

Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
Name of Company:	Financial Services Agency, Japan	
Disclosure of comments:	EIOPA will make all comments available on its website, except where respondents specifically request that their comments remain confidential. Please indicate if your comments should be treated as confidential:	Confidential /Public
<p>Please follow the following instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ <u>Do not change the numbering</u> in the column "reference". ⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a paragraph, keep the row <u>empty</u>. ⇒ Our IT tool does not allow processing of comments which do not refer to the specific paragraph numbers below. <ul style="list-style-type: none"> ○ If your comment refers to multiple paragraphs, please insert your comment at the first relevant paragraph and mention in your comment to which other paragraphs this also applies. ○ If your comment refers to sub bullets/subparagraphs, please indicate this in the comment itself. <p>Please send the completed template, in Word Format, to equivalence@eiopa.europa.eu . Our IT tool does not allow processing of any other formats.</p> <p>The numbering of the paragraphs refers to Consultation Paper No. 05 (EIOPA-CP-05-11).</p>		
Reference	Comment	
General	The Financial Services Agency, Japan (FSA) is pleased to have an opportunity to make comments on	

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Comment	<p>the EIOPA Draft Report on Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive. Also, the FSA appreciates the work conducted by the EIOPA so far within a very limited time period.</p> <p>The following comments on individual paragraphs are made from the perspective of the accuracy of descriptions. While the Draft Report seems to grasp regulatory requirements for the supervision of insurers and supervisory practices in Japan reasonably, it appears that facts are not represented accurately in several aspects. It is expected that EIOPA's overall advice on Japan's equivalence as well as that on each Principle would be reviewed in parallel with modification of texts on which we made comments.</p> <p>The FSA recognises that the final decision on the equivalence will be made based on the overarching principle stated in <i>the Methodology for Equivalence Assessments by CEIOPS under Solvency II (CEIOPS-DOC-94-10)</i>, i.e. "Equivalence assessments aim to determine whether the third country supervisory system provides a similar level of policyholder/beneficiary protection." There could be various differences in specific regulatory requirements among countries due to e.g. nature of insurance businesses. When assessing equivalence of "regime", therefore, the third country's supervisory regime should be reviewed from the perspective of similarity in the level of policyholder protection.</p> <p>The FSA is more than willing to, where necessary, continue to have a dialogue with a relevant organisation(s) to have a common understanding on the equivalence of solvency regime both in Japan and EU.</p>	
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Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
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Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
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33.	<p>While 2nd sentence of this paragraph describes that <i>"the possibility of carrying out both insurance and incidental non-insurance business in a single company represents a potential risk for reinsurance cedants, and constitutes a significant difference from the Solvency II regime"</i>, the FSA believes that the possibility is not significantly different from the Solvency II regime.</p> <p>As described in paragraphs 118 and 119, an insurer is allowed to engage in incidental businesses to the extent that financial soundness and appropriateness of business operation of the insurer is not harmed by the engagement in incidental businesses, and incidental business shall have the nature close to insurance business in terms of its function and be homogeneous with insurance business in terms of risks profile.</p> <p>The FSA acknowledges requirements in Article 18 (1) of the "DIRECTIVE 2009/138/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)" (Solvency II Directive), which stipulates that <i>"The home Member State shall require every undertaking for which authorisation is sought:</i></p> <p><i>(a) in regard to insurance undertakings, to limit their objects to the business of insurance and</i></p>	

Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
	<p><i>operations arising directly therefrom, to the exclusion of all other commercial business;</i></p> <p><i>(b) in regard to reinsurance undertakings, to limit their objects to the business of reinsurance and related operations; that requirement may include a holding company function and activities with respect to financial sector activities within the meaning of Article 2 (8) of Directive 2002/87/EC."</i></p> <p>The FSA understands that being allowed an insurer to conduct incidental business under the Insurance Business Act (IBA) is not deviate from the requirement under Article 18 (1) and (2) of the Solvency II Directive, in which an insurer is allowed to engage in "operations arising directly therefrom" and "related operations."</p> <p>Accordingly, the FSA recommend paragraph 33 to be changed as follows so that it describes the fact in a more proper manner. As a result of the change, the FSA believes the assessment of Principle 3 itself would be amended.</p> <p>33. While the possibility of carrying out both insurance and incidental business in a single company could represents a potential risk for reinsurance cedants, this does not constitutes a significant difference from the Solvency II regime.</p>	
34.	<p>With regard to the 2nd sentence of this paragraph, it is not clear what the term "auditors" in this paragraph is referring to. If it is referring to accounting auditors, it is necessary that the description of paragraph 155 is quoted appropriately. If it is referring to company auditors, it is necessary that the description of paragraph 158 is quoted appropriately.</p> <p>With regard to the last sentence of this paragraph, the FSA believes that it does not summarise EIOPA's observation (e.g. paragraphs 159 and 160) appropriately, thus the sentence needs to be deleted. As described in the EIOPA Draft Report, items that need to be disclosed are stipulated by the IBA and IBA Ordinance (paragraph 159), and additional disclosure items are provided by the industry Associations (paragraph 160). While this observation itself seems not to be inaccurate, it should be</p>	

Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
	<p>stressed that material disclosure items are stipulated by the IBA and IBA Ordinance.</p> <p>34. We find the JFSA largely equivalent with regard to its governance and public disclosure requirements. <u>There is scope for encouraging and facilitating further auditors' reporting to the supervisory authority where problems are discovered or the performance of the insurer is deteriorating.</u></p>	
35.	<p>While the 2nd sentence of this paragraph describes that "<i>but this is inconsistent with Solvency II approach to explicitly establish intervention thresholds as to ownership change</i>", the FSA believes that regulation of Primary shareholders is not inconsistent with Solvency II approach in that the FSA has supervisory authority to intervene Primary shareholders, including revocation of an authorisation granted to a Primary shareholder (Article 271-16 of the IBA), irrespective of the level of participation.</p> <p>In our understanding, there are three thresholds of participation (i.e. 20%, 30% and 50%), at each of which the suitability of a proposed acquirer and the financial soundness of the proposed acquisition are assessed, and a proposed acquisition is opposed only in cases where requirements set out Article 59 of the Directive are not met or information provided by the proposed acquirer is incomplete under the Solvency II Directive (Article 57 and 59 of the Solvency II Directive).</p> <p>In Japan, a person who intends to become a holder of more than 20% (or 15% with significant influence) of the voting rights of an insurance company or an insurance holding company (Primary shareholder) has to obtain authorisation from the FSA. (Article 271-10 of the IBA).</p> <p>The FSA has the authority to require a Primary shareholder approved by the FSA to submit reports or materials (Article 271-12) and to conduct an on-site inspection against it (Article 271-13). Also, the FSA may order a Primary shareholder (those with participation more than 50%) to improve its business operation (Article 271-15).</p> <p>Moreover, the FSA may revoke an authorisation granted to a Primary shareholder, when a Primary shareholder has violated any laws and regulations or has committed an act that harms the public interest (Article 271-16).</p>	

Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
	<p>These requirements of Articles 271-12, 271-13 and 271-16 are applicable irrespective of the level of participation such as 20, 30 or 50%.</p> <p>Accordingly, the FSA believes that our regulatory approach is not inconsistent with that under the Solvency II. Therefore, the 2nd sentence needs to be changed as follows. As a result of the change, the FSA believes that the assessment of Principle 5 itself would be amended.</p> <p>35.The Japanese law grants powers for the JFSA to authorise those with a qualifying holding (Primary shareholders) and to intervene in them whenever deemed necessary.</p>	
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Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
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62.	<p>This paragraph does not represent facts accurately and thus needs to be changed as follows.</p> <p>62. Shareholders that directly or indirectly hold 5% or more of the voting rights in an insurer (“large shareholders”) must notify the JFSA of their shareholding within five business days of the acquisition. Every further 1% change in the level of their voting rights also has to be notified. JFSA approval is required for “primary shareholders” defined as those which directly or indirectly, together with other persons acting in concert, hold 20% or more of the voting rights. This also applies to those holding 15% or more of the voting rights with significant influence to an insurer. The JFSA may take administrative actions, when deemed necessary, such as; requiring a Primary shareholder to submit reports or materials concerning the status of its business or property (Article 271-12 of the IBA),</p>	

Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
	conducting on-site inspection against a Primary shareholder (Article 271-13) and revoking an authorisation granted to a Primary shareholder (Article 271-16). These actions can be taken irrespective of the level of participation of a Primary shareholder. In addition, Primary shareholders holding 50% or more of the voting rights of an insurer may be subject to an administrative order to develop and implement a remediation programme to ensure the soundness of the insurer and to protect the insurer's policyholders (Article 271-15).	
63.	<p>The description of the 2nd sentence of this paragraph by itself is not inaccurate. Also, paragraph 64 by itself is not inaccurate. However, paragraphs 62 to 64 as a whole are misleading and, therefore, paragraph 63 needs to be changed as follows and paragraph 64, the content of which is already covered by revised paragraph 62 above, needs to be deleted.</p> <p>63. With respect to a Large shareholder, it shall notify the JFSA whenever it increases and decreases its holding of voting rights by 1% ("Change report" to be filed in accordance with Article 271-4 of the IBA) once it submitted a report to the JFSA when its holding reaches 5% of voting rights threshold. This reporting enables the JFSA to check changes in participation. In addition, insurers are required to submit information on their top 10 shareholders semi-annually as one of the information contained in supervisory reporting (Article 59 (2) of the IBA Ordinance).</p>	
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Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
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Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
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Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
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120.	<p>As described in paragraphs 118 and 119, an insurer is allowed to engage in incidental businesses to the extent that financial soundness and appropriateness of business operation of the insurer is not harmed by the engagement in incidental businesses, and incidental businesses shall have the nature close to insurance in terms of function of business and be homogeneous with insurance business in terms of risks.</p> <p>The FSA acknowledges requirements in Article 18 (1) of the "DIRECTIVE 2009/138/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)" (Solvency II Directive), which stipulates that "<i>The home Member State shall require every undertaking for which authorisation is sought:</i></p> <p><i>(a) in regard to insurance undertakings, to limit their objects to the business of insurance and operations arising directly therefrom, to the exclusion of all other commercial business;</i></p> <p><i>(b) in regard to reinsurance undertakings, to limit their objects to the business of reinsurance and related operations; that requirement may include a holding company function and activities with respect to financial sector activities within the meaning of Article 2 (8) of Directive 2002/87/EC."</i></p>	

Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
	<p>The FSA understands that allowing an insurer to conduct incidental business under the Insurance Business Act (IBA) is neither different from “the exclusion of all other commercial business” nor go beyond inclusion of “a holding company function and activities” under Article 18 (1) of the Solvency II.</p> <p>Therefore, this paragraph needs to be deleted.</p>	
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129.	<p>As EIOPA is aware in paragraphs 118 and 119, an insurer is allowed to engage in incidental businesses to the extent that financial soundness and appropriateness of business operation of the insurer is not harmed by the engagement in incidental businesses, and incidental businesses shall have the nature close to insurance in terms of function of business and be homogeneous with insurance business in terms of risks.</p> <p>However, the description in paragraph 129 is inconsistent with the proper recognition in paragraphs 118 and 119.</p>	

Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
	<p>Therefore, this paragraph should be changed as follows. (Text is taken from paragraph 33, reflecting our comment on it.)</p> <p>129. Nevertheless, we note the possibility of Japanese insurers to undertake certain types and amounts of incidental business which could have the potential to increase, but not substantially due to the limitation mentioned in paragraphs 118 and 119, the risk profile of a reinsurer.</p>	
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Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
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162.	It is not clear what the term "auditors" in this paragraph is referring to. If it is referring to accounting auditors, it is necessary that the description of paragraph 155 is quoted appropriately. If it is referring to company auditors, it is necessary that the description of paragraph 158 is quoted appropriately.	
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Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
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167.	<p>The following facts should be described in this paragraph appropriately and needs to be changed as follows; otherwise this paragraph is misleading.</p> <ul style="list-style-type: none"> - The FSA has the authority to require a Primary shareholder approved by the FSA to submit reports or materials (Article 271-12) and to conduct an on-site inspection against it (Article 271-13). Also, the FSA may order a Primary shareholder (those with participation more than 50%) to improve its business operation (Article 271-15). - Moreover, the FSA may revoke an authorisation granted to a Primary shareholder, when a Primary shareholder has violated any laws and regulations or has committed an act that harms the public interest (Article 271-16). - These requirements of Articles 271-12, 271-13 and 271-16 are applicable irrespective of the level of participation such as 20, 30 or 50%. <p>167. A natural or legal person intending to become a primary shareholder must be subject to authorisation by the JFSA and meet the following regulatory requirements (Article 271-11 of the IBA): healthy financial condition, sufficient to enable it to support the insurer if needed; good reputation and an understanding of the public nature of the insurance business; and sufficient proof that the applicant will not impair the sound management and proper business of the insurer it intends to acquire. Further to this, the IBA provides JFSA with the following specific powers of intervention as to primary shareholders of the undertaking:</p> <ul style="list-style-type: none"> - The FSA has the authority to require a Primary shareholder approved by the FSA to submit reports or materials (Article 271-12) and to conduct an on-site inspection against it (Article 271-13). Also, the FSA may order a Primary shareholder (those with participation more than 50%) to improve its business operation (Article 271-15). 	

Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
	<p>- Moreover, the FSA may revoke an authorisation granted to a Primary shareholder, when a Primary shareholder has violated any laws and regulations or has committed an act that harms the public interest (Article 271-16).</p> <p>- These requirements of Articles 271-12, 271-13 and 271-16 are applicable irrespective of the level of participation such as 20, 30 or 50%.</p>	
168.	As mentioned in our comment on paragraph 167, the requirements of Articles 271-12, 271-13 and 271-16 are applicable irrespective of the level of participation such as 20, 30 or 50%. In this context, this paragraph is not accurate and thus needs to be deleted.	
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Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
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187.	<p>As mentioned in our comment on paragraph 167, the requirements of Articles 271-12, 271-13 and 271-16 are applicable irrespective of the level of participation such as 20, 30 or 50%. So, the following description would represent the facts in a much more accurate manner.</p> <p>187. We note that the Japanese law establishes licensing powers for the JFSA in relation to shareholder structure which allow it to control the fitness and property of shareholders with a qualifying holding while this is not the same as Solvency II approach to establish explicit intervention thresholds as to ownership changes.</p>	
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190.	<p>EIOPA's view on the first bullet point "communication of concerns relating to the insurer's financial position" contradicts paragraph 155 and needs to be deleted.</p> <p>190. There are currently provisions in place that allow the JFSA to fully exercise supervision in normal circumstances, including:</p> <ul style="list-style-type: none"> · communication of concerns relating to the insurer's financial position; 	

Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
	<ul style="list-style-type: none"> · obligation on the insurer to respond to concerns raised; and · obligation to submit financial reporting to the supervisor. <p>However, on the third of the above mentioned point, the following weakness was noted:</p> <p>A) Financial reporting to the JFSA does not include loss triangles completely consistent with that required under Solvency II, beyond those provided by provisions relating to public disclosure. These are discussed hereunder.</p>	
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197.	<p>Technical provisions are calculated conservatively under our solvency regime for the proper protection of policyholders. Based on the philosophy, the methodology for determining a discount rate is provided by the Insurance Business Act, by which it is intended to avoid unduly fluctuation of a rate applied every year with striking a right balance with economic valuation.</p>	

Comments Template on EIOPA-CP 05-11

**Deadline
23.09.2011
17.30 CET**

EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive

Even under the scheme, it should be noted that a discount rate is determined with reference to market. More specifically, discount rates are determined by comparing the Base Rates multiplied by the following factors with assumed interest rates. Base Rate is the lower rate subscribers' yield of either the 3-year moving average of 10-year government bonds or the 10-year moving average of 10-year government bonds. When there is a 50 bps or more deviation between the Base Rate and the Assumed Interest Rate, the Assumed Interest Rate is adjusted by integral multiple of 25 bps. Discount rate is reviewed annually.

Base Rate (b)	Coefficients applied
$0% < b \leq 1.0%$	0.9
$1.0% < b \leq 2.0%$	0.75
$2.0% < b \leq 6.0%$	0.5
$6.0% < b$	0.25

In addition, this requirement was introduced in 1996 for life insurance and in 2001 for non-life insurance contracts. The actual discount rates applied are 2.75% from 1996 to 1998, 2.0% from 1999 to 2000, and 1.5% 2001 and thereafter. This appropriately reflects changes in JGB yields in the past.

Moreover, it should be aware that an insurer is required to carry out future cash flow analysis at every fiscal year end and to accumulate additional reserves.

Therefore, this paragraph should be revised as follows.

Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
	197. For life and long-term non-life business, TP are currently discounted at 1.5% (from 2001 on). The fact that they are valued at a conservatively adjusted rate, rather than a rate observed at the market, could raise questions as regards their resilience, insofar as the regulatory discount rate for liabilities is 1.5%, while the returns on bonds seem to be around 1.2%. However, it should be acknowledged that there is a system in place in which an insurer is required to carry out future cash flow analysis at every fiscal year from the perspective of the appropriateness of technical provisions and, where deemed necessary, to accumulate additional reserves.	
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201.	<p>The FSA is not sure how ¥2,197 trillion was calculated: Clarification is appreciated. Also, this paragraph needs to be changed as follows.</p> <p>202. Non-life TP are not discounted, except for long term business (see above). Non-life long-term TP, in particular, include the refund reserve (¥787 trillion, or 36% of total non life TP, which amount to ¥2,197 trillion). It follows that, strictly speaking, non-life long-term TP are not market consistently valued. The JFSA has stated that (apart from the refund reserve) they have little in the way of long tail TP, however, which qualifies this statement.</p>	
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Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
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211.	The FSA believes that this, i.e. defining the SMR as twice the own funds over the 'total risk', does not give rise to any gap in the level of policyholder protection.	
212.	<p>For the further clarification purpose, this paragraph should be revised as follows. Paragraph 212 with the changes describes the fact in a more accurate manner.</p> <p>212. From the above description, it follows that in terms of supervisory action the JFSA system has at least one supplementary level of intervention, compared to the Solvency II system. It also follows that supervisory actions taken at 200% of the SMR would, broadly speaking, correspond to those taken at the Solvency II SCR level of intervention –even though JFSA may intervene in a legally binding manner even if the SMR is more than 200%–, while supervisory actions taken at 0% of the SMR along with actions taken at the level of 100% of the SMR would, broadly speaking, correspond to possible actions under the Solvency II MCR16.</p>	
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Comments Template on EIOPA-CP 05-11		Deadline 23.09.2011 17.30 CET
EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
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231.	<p>The latter half of this paragraph contradicts paragraph 155 and needs to be deleted. See our comment on paragraph 190 as well.</p> <p>231. The JFSA's provisions relating to financial supervision do not raise substantive issues.</p>	
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235.	To ensure the consistency with paragraph 215, the following 3 rd sentence needs to be added.	

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EIOPA Draft Report - Equivalence assessment of the Japanese supervisory system in relation to article 172 of the Solvency II Directive		
	235. The JFSA's lower capital requirement is highly dependent on the level of prudence embedded in TP. We cannot positively conclude on the equivalence of this aspect, although the difference between Japanese and EU would not necessarily mean that the level of policyholder protection under the Japanese regime is lower than that established under Solvency II.	
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237.	As mentioned our comment on paragraph 33, the FSA is not convinced that Japanese regulation provides insurers with "much wider discretion to invest in derivatives and other products than under Solvency II." Therefore, this paragraph needs to be deleted.	
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