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“Global Regulatory Reform in Insurance: From a National Regulator’s Perspective”

It is my great pleasure and honor to be given this opportunity to deliver my remarks at the 2015 NAIC International Insurance Forum. On this wonderful and timely occasion, I would like to briefly present some of my thoughts on the global regulatory reform for the insurance sector, mainly from a national regulator’s perspective. The standard disclaimer applies: i.e. any views I express today are my own, and are not necessarily identical to the official views of the FSA of Japan or any other national or international body I work with.

(Organizational reform of the IAIS)

As you probably are aware, the IAIS is currently in a critical stage of its organizational reform. The IAIS needs to be transformed into a truly global official standard setter and a reference point for global regulation and supervision of the insurance sector. Important work now being undertaken by the IAIS, in coordination with the Financial Stability Board (FSB) and other global standard setters comprise: the development of international capital standards for internationally active insurers, the development and implementation of measures to deal with global systemically important insurers (G-SIIs) including the development of a methodology for assessing the systemic importance of insurers, along with measures to ensure higher

loss absorbency (HLA) of those designated as G-SIIs. Such work will necessarily continue for a number of years, if you draw upon the experience of the work at the Basel Committee with regard to internationally active banks and global systemically important banks (G-SIBs).

Insurance regulators and supervisors need to work with insurance groups not only from the viewpoint of policyholder protection, but also from the viewpoint of ensuring financial stability. While the systemic importance of insurers and insurance groups would differ widely across jurisdictions and markets, and vary from entity to entity, regulators and supervisors need to heed the lessons of the financial crisis that insurers are not immune from systemic risk, and cannot be ignored from the viewpoint of financial stability, depending on their size, interconnectedness, and substitutability, as well as the extent of their non-traditional or non-insurance activities.

Against this backdrop, effective and efficient cross-border regulation and supervision of insurance groups have become a necessity, as insurance groups expand the scope of their businesses both geographically and across a broader range of financial services sectors.

In order to ensure that insurers and insurance groups do not become a threat for financial stability, and a level playing field is maintained across jurisdictions in which they operate, we must have international standards in insurance regulation and supervision that are credible, that do not distort or create unintended incentives for the financial markets, and which are underpinned by consistent and effective implementation.

As a national regulator and supervisor, we rely on the IAIS to deliver those standards that fit those purposes and become the global benchmark for fair and effective regulation and supervision. The IAIS has to have the organizational structure

and governance framework that is fit for the purpose, and have sufficient and robust operational capacity to take on this huge task.

This is a huge challenge, and this is why I think the IAIS is at a turning point in its existence. In fact, the IAIS needs to be more transparent, more accountable to the public than ever before.

Under the able leadership of the current and previous Chairs of the Executive Committee, as well as the capable and efficient support of the Secretary General and the staff, the IAIS has been transforming itself into a much stronger and more accountable international organization. I would like to commend those people who have been working day and night to make it happen. As a national regulator, we have great respect for them, and have appreciated their work tremendously until today.

But we should remind ourselves that the IAIS is a membership organization, a member-driven organization, and that only the IAIS members, including not just regulators and supervisors but also the broad membership of stakeholders, could give the credibility and the resources for the IAIS to do a proper job. The standards that the IAIS develops will be just pieces of paper, if not fully embraced and implemented by national regulators and supervisors.

This is why, I would like to emphasize today that national regulators and supervisors must hold a sense of ownership of those standards, and be ready to propose improvements or amendments when needed. We cannot just sit back, stay away and say, “Oh the IAIS has some standards that do not fit our market, so we will do something different.” Such an approach will come back and haunt us, as there will no longer be internationally consistent rules, so there will no level playing field.

Now, there may be views that we should prioritize the objective

of policyholder protection over and above that of maintaining financial stability in forming regulatory and supervisory policy for insurers: i.e. there may be views that either measures to protect policyholders are independent of measures to maintain financial stability, or perhaps that measures to strengthen the financial system could undermine the interests of policyholders.

But let us think in this way. If the insurer carries risks that could be a potential threat to financial stability, or if the firm is not resilient enough to weather a financial crisis, what will happen to policyholders? Policyholders cannot be immune from the devastation of a financial crisis, for sure. In fact, in the event of a financial crisis, it is always the consumer, the end-users of financial services that suffer the consequences. If public funds are called in to bail out an insurance group, the taxpayers may have to ultimately bear the costs in one way or another.

I should mention that national regulators and supervisors are aware of this potentially serious risk, and this is why we have supported the work at the FSB and the IAIS to take the lead in global financial regulatory reform, and develop a full range of regulatory measures that will make the financial system resilient, and will prevent future crises from inflicting huge damages on the public, while strengthening measures for policyholder protection.

The dual objectives of policyholder protection and financial stability therefore have to be pursued in parallel, and they reinforce and complement each other. In terms of global financial regulatory reform, we have come a long way in designing and implementing the necessary measures, but we still have a long way to go, particularly in insurance.

Another point I wish to mention in passing is that the IAIS derives its authority uniquely from its members, i.e. the national authorities and the stakeholders. Not the other way around. Each standard that the IAIS develops has to be transposed into and

made effective by national rules and regulations to be implemented and enforced.

So it is particularly unfortunate that sometimes the global standard-setters are criticized for not being transparent enough, or not accountable enough, to the public. The Members of the IAIS must work hard to ensure that the transparency and the accountability of their work are not questioned. In their standard-setting work, the IAIS must endeavor to build consensus around international standards that are truly embraced by all those concerned.

So I take heart in the recent initiatives at the IAIS to enhance transparency such as having regular and frequent stakeholder meetings, which effectively substitutes for and strengthens stakeholder input previously provided through the system of observers. So far, those stakeholder meetings have been held in Los Angeles, Rome, New York, Tokyo, and two more are to be held in Basel. I would like to encourage and support this effort, and would call on the IAIS to hold many more of those meetings around the world.

I am aware that some would question the recent decision at the IAIS to discontinue the system of observers. But, in my view, the previous system could have obscured the nature and the ownership of the standards developed, and therefore could have attracted undue criticism from the global regulatory community and the public as well.

So I do support this organizational change at the IAIS, but I repeat, there should be no misunderstanding: regulators and supervisors are even more committed than before to have full dialogue with stakeholders in the process of developing standards, not less. The standard-setting process had to be streamlined and the responsibilities clarified, in order to be more transparent and accountable to the general public.

(The important work currently ongoing at the IAIS)

There are two major strands of standard-setting work currently ongoing at the IAIS which have significant implications for stakeholders.

One is the work on ending the so-called Too-Big-To-Fail in insurance; i.e. refining the assessment methodology for the G-SIIs and developing the additional policy measures applicable to the cohort. This builds on the previous work to develop a methodology for designating G-SIIs as well as to develop a basic capital requirement (BCR) for those G-SIIs.

Another is the work to develop for the first time international capital standards for internationally active insurance groups (IAIGs). I will briefly mention my preliminary thoughts on those points.

(Measures to be applied to G-SIIs)

First, regarding the G-SIIs. If we look back into recent history, in July 2013, in collaboration with the IAIS, the Financial Stability Board (FSB) identified nine G-SIIs based on the assessment methodology developed by the IAIS. The list of G-SIIs was updated in November last year based on the latest data, and the list of nine insurers was unchanged. As you may know, the treatment of reinsurers and financial guarantors has been put on hold during this process.

The assessment methodology being refined at the IAIS has been applying a higher weight to non-traditional insurance and non-insurance (NTNI) activities. It also views interconnectedness as a critical measure of systemic importance. The design of the methodology is such that those NTNI activities and stronger interconnectedness are disfavored, creating incentives and the possibility for insurers to control and, if desired, reduce their systemic footprint. In this regard, I am supportive of the general

direction of the IAIS methodology in this work.

As regards reinsurance and financial guarantor services, they are conducted either by the same entity as primary insurance, or by independent specialized entities. This has given rise to a certain debate over whether those services should be treated integrally or separately in the methodology for designating G-SIIs, but we must find a solution to this question sooner rather than later. In principle, the same activities should carry the same risk weights when an assessment is made, regardless of the organizational structure of the insurance group. If reinsurance has a different risk characteristic compared to primary insurance, for example, there needs to be a clear articulation of that specificity, and proper measurement of that risk.

As I previously mentioned, in October last year, the IAIS published its final document for the basic capital requirements (BCR), which should form the basis for the “higher loss absorbency requirements” (HLA), one of the key policy measures applicable to G-SIIs. The IAIS is now actively considering the content of this HLA with the aim of issuing a consultation paper next month in June, and finalizing it before the end of this year. In addition, consideration is currently being given to a framework for effective resolution regimes applicable to G-SIIs, such as the establishment of Crisis Management Groups (CMG) and the development of Recovery and Resolution Plans (RRP).

One important consideration for national regulators in this context is to design the framework for assessment and designation, and the implementation process of the framework, to be transparent and accountable to our own constituents. The risks need to be measured by an objective scale and be able to withstand the test of time. If data is not immediately available, some practical expedients may become necessary, but caution is warranted in relying upon a small number of indicators which could only be proxies of the true scales of systemic risk.

As there is no reliable absolute numerical threshold for systemic importance, some degree of relative importance and supervisory judgment would need to come into play. But by using a set of indicators and complementing this with the sound judgment of regulators and supervisors, I am sure we can have a common methodology which is sufficiently robust and objective to be credible and transparent. I look forward to a speedy completion of this work.

On the topic of HLA, the reasoning behind the higher loss absorbency requirement for G-SIIs is to take account of the negative externalities caused by their systemic importance and internalize those costs in the form of capital, through higher capital requirements. The policy tools applied to G-SIIs should also enable them to control and scale their systemic activities. This leads me to think that incentives to reduce NTNI activities should be embedded in the policy measures applicable to G-SIIs, including in the design of HLA.

(The development of the ICS)

Second, concerning the ICS. As I mentioned, this is the first time we are developing an international capital standard for internationally active insurers, and therefore it is a truly groundbreaking piece of work. In December last year, the IAIS released its first public consultation document on the ICS applicable to IAIGs, and from the end of this April, it began a field-testing exercise for the ICS. The aim is to finalize the development of the ICS framework by the end of 2016.

In response to the public consultation on the ICS opened last December, as many as 1,600 pages of comments were received. This demonstrates the enormous amount of interest that stakeholders have in this subject. As a national regulator and supervisor, we must play a role in explaining the intentions behind the proposal, and provide feedback to the relevant IAIS

bodies for further discussion.

The challenge now is to take due account of the numerous issues raised in the comments efficiently. However, my hope is that the required speed does not become an enemy of the good. That is, if we should not try to jump to conclusions without taking proper steps to gather the data necessary to make an informed judgment, and fully analyzing the effect of the new standard on the industry and on the markets.

The IAIS will need to articulate its positions regarding each of the important points raised in those comments. It has to help national authorities understand the reasoning behind those positions and be able to explain to the public how and when they would be translated into policy actions. Another public consultation is envisaged towards the end of this year. The IAIS will need to closely engage with its member authorities and stakeholders to meet its goal.

As you may already know, in February of this year, agreement was reached at the IAIS Executive Committee on the ultimate goal of the ICS. As this agreement shows, it is not intended to hastily put together a set of prescriptive standards that will impose a one-size-fits-all for all insurers. It is to have a common methodology that would enable us to achieve comparable, i.e. substantially the same outcomes, across jurisdictions with respect to capital standards. If I interpret it from a national regulator's perspective, different jurisdictions will have different rules, but the aim will be to produce substantially the same results in terms of capital adequacy by developing a sufficiently flexible and robust methodology on an internationally agreed basis. It is also acknowledged that ongoing work is intended to lead to improved convergence over time on the key elements of the ICS, namely: valuation, capital resources, and capital requirements.

An important point when considering the design of the ICS is a necessity to build a framework which captures the specificities of insurance. This applies to the valuation of insurance liabilities, as well as to risk measurement and the definition of capital.

In this regard, the most critical issue in the first draft public consultation was the comparability of the valuation of insurance liabilities. Currently, two alternatives are on the table, which are (1) the current estimate and (2) GAAP plus adjustments (GAAP plus). Going forward, the validity and robustness of those two valuation methods will be assessed through field tests to see whether comparable outcomes can be achieved.

Another important consideration is that a risk-based ICS must not lead to a situation that produces unintended consequences on the availability of long-term insurance contracts or creates undue disincentives for long-term investment by insurance companies. We will need to give some thought to this point which implicates a number of critical elements in the calculation of capital adequacy for an insurer, both in the numerator and the denominator, and relates to both sides of the balance sheet.

With regard to the definition of capital, the loss absorbing capacity of technical reserves is a key feature of insurance, and due consideration of this capacity in the assessment of capital adequacy is warranted within the ICS framework.

Conducting sufficient and robust field testing is a critical element in the development process of international standards. Although the purpose of a field testing exercise may vary depending on where you are in the development process of a standard, but ultimately, it is conducted to test the feasibility of implementation of the standard, and in assessing the need for any transitional measures or determining the timeline for the implementation of the standard. So you can see that this process is absolutely critical to the process for developing a credible and

feasible ICS.

In this context, I should allude to the regular dialogue being held between the NAIC and ourselves. In the most recent meeting held this April in Tokyo, we reaffirmed the importance of considering the cost effectiveness of any proposed standard, and their impact on the markets, including on insurance product availability and affordability. We also agreed that one should be mindful of the compatibility of the proposed standards with the respective insurance regulatory systems of jurisdictions. While I would favor further harmonization of the rules across jurisdictions, the IAIS has to keep in mind that there is no quick and easy route to achieving that in the near term.

(Conclusion)

I have emphasized in my remarks that, in an increasingly global insurance marketplace, we are feeling an ever stronger need to make progress in making our rules and standards more internationally consistent, and in coordinating our supervisory actions.

Coordination and cooperation between authorities of different jurisdictions have become an imperative. Group-wide supervision has become a norm. A growing global insurance market must be underpinned by effective regulation and supervision which are globally consistent, well-coordinated, and based on a foundation of true mutual trust and confidence between jurisdictions.

On the other hand, any international standards agreed at the IAIS are not applied directly in individual countries. As I emphasized, they need to be applied in each jurisdiction after following each jurisdiction's legislative and administrative procedures. There should be no misunderstanding that we are the owners of those standards, not any supranational body.

Given the current reality of internationally active insurance

groups, it is imperative that consistent international standards be developed and implemented to the extent possible, but it is also necessary to allow for some jurisdictional discretion, paying due attention to the different market conditions and practices of each jurisdiction. Striking the right balance between internationally consistent rules and jurisdictional discretion is a real challenge.

In overcoming this challenge, we need to cooperate and coordinate more with our counterparts and partners around the world. I can assure you that the JFSA is committed to strengthening cooperation and coordination with our foreign colleagues. But we definitely need the understanding and support for our work from stakeholders like you, worldwide.

Thank you very much for your kind attention. (End)