insurance premiums, fees, etc.) within three months of their year-end (Article 304 of the IBA).
- The FSA supervises agents indirectly via requirements imposed on insurers in relation to their solicitation activities, including their arrangements with agents, and may undertake supervisory work to assess insurers' compliance.

There are extensive provisions in the Guidelines (II-4-2) on insurers' controls over the management of insurance solicitation, including measures that apply to their direct sales. In respect to their solicitation via agents, insurance companies are required, for example, to:

- provide appropriate education, management and guidance for their agents (Article 100-2 of the IBA, Article 53 (1) item 3 of the OEIBA and Guidelines II-4-2-1 (4));
- ensure that insurance agents are carrying out their business in an appropriate manner through audits, etc. on a regular or as-needed basis, and that they make improvements as necessary (Article 53-11 of the OEIBA, Guidelines II-4-2-1 (4) (iii)); and
- examine the suitability of insurance sales representatives when recruiting them or assigning them to insurance agencies (Guidelines II-4-2-1 (3) - I)).

There are also extensive requirements on solicitation via banks, reflecting concerns that banks may use their lending operations to pressure borrowers to buy insurance (banks

were in the past banned from selling insurance because of such concerns) (Article 53-3-3 and Article 212 of the OEIBA, Guidelines II-4-2-6). Banks with significant insurance sales may be subject to supervision work by FSA's Banking Business Divisions, which are responsible for all aspects of banking supervision.

Brokers are directly supervised by both LFBs and FSA. Similar to agents, they are required to submit an annual business report. Supervisory work may be undertaken by the LFB or FSA, The Guidelines Section V set out detailed requirements on brokers.

In practice, the FSA and LFB supervisory work is mainly focused on responses to areas of concern (see *Supervisory measures* below). They have recently undertaken extensive thematic work on insurance solicitation, including on-site work, but focused on direct sales in life insurance where serious problems had been identified, rather than on intermediaries. On-site inspections are rare. There is no on-site supervision of brokers, reflecting the small scale of the broker channel.

Professional qualifications etc.

The Life Insurance Association of Japan (LIAJ) and the General Insurance Association of Japan (GIAJ) provide curricula for the training of insurance agents, including examinations. For example, for non-life insurance agents, the course includes basic training on insurance and then training on specific products. All agents (i.e., individual sales staff) are required to take an examination before they engage in insurance sales activities. They must also sit regular further examinations, for example every five years in the case of non-life insurance. GIAJ also provides an "experts course" with more in-depth training and a "consulting course" on practical knowledge, but these are not mandatory.

For brokers, the Japan Insurance Brokers Association (JIBA) has developed curricula and manages examinations. There are requirements for brokers applying for registration to certify that they have required capacity (Article 287 of the IBA, Article 219 of the OEIBA, Guidelines V-1-3). Checks are made that brokers have passed the examination (Article 289 of the IBA, Guidelines V-1-7). JIBA organizes qualification renewal training for already qualified brokers, which they must do every three years.

LIAJ, GIAJ and JIBA consult FSA on the scope of curricula and examination processes, but they do not enforce examination requirements. In the case of agents, it is for insurers to check that examinations have been passed by sales staff selling their products.

Governance

There are requirements in legislation that agents and brokers take measures to ensure sound and appropriate operation of the business of insurance solicitation (Article 227-7 of the OEIBA). However, there are no explicit requirements on intermediary governance (for example on the role of the board of directors in the case of companies etc.) other than the generally applicable governance requirements of the Companies Act.

Disclosure to customers

Agents are required to provide appropriate information when undertaking insurance solicitation (Article 294 (1) of the IBA). This should include the name of the affiliated insurer and their status as agent, i.e., clarifying that they act for the insurer (Article 227-2 (10), Item 1 of the OEIBA). Agents are not required to disclose the basis of their remuneration.

Insurance brokers must inform their clients of their name, details of their authority (including that it may not conclude, amend or cancel insurance contracts or receive or refund insurance premiums on behalf of an insurer) and the particulars of their broker's compensation for damages etc. (Article 294 (4) of the IBA). On request of a customer, brokers must disclose the amount of commission, reward, or any other consideration that they receive (Article 297 of the IBA).

Client money

When they receive payment of premiums, agents are required to issue a receipt as specified by the insurer clearly separating the premiums from the agent's own property and to settle the payment with the insurer in a timely manner (Guidelines II-4-2-1 (4)).

To protect policyholders, insurance brokers, although not permitted to handle client money, are required to ensure their financial resources for compensation by making security deposits (Article 291 of the IBA and Guidelines V-2). This requirement reflects the fact that insurers are not liable for damage caused by a broker to a policyholder, as they are for agents.

The amount of the required deposit is the higher of JPY 20 million yen and an amount equal to the total commissions received by the broker in the past three years with an upper limit of JPY 800 million. There are notification requirements in relation to brokers' deposits, and supervisors can (but in practice do not actively) check that they have been made and are managed appropriately. Brokers may, with the approval of the FSA, obtain insurance in place of having to make a security deposit.

Supervisory measures

In case of concerns about either agents or brokers, which would typically arise from the analysis of business reports, from reports by insurers or intermediaries (all are required to report "deplorable events") public sources or complaints, the LFB would normally coordinate with FSA on a supervisory response. The LFB or FSA may conduct on-site supervisory work, separately or together. Documentation of a joint inspection carried out on a medium-sized agent company was reviewed for the purposes of this assessment. It involved six staff over a two-week period.

In case that formal powers need to be used, such as an order requiring submission of information or imposition of a business improvement order, the LFB and FSA work together and may issue an order using powers in the IBA to require information (Article 305). Powers to issue a business improvement order under Article 306 are delegated to

	<p>the LFBs. Examples of where LFBs have issued orders were discussed with FSA and a representative LFB for the purposes of this assessment.</p> <p><i>Unregistered business</i></p> <p>The FSA (or LFBs) may identify as part of its oversight of the sector insurance solicitation being carried out by an unregistered person. They may involve law enforcement agencies. The FSA noted that there have been cases, but mostly where unqualified individuals within a registered company have been found to be involved in solicitation. Corrective actions have been required, but no sanctions, which may include fines, have been imposed to date (they may also be applied to persons registered as an agent or broker by wrongful means).</p> <p>Insurers are required to establish a control framework to prevent violations of insurance sales regulations, including sales by unregistered entities (Guidelines II-4-2-1).</p>
Assessment	Largely Observed
Comments	<p>There is an extensive framework of requirements on intermediaries, covering registration and supervision as well as regulatory standards. Delegation by the FSA of agent and broker registration and other work to the LFBs has brought supervision closer to markets and enabled FSA to focus limited resources on addressing areas of supervisory concern, in close cooperation with the LFBs. Much of the work of monitoring agent conduct is undertaken by insurers.</p> <p>There are some areas where the approach could be more aligned to the ICP standards: governance requirements and requirements on agents to disclose the basis of their remuneration.</p> <p>FSA could also increase its supervisory work on intermediaries, which is mainly reactive at a time when many of the supervisory concerns have been arising in the insurers' direct sales channel rather with agents and brokers. There is scope for FSA, with LFB support, to undertake more proactive supervisory work on insurers' oversight of agents, potentially also on agents directly and on brokers, where selective supervisory work would help develop expertise in this important area of intermediation at the FSA. More focus on brokers could also help FSA address reasons for the unusually limited use of brokers in the Japanese market, when the broker's role in acting for customers can improve policyholder outcomes. This additional work could not be undertaken without increased FSA resources.</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> the FSA review the limited areas where their approach does not clearly meet ICP standards (governance and some disclosure requirements) and make changes to existing Guidelines; and

	<ul style="list-style-type: none"> the FSA develop a process for risk-based supervisory work on agents and brokers (notwithstanding their current limited market share), focusing (for direct supervision) on larger entities and/or those assessed as higher risk; and (in indirect supervision) on insurance companies' monitoring of their agents.
ICP 19	<p>Conduct of Business</p> <p>The supervisor requires that insurers and intermediaries, in their conduct of insurance business, treat customers fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied.</p>
Description	<p><i>General framework</i></p> <p>Insurers and intermediaries are subject to general requirements in the IBA on how they conduct business. Further requirements are set out in OEIBA. The FSA's Guidelines create expectations on insurers and intermediaries at a more detailed level (Section II for insurers and agents, including provisions on solicitation (see ICP 18), complaints handling, disclosure to customers etc.; and Section V on brokers). Section IV of the Guidelines covers FSA's approach to the approval of new insurance products, a process which aims to assess products from a protection of policyholders as well as a prudential supervisory perspective (IV-1-1).</p> <p>The FSA also works with trade associations to improve business conduct. For example, following recently identified cases of fraud by life insurers' direct sales staff (see ICP 21), the FSA requested LIAJ to develop material – published in the form of principles and practices reported by life insurers – to help life insurers to upgrade relevant systems and controls (Points of focus regarding further development of compliance and risk management systems for sales staff channels, LIAJ, February 2023). LIAJ is following up on the publication with implementation questionnaires to member companies. The FSA is considering its own follow-up action, considering its own supervisory work in this area (see ICP 21).</p> <p>The FSA carries out integrated supervision. Teams of supervisors are responsible for both prudential and conduct supervision of insurers, including the Monitoring and Inspection section (see organization chart under ICP 2 above), although much of the work on prudential issues falls to the Insurance Prudence Monitoring Office. A separate Insurance Products Office assesses new product approval requests.</p> <p>In practice, most of the work of supervision teams (i.e., those responsible for day-to-day oversight of insurers) as well as the teams working on intermediaries and the Monitoring and Inspection Section have been devoted to business conduct issues in recent years because of the extent and severity of the issues that have arisen.</p> <p>There is, however, no wider risk assessment of conduct-related risks in the market. Supervision teams and the Products Office develop insights into new and emerging risks to policyholders etc. Areas where a supervisory response is required, including thematic</p>

work, are discussed by relevant staff, responsibility allocated and action taken, without a defined risk assessment process or dedicated staff. The annual planning cycle is when resource allocation is usually decided.

Due skill, care and diligence and fair treatment of customers

Article 100-2 of the IBA sets out a core requirement that insurers ensure sound and appropriate management, such as explanation of material particulars of its business to its customers, appropriate handling of customer information acquired in relation to its business. Article 100-2-2 requires them to take measures so that the interests of the customers of the business will not be unjustly harmed. The Guidelines (II-4-4) set out similar high-level requirements on appropriate execution and sound management of business, supported by extensive detailed requirements. These cover, as applicable, both the insurers' own sales and business conducted via agents.

In respect to agents, under the indirect supervision approach (see ICP 18), insurers are required to monitor agent performance, ensuring, for example, that they carry out their business in an appropriate manner (Article 53-11 of the OEIBA, Guidelines II-4-2-1 (4) (iii)). Among the many matters to be covered by insurers are assessments of whether their agents have taken measures to prevent policyholders being unfairly induced to switch from one insurer to another.

Insurance brokers are subject to expectations that they act in good faith in accordance with their obligations to clients, taking into consideration the situation of the client and advising on the most appropriate insurance products, regardless of the amount of commission etc. they receive from insurers (Guidelines V-5-3).

Conflicts of interest

FSA's Guidelines set out expectations that in order to manage conflicts of interest, insurers should identify transactions with the risk of such conflicts, develop controls for managing them and formulate (and disclose in outline) a Conflict of Interest Management Policy. Supervisors are expected to assess whether disclosures of conflicts have been made to customers through appropriate means (Guidelines II-4-6).

There are also provisions on sources of conflict of interest such as those that may arise within a group (Article 100-2-2 (1) of the IBA and Guidelines II-4-6-1)). For intermediaries (see ICP 18 also), the requirements on potential conflicts, such as in relation to the role of agents and broker remuneration are addressed through disclosure requirements (Article 297 (3) item 2 of the IBA).

Arrangements between insurers and intermediaries

There is extensive material in the Guidelines covering both agents' and brokers' relationships with insurers. Section II-4-2 of the Guidelines (Control Environment for Managing Insurance Solicitation) covers the controls which insurers and agents need to establish to prevent harm to policyholders, for example the checks which insurers must

	<p>carry out when deciding to sell through agents (including the examination status of sales persons and processes for disclosure of required information).</p> <p>Brokers are required to maintain relationships with insurers consistent with acting on behalf of customers. The Guidelines set out expectations (in the form of issues for supervisors to consider rather than detailed requirements) on, for example, investments in brokers by insurers, loans from insurers and exchanges of staff (V-4-3).</p> <p><i>New products and consumer interests</i></p> <p>The Guidelines set out expectations on insurers, including that they verify whether the coverage etc. suits the needs of policyholders; and that they take appropriate measures to address risks associated with the product and points to be disclosed noted in sales, taking into account customer characteristics etc. (Guidelines II-2-5-2 – Internal Control Environment for Product Development, although the focus of this material is mainly on financial management and systems issues). Supervisors are expected to confirm whether the board of directors has established arrangements and procedures for managing internal controls related to product development.</p> <p>Insurers must obtain prior approval from the FSA of new products, except where the product is judged not likely to impair the protection of policyholders, in which case a notification requirement applies (Article 123 of the IBA and Guidelines Section IV).</p> <p><i>Promotions</i></p> <p>There are requirements in law prohibiting insurers, agents and brokers from providing misleading information about the content of an insurance contract or misleading policyholders over their benefits (Article 300(1) of the IBA and Article 234(1) of the OEIBA). The FSA notes that there have been cases specifically in relation to advertising, the latest in 2007, when these requirements were enforced through administrative actions.</p> <p>The Guidelines refer specifically to promotions in connection with supervisory assessment of insurers' measures to obtain understanding of the customer on the presentation of an insurance contract, where presentations are defined to include advertisements using posters, signboards etc. or in newspapers, broadcasting etc. or using the internet (Guidelines II-4-2(9), which references Article 300(1) of the Act). In addition, LIAJ and GIAJ have prepared guidelines on promotions.</p> <p>The FSA does not check websites and advertisements, even on a sample basis, expecting insurers to make their own efforts based on the LIAJ and GIAJ guidelines.</p> <p><i>Pre-contractual and other information</i></p> <p>Insurers and intermediaries are required to provide policyholders with information on the contents of insurance contracts and any other relevant information that would contribute to the protection of policyholders (Article 294 (1) of the IBA; Article 227-2 (3) of the OEIBA). Failure to disclose required information subject to penalties (Article 300(1) of the IBA).</p>
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The Guidelines elaborate extensively on the information that insurers and agents must provide (II-4-2-2 (2)), listing generally applicable items and specific disclosures for types or features of products such as foreign currency insurance and market value adjustments. There are also expectations on the conduct of sales to the elderly (II-4-4-1-1(4)). The Guidelines include requirements on the adequacy of systems to ensure delivery of adequate information. For insurance products such as variable annuities with no minimum guarantee, insurers and intermediaries must provide documentation on their asset management performance (Article 53(1) of the OEIBA).

Insurers and agents are required to develop an understanding of the customer's intention and propose insurance in line with that intention. They must explain the content of the contract and provide the customer with the opportunity to confirm that it is aligned with their intention (Article 294-2 of the IBA, Guidelines II-4-2-2(3)).

Advice

There are no specific provisions in insurance legislation on giving of advice to customers. However, as noted, there are requirements on ascertaining the customer's intention before proposing an insurance product.

Other expectations in the Guidelines (II-4-4-1-3) address the principle of suitability of a product for the customer, creating an expectation that insurers and agents ensure that sales of insurance are suited to their customer's attributes, etc. and based on an understanding of the customer's knowledge, experience, asset status and purpose for concluding a contract. Provisions in Article 40(i) of the Financial Instruments and Exchange Act apply as does (for agents and brokers) Article 234-27(1)(iii) of the OEIBA.

Service through the policy life

There are no specific provisions citing service following the sale of a product (and much of the material in law and Guidelines refers to solicitation, i.e., point of sale requirements). However, the general requirement on insurers to take measures to ensure sound and appropriate management applies (Article 100-2 (1) of the IBA).

Claims handling

There are no specific legislative requirements on fair claims handling, but FSA has set out extensive expectations in its Guidelines (II-4-4-2 Control Environment for Managing the Payment on Insurance Proceeds). It notes there that there have been significant delays in the past (as there were during the COVID-19 pandemic) in claims payments. There are also guidelines published by LIAJ and GIAJ on claims handling.

As well as a general expectation that insurers establish appropriate systems to ensure timely and appropriate payment of insurance claims, the Guidelines include (as supervisory viewpoints), for example, whether the insurer has a control environment under which it recognizes that the payment of insurance claims is its core business and makes continuous efforts to develop and establish an appropriate insurance claim

	<p>payment management system; and whether it reflects the opinions of outside experts as necessary in making the final judgment on the assessment of claims (Guidelines (II-4-4-2)).</p> <p>FSA conducted extensive monitoring of claims performance of insurers during and after the COVID-19 pandemic. It has not had to issue any corrective action requirements or otherwise use powers (e.g., to impose sanctions) on the issue in recent years.</p> <p><i>Complaints handling</i></p> <p>The Guidelines set out an expectation that insurers establish a control framework to address complaints filed by customers promptly, fairly and appropriately (II-4-3-2 Control Environment for Dealing with Complaints). They cover internal procedures for handling complaints to the insurer, including adequacy of its resources, and the quality of the insurer's dealings with customers such as keeping the customer informed.</p> <p>There are also expectations on insurers to cooperate with Alternative Dispute Resolution (ADR) Systems. Since 2010, insurers must conclude a contract with an ADR institution designated by the FSA and comply with its procedures etc. (they also have rights of access, as do policyholders etc., to a court). There are four main ADRs operated by LIAJ, GIAJ, the Insurance Ombudsman and the Small Amount and Short-Term Insurance Association. Compliant volumes are low, for example 9,298 were received by the GIAJ ADR in FY 2021.</p> <p><i>Protection of customer information</i></p> <p>There are requirements in legislation on insurers' approach to the security of information concerning individual customers. They must take necessary and appropriate measures to prevent the leaking, destruction or loss of such information (Article 53-8 of the OEIBA). General requirements on protection of information apply to insurers, including the Act on Protection of Personal Information and related guidelines.</p> <p>The FSA's Guidelines set out various expectations, again in the form of supervisory viewpoints, for example whether senior managers recognize the need for controls and whether the insurer has established appropriate controls in practice. There are expectations on procedures where the insurer has entrusted information handling to third parties, including agents and outsourcing contractors. Insurers are expected to carry out audits of the operation of controls. There are detailed provisions specifically on the protection of information about customers that are individual persons (Guidelines II-4-5 – Management of Information Related to Customers etc.).</p> <p><i>Disclosures by the supervisor in support of customer protection</i></p> <p>The FSA issues warning notices, sometimes in cooperation with other agencies including law enforcement, regarding unlicensed activities, the risks of fraud on policyholders etc. It publishes consumer information on its website.</p>
Assessment	Largely Observed

Comments	<p>There are extensive provisions, especially in FSA's Guidelines, on all aspects of business conduct, covering insurers (in relation to their direct sales), agents (including the oversight expected of insurers) and brokers. The FSA's product approval work, integrated approach to supervision of insurers and intermediaries and its extensive framework of supervisory viewpoints included in the Guidelines equips FSA to identify and respond effectively to conduct issues.</p> <p>Supervision work is, however, in practice mainly focused on addressing significant concerns over past misconduct, often following reports by insurers themselves. Wide-ranging and effective thematic work has been undertaken in recent years on fraud-related issues (see also ICP 21) and corrective actions required of certain insurers. However, market-wide intelligence gathering and risk assessment (in coordination with Insurance Product Office and using product data reports, complaints etc. and surveys of financial promotions) could be developed to enable FSA to identify and respond to potential future misconduct or new and emerging areas of concern across the market. It could also develop related processes for proactive supervision of controls over conduct issues, corporate culture and the effectiveness of compliance functions.</p> <p>It is recommended that FSA strengthen assessment of conduct risks, market wide and at insurers and intermediaries, through enhanced market intelligence and supervisory work, including on-site supervision as appropriate.</p>
ICP 20	<p>Public Disclosure</p> <p>The supervisor requires insurers to disclose relevant and comprehensive information on a timely basis in order to give policyholders and market participants a clear view of their business activities, risks, performance and financial position.</p>
Description	<p><i>Legislative requirements for disclosure</i></p> <p>Insurers are required to make disclosures in line with Article 111(1) of the IBA with matters prescribed to be reported in an annual business report set out in Article 59-2 and 59-3 of the OEIBA. These requirements include that financial statements must be published including a consolidated balance sheet, consolidated profit and loss statement, consolidated cash flow statement and a consolidated statement of change in shareholders' equity as well as notes providing further explanation of items in these statements. Where consolidated financial statements are not available, financial statements for the insurer are required. Insurers are required to make available financial statements within four months from the beginning of the following business year (Article 59-4(1) OEIBA) A less comprehensive interim semi-annual business report is also required under Article 110(1) of the IBA with matters set out in Article 59-1 of the OEIBA.</p> <p>Insurers are required to have audits of financial statements (except for foreign insurers operating in the form of a branch)—see Articles 54-4 and 199 of the IBA, Item 1 of Paragraph 2 of Article 436 of the Companies Act.</p> <p>Other requirements in Article 59-2 and 59-3 of the OEIBA relevant to ICP 20 are:</p>

	<ul style="list-style-type: none"> • framework for risk management; • organizations for business management (may be equivalent to governance framework but details are not elaborated); • capital adequacy; • the details of the principal business of the insurer; • the status of soundness of solvency margin; • the acquisition value, contracted value, market value and loss or gain on valuation, in relation to <ul style="list-style-type: none"> – securities; – monetary trust; and – derivatives <p>In addition, the appendix tables on the Article 59-2 and 59-3 of the OEIBA provides detailed lists of items and further guidance on indicators of the status of business for the latest two business years (Article 59-2 (1) (iii) (c) of the OEIBA), outstanding policy reserve (Article 59-2 (1) (iii) (d) of the OEIBA), and the status of soundness of solvency margin (Article 59-2 (1) (v) (d) of the OEIBA).</p> <p><i>Supervisory Guidelines</i></p> <p>Guideline III-2-15 also provide some elaboration on the statutory disclosure requirements set out in the IBA and OEIBA. In particular, III-2-15 (2) f provides elaboration on risk management disclosures.</p> <p><i>Industry Disclosure Standards</i></p> <p>The LIAJ and the GIAJ publish Disclosure Standards for member insurers which address many of the requirements of ICP 20. These have not been assessed as they are not regulatory requirements issued by the FSA.</p> <p><i>Approach to supervision</i></p> <p>Disclosure by insurers is only routinely assessed by supervisors at the FSA in relation to the eight insurers that are part of the holistic framework monitoring.</p>
Assessment	Largely Observed
Comments	<p>Article 59-2 (1) (iv) (a) of the OEIBA requires insurers to disclose their risk management system, and section III-2-15-2 (2) of the Supervisory Guidelines clarifies that it includes “the risk content, basic policy for risk management, and risk management systems such (as) the examination systems, inspection systems, and comprehensive management systems for asset liabilities”. The “risk management system” referenced here is linked to</p>

detailed requirements on ERM (Guidelines II-3 and VII-3), including asset-liability management (Supervisory Guidelines II-3-8 and VII-3-4) and liquidity risk management (Supervisory Guidelines II-3-12 and VII-3-8). These requirements together meet components of ICP 20.2, ICP 20.3, and address the requirements of ICP 20.7, ICP 20.8, ICP 20.9, ICP 20.11

There are disclosure requirements by business segments contained within Article 59-2 (1) (iii) (c) of the OEIBA and the associated tables with insurers required to disclose indicators on the status of principal business and insurance contracts by different insurance product categories. So, the requirement to make disclosures about key business segments in ICP 20.3 is met. Article 59-2 (1) (iii) (a) requires the disclosure of the “overview of the business for the Most Recent Business Year”. Section III-2-15-2 (2) b. of the Supervisory Guidelines requires that such disclosure provides “a general explanation of the business conditions, business performance, asset management, profit and loss status, and issues that the Company should address”. Therefore, the requirement in ICP 20.3 for an insurer to make disclosures external environment in which it operates is met.

Insurers are required to disclose organizations for business management (Article 59-2 (1) (i) (a) of the OEIBA, solo-basis), and the details of the principal business of the Insurance Company and its Subsidiary Company and their organizational framework (Article 59-3 (1) (i) (a) of the OEIBA, group-basis). Additional guidance is provided through Guideline II-2-15-2. There are disclosures required about compliance and risk management. So, the requirements of ICP 20.4 are met.

There are extensive disclosure requirements on a breakdown of policy reserves, rates and methodologies for funding of policy reserves, outstanding, assumptions (calculation coefficients) including assumed interest rates, in the appendix tables on Article 59-2 (1) (iii) (c) and Article 59-2 (1) (iii) (d) of the OEIBA. Disclosure of information on the future cashflow analysis conducted by the Responsible Actuary is also required. (Article 59-2 (1) (iv) (c) of the OEIBA, Supervisory Guidelines II-2-1-4 (1)). Therefore, the requirements of ICP 20.5 are met. The requirements related to ICP 20.6 are met based on the combination of requirements in the OEIBA and the Guidelines.

The appendix tables for Article 59-2 (1) (iii) (c) of OEIBA which requires detailed disclosure about assets held, and in combination with the detailed risk management disclosures required under Article 59-2 (1) (iv) (a) of the OEIBA and section III-2-15-2 (2) f of the Supervisory Guidelines meet the requirements of ICP 20.7 and ICP 20.8

The requirements of ICP 20.10 to disclose details about an insurer capital adequacy are met by the appendix table to Article 59-2 (1) (v) (d) of the OEIBA.

	<p>There are a wide range of disclosure requirements on financial performance in Article 59-2 (1) of the OEIBA and Supervisory Guidelines II-2-1-4(1) which meet the requirements of ICP 20.12</p> <p><i>Supervision</i></p> <p>Disclosure standards are only assessed in detail in relation to the large insurance companies – these companies are less likely to fail to meet supervisory disclosure and in fact make voluntary disclosures in excess of supervisory requirements. There is some checking of compliance with disclosure requirements for small-to-medium companies through analysis related to the EWS. Checking of compliance with disclosure requirements should be addressed more systematically in relation to all individual insurers. This would be made possible if the recommendations in relation to ICP 9 are introduced and supervisory plans are developed for each insurer.</p> <p>Recommendation:</p> <p>Supervisory assessment of insurers’ disclosures should be addressed more systematically in relation to all individual insurers.</p>
ICP 21	<p>Countering Fraud in Insurance</p> <p>The supervisor requires that insurers and intermediaries take effective measures to deter, prevent, detect, report and remedy fraud in insurance.</p>
Description	<p><i>Insurance fraud as a criminal offence</i></p> <p>Article 246(1) of the Penal Code provides that a person who defrauds another person of property is punished by imprisonment for not more than 10 years. Insurance is not specifically mentioned, but the provision has been used by the law enforcement authorities in insurance fraud cases (the FSA understands there have been such cases, but numbers are not available). The FSA cooperates with the relevant authorities as necessary.</p> <p><i>Understanding and assessment of fraud</i></p> <p>FSA assesses fraud risks and controls in its supervisory work on insurers and develops a view of the key issues and risks. A key focus has been on insurers’ control environment for managing claims payments in a timely and appropriate manner, ensuring compliance with FSA expectations (Guidelines II-4-4-2).</p> <p>FSA is also well-apprised of long-standing insurance fraud in connection with natural catastrophes (for example, criminals fraudulently holding themselves out to help policyholders with claims) and more recently COVID-19-related fraud. The FSA has also recently been addressing the fraudulent actions by sales staff at several life insurers including “money fraud” (theft of customer funds) (FSA’s Insurance Monitoring Report, June 2023).</p> <p>There have also been recent reports of claims fraud perpetrated by a motor dealer acting</p>

as agent of a large non-life insurer. FSA also assesses there to be a continuing risk from organized crime groups.

There are no dedicated staff or specialist expertise within the FSA on insurance fraud issues nor any regular assessment of the risks facing the insurance sector generally. The FSA has generally regarded the risk as low compared with other risks facing insurers.

Supervisory work

The FSA includes fraud issues in its supervision work, taking account of its overall assessment of the risks and its limited resources. In practice, the FSA has mostly undertaken supervision work in reaction to cases of fraud reported to it by insurers (who are required to report “deplorable events”). They have devoted extensive resources to the investigation of the sales staff of insurers, undertaking on-site work at multiple insurers based on a questionnaire and assessment of the higher risk companies.

The FSA described, for the purposes of this assessment, a case involving a major life insurer, where the FSA had responded to reporting of fraud by sales staff by issuing an order requiring the company to report information, which was followed up by on-site work. The company made changes to its controls etc. and further use of powers was not required.

FSA supervisors meet regularly with the senior staff of internal audit departments at larger insurers. Fraud risks and controls may be discussed at these meetings.

Market-wide systems for fraud detection

The FSA promotes the use of systems run by the trade association GIAJ to share data across insurers to support the identification of potential frauds. These include (both for motor insurance and separately for fire, personal accident insurance etc.):

- a claims history and fraudulent claims information exchange system: for exchanging information on claim histories and fraudulent or suspicious claims among general insurers;
- a system to share information provided by the public regarding fraudulent insurance claims: aimed at sharing information about reported fraudulent insurance claims and reports that indicate the possibility of such claims among general insurers; and
- a claims history exchange system: to share claimants’ insurance claims record information to help exclude fraudulent claims as well as working out the appropriate amount of damage and assuring proper claim payments.

Only 29 of the 55 non-life insurers are members of GIAJ, but they account for 97 percent of the market and others (mostly branches of foreign insurers) participate in the information exchange systems.

Cooperation with other authorities

The FSA shares information and takes measures to prevent fraud in insurance in cooperation with other agencies such as the National Police Agency and industry

	associations.
Assessment	Largely Observed
Comments	<p>Insurance fraud has been a long-standing challenge in Japan, although insurers' controls had been regarded as strong. Discussions with FSA and the industry for this assessment highlighted that fraud is becoming a larger concern and that controls and culture at some insurers may need to be improved. The investigation of a high-profile fraud issue involving a large non-life insurance group may require more focus on non-life insurance. The FSA had already been responding to significant fraud by the own sales staff of some life insurers, conducting a thorough investigation of several companies.</p> <p>However, as in other areas of its supervisory work, the FSA's approach has been mainly reactive (responding to insurers' own identification and reporting of actual fraud). It does not focus systematically on fraud risk and insurers' controls in risk assessment and proactive supervisory work. It would need significantly increased resources to do so effectively.</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> • the FSA establish risk-based tools and procedures for regular in-depth assessment of insurers' fraud risks and controls (potentially as part of a wider reform of supervision practices as recommended in the assessment of ICP 9 and other ICPs in this report); • the FSA develop specialist expertise in insurance fraud (in the context of an increase in staff resources as recommended in the assessment of ICP 2 and elsewhere in this report); and • the FSA (in cooperation with law enforcement agencies, as necessary) and industry bodies develop a strategy and action plan for addressing fraud risk which may imperil confidence in insurance.
ICP 22	<p>Anti-Money Laundering and Combating the Financing of Terrorism</p> <p>The supervisor requires insurers and intermediaries to take effective measures to combat money laundering and terrorist financing. The supervisor takes effective measures to combat money laundering and terrorist financing.</p>
Description	<p>The general legislation on AML/CFT in Japan is the Act on the Prevention of Transfer of Criminal Proceeds 2007 (Anti-Criminal Proceeds Act), with a related Cabinet Order and Ministerial Ordinance. It requires the application of preventive measures, including suspicious transaction reporting (STR), by financial institutions and others, and the conduct of AML/CFT supervision by relevant authorities, which for the insurance sector is the FSA.</p>

Since 2018, the FSA has had a dedicated AML/CFT Policy Office. The development of regulatory policy and AML/CFT supervision, including for the insurance sector, is carried out by this office, cooperating and exchanging information with supervisors in the Insurance Business Division, as necessary. Of the 40 total staff in the office, an estimated three are engaged in insurance sector work, reflecting the priority given to other sectors, especially banking.

Understanding of AML/CFT risks

The FSA assesses money-laundering and related risks and vulnerabilities in the insurance sector, drawing on its supervisory work, and publishes its findings in its annual AML/CFT Report. This includes details on preventive measures which it expects all financial institutions to take. In addition, the FSA's Insurance Monitoring Report summarizes insurers' vulnerabilities (highlighting risks in savings-related life insurance and risks of CFT in maritime insurance) and actions being taken. These reports also emphasize the need for insurers to be vigilant according to the risk that their products could be used for money laundering.

LIAJ and GIAJ also publish guidance on appropriate AML/CFT measures to be taken by their members, for example in life insurance by incorporating AML/CFT policies into the LIAJ Code of Conduct.

AML/CFT requirements

In addition to the requirements in law, the FSA has since 2018 published Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism (the latest version is dated November 2021). All financial institutions, including insurers and intermediaries, have been asked to satisfy all requirements in the Guidelines by March 2024. The Financial Action Task Force (FATF) has noted that these guidelines qualify as enforceable means for the purposes of its view of what is an adequate legal basis of requirements on financial institutions.

The latest version of the Guidelines and implementation plan were developed as part of a national plan agreed in 2021 to strengthen AML/CFT measures in the financial sector. An Inter-ministerial Council for AML/CFT & CPF (Countering Proliferation Financing) Policy developed and issued the plan to address deficiencies identified in a Mutual Evaluation Report (MER) issued by FATF in 2021 in areas including the national co-operation and co-ordination framework and the level of understanding of AML/CFT risks by financial institutions other than banks.

The FSA has also published (most recently in March 2022) guidance in the form of answers to frequently asked questions on its guidelines.

The key guidelines establish expectations that insurers and other financial institutions will identify and assess their AML/CFT risks in a timely manner, including risks relating to their customers' operations, and take mitigation measures commensurate with those risks.

The FSA's general guidelines (the Comprehensive Supervisory Guidelines for Supervision of Insurance Companies – the "Guidelines") also set out certain expectations of insurers, as well as areas of supervisory focus (II-4-8: Measures such as Verification at the Time of Transaction). They emphasize that insurers should take a risk-based approach. Insurers are expected to establish an internal control environment for measures such as verification at the time of transaction, preservation of transaction records etc. and reporting of suspicious transactions.

Supervision

The FSA's AML/CFT Guidelines set out areas of focus covering the key issues to be addressed by supervisors.

The FSA has a dedicated risk rating system, the Corporate Risk Rating (CRR) system, for assessing AML/CFT risks at individual financial institutions, including insurers. Inherent risks, controls and residual risks are assessed at least annually and the CRR assigned, taking into account other supervisory information. The FSA supervisors then conduct risk-based AML/CFT monitoring using the CRR ratings. The CRR is informed by extensive quantitative and qualitative information that financial institutions including insurers must submit on a regular basis (separate templates have been developed for life and non-life insurers). They are also required to submit an annual Risk Assessment Report describing their risks and controls framework.

SASTIs are not required to make these reports at present.

In 2022, the FSA identified a sample of 12 life and the same number of non-life insurers for further monitoring work based on the risks of money-laundering associated with their product mix. Meetings were held with these insurers to assess their reported information and controls in more depth. Corrective actions were required of some insurers and results of the monitoring were reported in the Insurance Monitoring Report of 2022. The companies selected were medium-sized and small, the larger companies having been covered by a similar exercise in 2021.

The FSA's powers to impose administrative orders on insurers and intermediaries apply to shortcomings in AML/CFT controls which amount to a breach of an AML/CFT requirement (they may impose reporting orders, business improvement orders, rectification orders and business suspension orders (see ICP10)). These powers have been used by the FSA but to date not in relation to insurance companies.

The FSA may also request a remediation plan to address gaps and deficiencies, with a requirement to report progress to FSA.

Cooperation with other agencies

The FSA engages with other bodies with AML/CFT responsibilities. It is a member of the inter-ministerial Policy Council on AML/CFT (see above), led by the National Police Agency (NPA) and the Ministry of Finance but comprising 17 ministries and agencies in total. FSA

	also works bilaterally with other bodies such as the NPA and JAFIC, which acts as the Financial Intelligence Unit in Japan, receiving STRs etc. Internationally, the FSA would use its status as signatory of the IAIS MoU (see ICP 3) to cooperate and exchange information for AML/CFT purposes with other countries' supervisors.
Assessment	Observed
Comments	There is an extensive framework of legislation and detailed guidelines issued by the FSA, much of it applying to financial institutions generally but also material specific to insurance. The FSA has developed an understanding of risks in the insurance sector, a system of risk assessment based on detailed reporting and a program of supervisory work proportionate to the risks in insurance business. Coordination with other agencies has been strengthened and the insurance sector is included in the national plan to raise standards. It will be important for FSA insurance supervisors to ensure that the high-profile deadline of March 2024 for all financial institutions to be compliant with the FSA's revised AML/CFT Guidelines is adhered to by insurers, which will require a continued program of risk-based supervisory monitoring. Attention could be given to the risks, low as they may be, in the SASTIs, for example by including a small sample in future supervisory work on selected insurers' AML/CFT risks and controls.
ICP 23	<p>Group-wide Supervision</p> <p>The group-wide supervisor, in cooperation and coordination with other involved supervisors, identifies the insurance group and determines the scope of group supervision.</p>
Description	<p>The FSA is responsible as group-wide supervisor for 15 groups headed by Insurance Holding Companies (IHC), which include the four IAIGs. IHCs are required to seek authorization from the FSA (Article 271-18 of the IBA) and the FSA has a wide range of powers to supervise IHCs. There are additional insurance groups, including mutual life insurers, not headed by an IHC. SASTIs do not form insurance groups, although individual SASTIs may be part of a wider insurance group.</p> <p>Insurers do not own (or are owned by) banks, although in some cases banks and insurers have common non-financial company ownership and there are four insurers which are parts of wide-ranging conglomerates led by non-financial companies.</p> <p><i>General framework</i></p> <p>Powers and polices on group supervision are set out in the IBA and FSA's Guidelines. The FSA defines an insurance group as "a group of insurance companies that manage business operations of their subsidiary companies conducting insurance business or insurance holding companies and their subsidiary companies, etc." (Guidelines (I-2 (2)).</p> <p>Article 106-2 of the IBA sets out requirements on business management of groups. A</p>

group company that conducts business management of an insurance group is referred to as a “management company”, in practice always the IHC itself, for groups which are headed by an IHC. Business management is defined to include, for example, formulation of policies for management of the group and ensuring their proper implementation; and addressing conflicts of interest among companies belonging to the group (Article 106-2(2) of the IBA).

There are restrictions in the IBA on the types of entity which an insurer and an IHC may own (Article 106(1) and Article 271-22(1)) – only other financial services providers, domestic and foreign, including other insurers and banks as well as businesses that are dependent on or incidental to the business of the parent insurer or subsidiaries.

For certain types of proposed subsidiary, including insurers and banks, insurers and IHCs must obtain approval from the FSA (Articles 106 (4) and (7) and 271-22(1) of the IBA). For other types, they must notify the FSA (Article 127 (1)) before acquiring the new subsidiary. When applications for approval or notifications are received, the FSA confirms compliance with Article 106 of the IBA (Guidelines II-2-2).

With limited exceptions, insurers and their subsidiaries may not acquire a more than 10 percent interest in any other company in Japan, (Article 107(1) of the IBA).

The FSA has various layers of requirements applicable to groups:

- Its main expectations and approach to supervision are set out in Section VII of the Guidelines, developed in 2020 and which applies to all groups, including IAIGs and are expressed in high level terms to allow for proportionate application. All groups will be subject on a solo and consolidated basis to the FSA’s introduction of the economic value-based solvency regulation from FY 2025.
- In addition, for IAIGs, the FSA has established supervisory colleges and Crisis Management Groups (see ICP 25). All IAIGs will be subject (at group level only) to the FSA’s implementation of the IAIS’s Insurance Capital Standards from 2025.
- Further, for the five largest life insurers, including four groups, and the three largest non-life insurers, all groups, the FSA has established special monitoring arrangements by way of implementation of the IAIS’s Holistic Framework (see ICPs 16 and 24).

Mapping of groups and the scope of group-wide supervision

The FSA is aware of the scope and structure of groups from its supervision of insurers IHCs. It identifies the management company within the group, assessing where control lies in practice. The management company must be a licensed insurer or IHC. The FSA identifies other group entities. Non-insurance entities are limited in practice.

Insurers may own minority interests in entities that fall within the scope of permitted subsidiaries, but these do not fall within the approval or notification requirements of the IBA (Articles 106 and 127) which apply to subsidiaries. The FSA considers that it would be aware of such investments in practice, from voluntary notifications by insurers or

supervisory work. However, minority interests are not included within the scope of group supervision. The risks that can arise were highlighted by one major group's major loss at a foreign joint venture due to COVID-19 insurance in 2022, leading to the group taking majority ownership.

Many insurers, especially non-life companies, own what are known as strategic holdings (long-standing equity interests in Japanese companies). The FSA conducts monitoring of these holdings related to the reduction of these shareholdings which it is requiring over time.

Insurance supervisors may exchange information and coordinate work with supervisors of investment firms elsewhere within the FSA (several insurers own asset management companies supervised by the FSA's Securities Business Division, for example). However, there are no standing arrangements such committees or colleges of supervisors to manage this process.

In cases where there is a non-financial parent, as for the four insurers part of wider conglomerates, the FSA looks to its requirements on suitability of major shareholders (see ICP 5) as a framework for monitoring and managing risk to the insurer; and to insurers themselves to manage risks within the framework of their ERM and ORSA processes (ICP 16).

IAIGs

The FSA designates IAIGs, after consultation with other supervisors, having adopted the criteria in the IAIS's ComFrame (Guideline III-1 (4)):

- whether the group is internationally active (i.e., premiums are written in three or more jurisdictions and GWPs outside the home jurisdiction are equal to at least 10 percent of the group's total); and
- the group's size (whether the three-year moving averages of (i) total assets are equal to at least USD 50 billion, or (ii) total GWPs are at least USD 10 billion).

There are currently four designated IAIGs: Tokio Marine Holdings, Inc., MS&AD Insurance Group Holdings, Inc., Sompo Holdings, Inc., and Dai-ichi Life Holdings, Inc.

The FSA has discretion to determine that groups are or are not IAIGs, whether or not they meet the criteria, but has not exercised this discretion. It would also review a designation and consider a new designation in case of developments in the scale and nature of particular insurers but has not done so yet (IAIGs were first designated in 2020; there were no Japanese groups previously regarded as Global-Systemically Important Insurers under the former IAIS and Financial Stability Board arrangements).

The FSA discussed the designation of IAIGs in the pre-existing supervisory colleges for the four groups and informed college members as well as the groups' management of its decision to designate and its reasons as well as the basis for choosing the head of the IAIG (CF23.1f), i.e., the management company.

	<p>The FSA does not collect significant information about individual legal entities within IAIGs (CF23.2a). It relies on the involved supervisors of such entities to monitor and report on developments, including at college meetings, and on communications from the parent insurer. It does not carry out on-site work at such entities (see also ICP 25). The FSA has, however, reviewed governance and controls over overseas operations of the major groups (see ICP 7).</p>
Assessment	Largely Observed
Comments	<p>The FSA has a well-developed approach to group supervision which has been extended in recent years to apply ComFrame requirements to IAIGs. However, there are some areas where FSA could develop the approach further. It should include not only holding companies and subsidiaries but also minority interests within the scope of group supervision where necessary, meaning that groups and their supervisors at the FSA should assess the risks posed by such investments and whether they should, for example, be covered in full in group solvency requirements (supervisory work on its own may be insufficient).</p> <p>The assessment of ICP 25 notes that the FSA is not currently undertaking inspection work, itself or on a joint basis with involved supervisors, at the major groups' overseas insurers. It is also not collecting detailed information of such entities, as required under ComFrame standards. Collection, analysis and making appropriate responses to such information would be likely to require commitment of resources not currently available to the FSA.</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> • the FSA should have appropriate policies to include within the scope of group-wide supervision entities not currently captured (such as minority interests) where necessary to obtain a group-wide overview of risk; and • the FSA should strengthen the collection of information on significant individual entities within insurance groups building on its existing close collaboration with involved supervisors.
ICP 24	<p>Macprudential Supervision</p> <p>The supervisor identifies, monitors and analyses market and financial developments and other environmental factors that may impact insurers and the insurance sector, uses this information to identify vulnerabilities and address, where necessary, the build-up and transmission of systemic risk at the individual insurer and at the sector-wide level.</p>
Description	<p>The FSA requests insurers to submit the data required for macroprudential supervision as required by laws and regulations. For example:</p> <ul style="list-style-type: none"> • ORSA report (annually);

- financial information and operational reports such as BS/PL report (semiannually); and
- information related to market risks (quarterly).

In addition, the FSA requests various data from insurance companies as part of supervisory activities to be submitted by insurers on a voluntary basis. For example:

- major financial information such as BS/PL report (quarterly),
- questionnaire on financial flows to major insurance companies (monthly),
- materials from management meetings of major insurance companies (soon after the meetings)

As part of the Holistic Framework (HF), the FSA assesses the Japanese insurance sector annually based on various data in light of the current economic environment and circumstances surrounding the insurance sector. This assessment focuses on the five largest life insurers and the three largest non-life insurers. This monitoring is focused only on FSA supervised insurers. Zenkyoren which is one of the largest institutions conducting insurance activities in Japan but as a cooperative insurer (kyosai organization – see Box 1) is not included in the FSA’s macroprudential surveillance.

In the 2022, the FSA conducted a focused analysis of credit risk, interest rate risk, liquidity risk in light of the current economic environment, and confirmed that there were no material concerns in the Japanese insurance sector. This is more an assessment of the current vulnerabilities of the insurance sector rather than an assessment of the potential systemic risk of individual insurers. There are no criteria to assess the systemic risk of individual insurers. While the FSA conducts monitoring of individual insurers through its holistic framework monitoring of each insurer’s liquidity risk management, individual insurer’s own stress testing of macroeconomic exposure and insurer determined risk limits with respect to interconnectedness, this does not constitute a systemic risk assessment. A systemic risk assessment requires criteria in the form of thresholds to be set and then if an insurer breaches these thresholds further analysis should be undertaken to assess whether it is systemic. An example of this is the IAIS Individual Insurer Monitoring as part of its Global Monitoring Exercise. That is an example of the indicator method, other methods such as the total balance sheet method can also be applied (see Section 4 of the IAIS Application Paper on Macroprudential Supervision).⁴

The FSA does follow-up on issues with individual insurers that are identified through HF monitoring. It also considers the evolving nature of investments and the insurance business mix to consider thematic issues to consider in the annual monitoring process.

The FSA also has its Early Warning System which is described as much as can be done so in a public document in the detailed assessment of ICP 10 above. The FSA prepares a market risk dashboard on a quarterly basis to estimate the impact of market risks such as interest rate on life insurance companies’ financial situations in light of the current financial environment. The FSA also estimates the impact of the rise in interest rates on life insurance companies’ financial positions at the time of transitions in financial market circumstances, such as when the BOJ changes its monetary policy.

⁴ <https://www.iaisweb.org/uploads/2022/01/210830-Application-Paper-on-Macroprudential-Supervision.pdf>

	<p>All stress testing and sensitivity analysis uses the valuation basis as required for the SMR. So, assets that are held at amortized cost valuation that back insurance reserves are not subject to the top-down stress testing and sensitivity analysis. The assessment of interest rate risk is also impeded by a lack of data about the terms of bond investments.</p> <p>The FSA publishes an annual Insurance Monitoring Report⁵ and publishes the results of the major life insurers and non-life insurers on an annual and half-year basis. Some aggregate data on the insurance industry is published by the FSA in their annual report, while the LIAJ (for life)⁶ and GIAJ (for non-life)⁷ also publish such data. There is no single source of data on the life insurance sector from which individual insurer data is available. Insurers publish their own disclosures (see ICP 20). The aggregated data published by the FSA in its annual report is highly summarized profitability and solvency data. It does not include detailed breakdown of sources of revenues by business line, costs, details of asset holdings and details of technical provisions that are disclosed by many other supervisors.</p> <p>The FSA meets with the asset management executives of 4 large life insurers once a quarter to exchange information on market trends to inform the focus of its macroprudential surveillance. In some cases, this was able to be identified from regular data, particularly from the eight insurers involved in HF monitoring. For others a small survey was requested to be completed. The FSA also receives annual data on the top 100 counterparties of each insurer and this can be a reference for understanding exposure to particular counterparties that are in the news.</p> <p>The FSA also undertakes ad hoc real-time monitoring of exposures to financial shocks. For instance, in the March 2023 crisis involving US regional banks and Credit Suisse the FSA undertook analysis of the exposure of the Japanese life insurance sector.</p> <p>The FSA sometimes works with the Bank of Japan to investigate certain vulnerabilities. In 2020 the theme considered by the FSA and BOJ was overseas credit investments. There was also a recent survey about the cessation of LIBOR reference rates.</p> <p>IBD receives timely updates on market developments from the Macroanalysis Office of the FSA. This is used to identify shocks or trends that are then subject to analysis in terms of their impact on the insurance sector.</p> <p>Where issues are found with individual insurers through the HF monitoring, the EWS, the market risk dashboard or ad hoc surveys and joint exercises with the BOJ, those issues are followed up by supervision teams.</p>
Assessment	Partly Observed
Comments	The FSA has made significant strides forward in its macroprudential supervision since previous FSAPs.
<p>⁵ See for example https://www.fsa.go.jp/en/news/2022/20221024.html</p> <p>⁶ https://www.seiho.or.jp/english/statistics/summary/</p> <p>⁷ https://www.sonpo.or.jp/en/statistics/index.html</p>	

The FSA receives adequate data to undertake macroprudential supervision and where this data does not address a particular vulnerability, the FSA requests that data from insurers. The FSA performs analysis of financial markets and impacts or potential impacts of events in those markets on insurers. The FSA uses the results of its macroprudential supervision in its supervision of individual insurers.

One concern with the data used in macroprudential surveillance is it does not include entities selling insurance business that are not supervised by the FSA. One major entity is not included in macroprudential surveillance and this is one of the largest institutions conducting insurance activities in Japan.

The FSA does not have a methodical approach to determining the systemic risk of individual insurers (as required by ICP 24.3). There are no assessment criteria for assessing the systemic risk of individual insurers and therefore, while the FSA conducts holistic framework monitoring based on 8 large insurer's own risk management, this does not constitute a systemic risk assessment.

The data published by the FSA about the insurance sector is far less comprehensive than that provided by other supervisors (ICP24.5). There is no one place to find data about the Japanese insurance sector as in other major insurance markets. The Insurance Monitoring Report and the financial results published are for the eight major insurers included in HF monitoring. Aggregate data across the industry is published by industry associations and the material in the FSA annual report is highly summarized.

In general, there is not as much information about the insurance sector in the public domain as compared to other large, developed insurance markets. This is manifested in the very limited aggregate data, a lack of data about individual insurers in a comparable way and the limited published information on the Early Warning System and on the requirements of ORSA reports applicable to insurers. The FSA needs to reconsider its approach to publication of data and requirements to enable all stakeholders to fully understand the industry, have access to comparable data about individual insurers and fully understand the regulatory framework applicable to insurers in Japan.

Recommendations:

The FSA should coordinate with other ministries as relevant, for the purpose of macroprudential supervision to ensure all large entities conducting insurance activities are included in macroprudential supervision.

The FSA should create a methodical approach to assessing the systemic risk of individual insurers, starting with assessment criteria and then regular exercises to assess systemic risk of individual insurers.

The FSA should reconsider its approach to publication of data and requirements applicable to insurers with a view to publishing data on all insurers and granular

	aggregate data on the life insurance sector and non-life insurance sector to encourage research, analysis and market discipline.
ICP 25	<p>Supervisory Cooperation and Coordination</p> <p>The supervisor cooperates and coordinates with involved supervisors and relevant authorities to ensure effective supervision of insurers operating on a cross-border basis.</p>
Description	<p><i>Cross-border business</i></p> <p>The FSA has extensive responsibilities in relation to cross-border supervision, as both group-wide and involved supervisor of insurers operating in Japan.</p> <p>Of the 42 <u>life</u> insurance companies, one domestic group is designated by the FSA as an IAIG and all the other three groups regarded by the FSA as major groups, have foreign operations; 13 are at least 50 percent owned by foreign insurance groups (based in USA, Canada, France, Switzerland, Hong Kong SAR, of which 12 are designated as IAIGs by the group-wide supervisor); three foreign companies are amongst the top 10 but the largest accounts for only 3.6 percent of total sector assets. There are no branches of foreign life companies.</p> <p>Of the 55 <u>non-life</u> companies, including branches of foreign insurers, all three domestic groups regarded by the FSA as major groups are designated by FSA as IAIGs; seven are at least 50 percent owned by foreign insurance groups (from USA, Germany and France, all of which are designated as IAIGs by the group-wide supervisor); the largest ranks fifth by GWPs (FY 2022) and accounts for 4.4 percent of the sector total; and 22 are branches of foreign insurance or reinsurance companies (from USA, UK, France, Switzerland, Luxembourg, Norway, India, South Korea, Singapore, Germany, Belgium and Spain; six are IAIGs).</p> <p>The SASTIs are domestic only (no foreign ownership or foreign business), although some are part of wider groups that may operate internationally.</p> <p><i>Framework for international cooperation</i></p> <p>The LEFSA includes international cooperation amongst the areas for FSA to administer where necessary to fulfil its duties (Article 4 of the LEFSA). The FSA's Guidelines set out the approach to ensuring that there is effective international supervision, explicitly committing FSA to implement the IAIS Common Framework for the Supervision of IAIGs (ComFrame) (Guideline III-1 (4)). The Guidelines require FSA supervisors both to designate relevant Japanese-owned groups as IAIGs and to cooperate with foreign supervisory authorities in the relevant host jurisdictions (Guideline III-1 (4)). The designation, based on ComFrame, is assessed annually and ad hoc as necessary, in cooperation with other supervisors.</p> <p>The FSA has identified four IAIGs for which it is the group-wide supervisor. Its role and responsibilities have been agreed with other involved supervisors through the mechanism</p>

of the pre-existing supervisory colleges.

In respect to other domestic insurance groups with operations outside Japan (i.e., non-IAIGs), the FSA maintains relationships with foreign supervisors and is aware of the significance of the operations within the local market. Where issues have arisen (as they have in the case of one group with operations in Australia), they maintain close contact during the resolution of the issue.

The FSA could conduct on-site inspections jointly with foreign authorities (either in Japan or in a foreign jurisdiction) and would facilitate an inspection in Japan by a foreign supervisor, if asked to do so. Where it has had supervisory concerns, it has found it possible to coordinate with other relevant supervisors without on-site work. The FSA noted that the commitment of resources for joint (or any overseas) inspections would be significant in relation to their total available resources.

Supervisory colleges (where FSA is group-wide supervisor)

For all four groups designated by FSA as IAIGs, it has established a supervisory college (Tokio Marine Holdings, Inc., MS&AD Insurance Group Holdings, Inc., Sompo Holdings, Inc., and Dai-ichi Life Holdings, Inc.). All involved supervisors have been invited to join colleges, including at least one market conduct supervisor. All members of the colleges have signed a specific confidentiality agreement covering college work.

Meetings of the colleges are held at least annually (virtually in recent years because of the COVID-19 pandemic). They are chaired by a member of FSA's senior management, typically the Deputy Director General of Supervision Bureau, an indication of FSA's commitment, if also an unusually senior level for a working level technical discussion. Scheduled meetings are at present relatively short, around three hours, because of time zone differences (the in-person meetings, held in Tokyo up until 2019, lasted one day) and comprise the following.

- The FSA presents a detailed update on the group, including recent performance and supervisory issues and including updates on the impact of FSA's introduction of the economic value-based solvency regulation and ICS (copies of presentations were reviewed for this assessment).
- Involved supervisors ask questions and discuss common issues affecting the groups (as confirmed in a short discussion held with members of two supervisory colleges for the purposes of this assessment).
- Senior management of the insurance group participates in meetings, responding to questions (during meetings conducted for the purposes of this assessment, insurers confirmed their participation and that they have received high level feedback from the college meetings).

The FSA holds ad hoc meetings during the year as necessary.

The FSA does not at present develop specific outputs in the supervisory colleges such as a

	<p>group-wide risk assessment or coordinated supervisory plan. It uses colleges to share information with other supervisors, for example comparing involved supervisors' perspectives on an issue with what the group senior management has told them.</p> <p><i>Supervisory colleges (where FSA is involved supervisor)</i></p> <p>The FSA participates in 13 colleges as a member (most still meet on a virtual basis only), covering the majority of foreign-owned insurance groups operating in Japan. Their commitment of resources to such colleges reflects the benefits from improved understanding of the parent company's and group-wide supervisor's perspectives.</p> <p><i>Crisis management preparations</i></p> <p>The FSA has established Crisis Management Groups (CMGs) for all the IAIGs for which it is the group-wide supervisor, as part of the wider supervisory college framework. CMGs have the same membership and meet at the same time as the supervisory college using the same confidentiality agreement. There are no separate resolution authorities with CMG membership (the Policyholder Protection Corporations in Japan do not function as resolution authorities – see ICP 12).</p> <p>CMGs have focused on recovery planning, reviewing the plans developed by the IAIGs, and crisis preparedness. The FSA decided not to develop resolution plans for the IAIGs as they are not regarded as being of systemic importance (see ICPs 12 and 24). College/CMG members were informed of this decision. The FSA has not developed a specific protocol for cross-border crisis management yet but plans to do so in future.</p> <p>The FSA does not have experience of cross-border crisis management in practice through the colleges/CMG mechanism as group-wide or as an involved supervisor.</p>
Assessment	Observed
Comments	<p>The FSA has a well-developed framework for cross-border cooperation, focusing mainly on the supervisory colleges which it leads for Japanese IAIGs and the large number of colleges for foreign-owned IAIGs in which it participates as an involved supervisor. It also cooperates with supervisors of parts of cross-border groups that are not IAIGs.</p> <p>The framework for cross-border crisis management is less developed, but FSA plans to develop a crisis protocol within the CMGs in the future. Further development of cross-border supervision such as development of a group risk assessment, cooperation on cross-border inspections and even a return to regular in-person college meetings may be hampered by FSA's low level of supervisory resources and (except for the Japanese IAIGs) the limitations of its current supervisory model.</p>

Annex I. Progress on the 2017 FSAP Recommendations

Recommendations	Time ¹	Authorities' Update on Progress (June 2023)
<p>FSA should take further steps to implement an economic-value-based solvency regime as soon as practicable. A communication strategy should be developed to help the public understand the potentially large variance from the current, published statutory solvency ratio.</p>	<p>Near Term</p>	<p>The FSA has been taking the following actions toward the introduction of new Economic value-based solvency regulation in fiscal year 2025.</p> <ul style="list-style-type: none"> • In May 2019, the "Advisory Council on the Economic value-based Solvency Framework" was established by external experts to discuss the direction of domestic regulations based on international discussions. • In June 2020, the FSA published a report by external experts that included a recommendation that "it is appropriate to develop the basic structure of the standardized model (which is the core of solvency regulation) for an ESR based on and to be consistent with the ICS" and conducted annual field testing of all insurers in line with the recommendation of the report. • In June 2022, the FSA published "Tentative decisions on the fundamental elements of the economic value-based solvency regulation" as a tentative conclusion and basic direction on the basic content of the new regulations, taking into account the contents of discussions to date and international trends. • The FSA will continue to steadily study and prepare for the development of domestic regulations with the aim of starting the application of the new regulations from fiscal year 2025, while holding dialogues with related parties including insurance companies, based on the contents of the above-mentioned public documents, the ICS study status by the IAIS, and the responses of insurance companies. <p>* The ICS will be introduced as regulatory capital for internationally Active insurance groups (IAIGs) beginning in fiscal year 2025, following a five-year monitoring period starting in 2020.</p> <p>Information on the purpose of the new regulations, including differences from the current regulations, is posted on the FSA's website for dissemination. In addition, we are considering measures to promote understanding of the new regulatory framework that is currently under consideration as a disclosure for consumers.</p> <p>The Advisory Council on the Economic Value based Solvency Framework</p> <ul style="list-style-type: none"> ➤ Summary and related documents https://www.fsa.go.jp/singi/keizaikachi/index.html ➤ Final Report
<p>¹ Immediate = within a year; Near Term = 1 to 3 years; Medium Term = 3 to 5 years.</p>		

Recommendations	Time ¹	Authorities' Update on Progress (June 2023)
		<p>https://www.fsa.go.jp/en/refer/councils/economic_value-based_solveny/report/01.pdf</p> <p>Tentative decisions on the fundamental elements of the economic value-based solvency regulation</p> <ul style="list-style-type: none"> ➤ Press release (June 30, 2022) (Japanese only) https://www.fsa.go.jp/news/r3/hoken/20220630_2.html ➤ Summary https://www.fsa.go.jp/en/laws_regulations/20220630_solveny.pdf <p>The current status of the work towards finalization of Economic Value-Based Solvency Regulation (only in Japanese)</p> <ul style="list-style-type: none"> ➤ https://www.fsa.go.jp/policy/economic_value-based_solveny/05_1.pdf (full report) ➤ https://www.fsa.go.jp/policy/economic_value-based_solveny/05_2.pdf (summary) <p>Information on solvency regulations based on economic value is published on the FSA website on a timely basis.</p> <ul style="list-style-type: none"> ➤ https://www.fsa.go.jp/policy/economic_value-based_solveny/index.html <p>ACCESS FSA (monthly magazine) https://www.fsa.go.jp/access/r4/229.html</p>
<p>FSA should continue to develop its risk-based supervisory framework. The framework should include a risk and impact assessment based on objective criteria, the resultant supervisory intensity, and a holistic supervisory plan for offsite and onsite supervision.</p>	<p>Immediate</p>	<p>In order to develop a risk-based supervisory framework, the FSA has expanded data collection and revised its early warning system, since March 2019. After the revision of early warning system, the FSA established a risk-based monitoring framework. For example, the FSA selects insurers with financial soundness or profitability problems as early warning destinations, and conducts onsite inspections for those with a high degree of urgency.</p> <p>In addition, in accordance with the IAIS' Holistic framework, the FSA has been monitoring large insurers in terms of risk management of factors relevant to systemic risk since fiscal year 2020.</p>

Recommendations	Time ¹	Authorities' Update on Progress (June 2023)
<p>The frequency and scope of onsite inspections should be part of the holistic supervisory plan to address entity-specific risks. Onsite verification of the qualitative and quantitative information used in offsite analysis provides the necessary feedback loop to the risk-based supervision.</p>	Near Term	<p>Based on an understanding of the characteristics and issues of each insurer, the FSA flexibly uses various monitoring methods, including onsite inspections, depending on the nature and priority of the issue.</p> <p>Among these, onsite inspections are conducted when detailed verification of the current soundness and appropriateness is deemed necessary.</p> <p>To conduct risk-based supervision, the FSA expanded its financial reporting data collection, enhanced its early warning system, and conducted analysis and profiling of conduct risk data. Based on the above information and qualitative information related to internal controls, the FSA selects the target of onsite inspections from the comprehensive and risk-based perspective.</p> <p>In addition, the FSA utilizes the findings from onsite inspections for offsite monitoring appropriately to enhance the effectiveness of our holistic supervision on risks faced by each insurer.</p>
<p>FSA should consider extending key elements of good governance practice, including those which could be found in CCG, to all insurers in a legally enforceable manner, such as minimum of two independent directors, and disclosure of governance information.</p>	Near Term	<p>Since 2016, the Supervisory Guidelines have required the appointment of at least two outside directors, and the adequacy of corporate governance systems of insurance companies is also a supervisory focus.</p> <p>Listed stock companies are subject to the Corporate Governance Code (CGC). Insurance companies that are listed stock companies disclose their CGC compliance status, while mutual companies that are not listed insurance companies also voluntarily disclose their CCG compliance status.</p> <p>On the other hand, as indicated by the OECD Principle of Corporate Governance, the FSA does not believe it is appropriate to apply the corporate governance model uniformly to all companies.</p> <p>The FSA monitors the effectiveness of governance and corporate governance of each insurance company, taking into account its size, organizational structure, and business characteristics.</p> <p>In addition, as groups, especially major insurance groups, continue to expand, including into overseas operations, there is a growing need for more sophisticated risk management systems, not only for individual insurance companies, but also on a group basis. In December 2020, the supervisory guidelines were revised to take into account the purpose of the international standards for group supervision (ComFrame, etc.).</p> <p>Furthermore, the FSA published the Monitoring Report for IAIGs, etc. in 2020. Since 2021, the FSA has published the Insurance Monitoring</p>

Recommendations	Time ¹	Authorities' Update on Progress (June 2023)
		<p>Report annually, which presents the results of monitoring IAIGs, etc., including group supervision, and the administrative policy for the year. When good governance practices are identified through monitoring, the FSA publishes them in this report, encouraging insurance companies to enhance their governance.</p> <p>The FSA will continue to engage in in-depth dialogues with insurance companies on their initiatives to strengthen governance, taking into account their size, organizational structure, and business characteristics.</p>
<p>FSA should collect more granular data to monitor insurers' foreign exchange exposure more precisely, as well as statistics on foreign currency denominated policies.</p>	<p>Immediate</p>	<p>The FSA has started collecting data on exposures by currency and annualized premiums since March 2019, and using that data for stress tests and other analyses</p>
<p>In light of the increased cross-border M&A activities, FSA need to continue to periodically review the membership of the supervisory colleges for insurers with material overseas operations and establish new supervisory colleges when necessary.</p>	<p>Near Term</p>	<p>The FSA continues to review the membership of supervisory college.</p> <p>The FSA also review the designation of IAIG annually. If the FSA designate a new group as IAIG, it will hold supervisory college for the group at least once a year.</p>