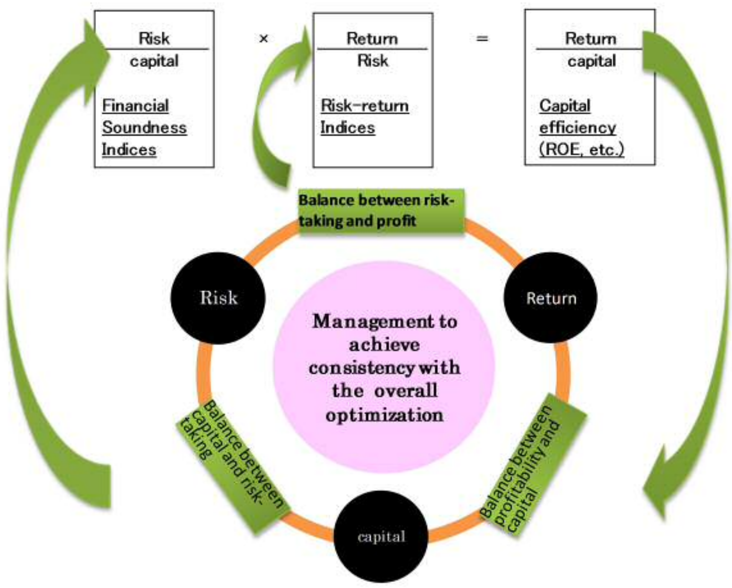
Overview of Results of ERM[1] Assessment based on ORSA[2] Reports and ERM Hearings

1. Background

Based on the equation below, assuming that the amount of capital is constant, insurance companies can improve their capital efficiency by increasing their risk-taking or return. However, to ensure the capability of insurance payments even in the case of materialization of unexpected risks, insurance companies have to set up certain limits to their risk-taking in light of their capital. Given such limitation, to improve capital efficiency and retain the capability to operate sustainable business into the future, it is important for insurance companies to increase return, through the effective use of capital for incremental profit generation.

Conceptual Diagram



From the above standpoint, through the sophistication of ERM, insurance companies are required to maintain a sufficient level of financial soundness to ensure their ability to make insurance payments in the future, and to strive to enhance the return, thereby distributing profits to policyholders and shareholders appropriately.

2. ERM assessment

As part of the efforts to promote ERM, the Financial Services Agency (FSA) implemented a reporting requirement in 2015, requesting each insurance company to prepare and submit to the FSA (by the end of September 2015) an ORSA Report that outlines the company's

[1] ERM= Enterprise Risk Management: A self-managed type of risk management, where a holistic risk management approach is taken by insurance companies to identify the risks facing them, including potentially major risks, comparing them against their own capital, and controlling risks as an overall business, including flow aspects such as insurance underwriting and premium rating.

[2] ORSA= Own Risk and Solvency Assessment: A process where insurance companies self-assess their capital adequacy, etc., by comparing current and future risks against available capital, etc., and comprehensively verifying the validity of their risk-taking strategies.

ORSA status, principally as of the end of March 2015.

Further, the FSA, utilizing submitted ORSA Reports, conducted a hearing based on the report and assessed the status of ERM of insurance companies. For the program year 2015(July 1, 2015 to June 30, 2016), given the characteristics associated with the scale of insurance business, based on the level of premium income, the FSA selected[3] and assessed[4] 8 insurance holding companies, 25 life insurance companies and 23 non-life insurance companies.

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. (For an overview of the assessment viewpoints, refer to the attached document, “Overview of ERM Assessment Viewpoints (as of June 2016)”.) Note that the standards are as of June 2016, and subject to revision depending on the progress of ERM sophistication in these insurance companies.

3. Overview of ERM assessment results

The results of the ERM assessment on insurance companies were classified into Assessment Levels 1-5, as detailed below.

ERM Assessment Levels Overview

Comprehensive assessment of financial soundness & profitability

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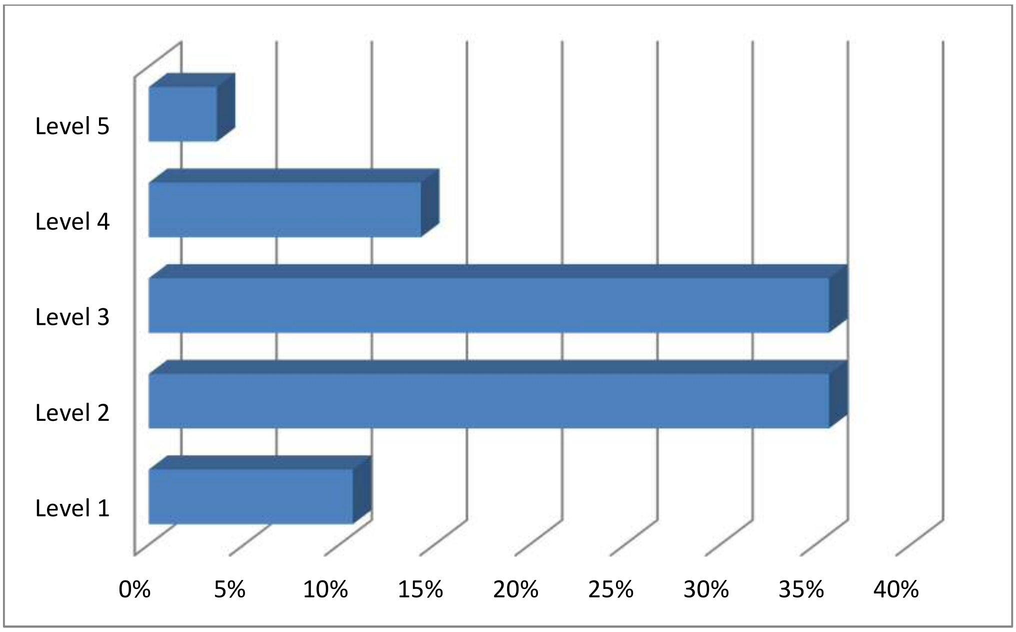
Assessment level	Financial soundness	Profitability
Level 5	The amount of capital is well above the amount of risk taken, and a robust system is in place to ensure financial soundness.	An advanced approach to enhance profitability while ensuring financial soundness is entrenched in the organization.
Level 4	The amount of capital is well above the amount of risk taken, and a system is in place to ensure financial soundness, but not considered robust; or A system is in place to ensure financial soundness, and financial soundness is maintained to some extent, but not considered sufficient.	An advanced approach is implemented to enhance profitability while maintaining financial soundness.
Level 3	Financial soundness is maintained to some extent, and a system is in place to ensure financial soundness.	An advanced approach to enhance profitability, while ensuring financial soundness, is under consideration.
Level 2	While maintaining financial soundness to some extent, the system ensuring financial soundness is weak: or While there are some problems as to financial soundness, a system for ensuring financial soundness exists.	Measures to enhance profitability while maintaining financial soundness are recognized as a challenge for the future.
Level 1	There are problems as to financial soundness, and the existing system to ensure financial soundness is weak.	No recognition of the issue.

3 Insurance holding companies (except for JP Holdings), Japanese and foreign life insurance companies generating a premium income of 100 billion yen or more, Japanese non-life insurance companies (except for Japan Earthquake Reinsurance, Co., Ltd.) and foreign non-life insurance companies with net premium income of 20 billion yen or more. Note that in the case of an insurance holding company that prepares an ORSA Report including its subsidiary insurance companies, and for which ORSA reporting is considered complete for the subsidiary with the submission of the ORSA Report, only the insurance holding company was selected as the target of assessment.

4 For insurance companies outside the scope of the assessment at this time, the FSA is considering including them for the program year 2016 or thereafter.

The assessment identified that only a few insurance companies have successfully adopted ERM into their governance and entire business management, where ERM is utilized for fostering a risk culture and enhancing profitability, in addition to ensuring financial soundness. The Assessment Levels assigned to insurance companies are distributed widely as follows.

Reference: Distribution of ERM Assessment Levels



(Note) Results of the assessment on target insurance companies (56 companies) for 2015

An overview of the results for assessment items "Risk Culture & Risk Governance," "Risk Control & Capital Adequacy," "Risk Profile & Risk Measurement" and "Application to Business Management" is provided below.

○ Risk Culture & Risk Governance

The assessment identified the following advanced practices in large-scale non-life insurance companies (groups) and some life insurance companies (groups), and recognized that a risk culture was fostered to some extent in their organizations. However, many insurance companies are at the stage of disseminating the ERM-based concept towards the future, thus they have yet to nurture the risk culture.

[Advanced practices]

- ✓ Through in-house training, internal dissemination of a management plan, etc., ERM matters, such as risk appetite, are well disseminated in the organization, or a mechanism exists to ensure that ERM matters are well disseminated in the organization.
- ✓ ERM is viewed as the foundation in the development/execution of the mid-term management plan, financial soundness is ensured based on ERM, with an intention to enhance capital efficiency and profit growth continuously, despite changes in the external environment.

- ✓ ERM is used effectively in an M&A transaction through, for example, confirmation of similarity and consistency as to the risk culture and ERM initiatives.

○ Risk Control & Capital Adequacy

The assessment identified the following advanced practices, mainly in large-scale insurance companies (groups), and the FSA recognizes some development of systems to ensure the adequacy of capital against risks. However, note that many small- and medium-scale insurance companies are yet to implement initiatives for internal control, in relation to economic-value-based financial soundness.

[Advanced practices]

- ✓ Internal control is based on both the existing regulatory and economic-value-based solvency margin ratios.
- ✓ Stress testing is effectively utilized, by identifying scenarios that may seriously impact business management and taking measures based on the results of the testing.

○ Risk Profile & Risk Measurement

The assessment identified the following advanced practices, mainly in large-scale insurance companies (groups), and the FSA recognizes some development of systems to identify not only quantifiable risks, but also risks that are difficult to quantify, such as emerging risks.[5] However, many small- to medium-scale insurance companies are not prepared for such advanced practices or taking model governance measures, etc.

[Advanced practices]

- ✓ Rules are set out to manage internal models, and a system is established so that a unit independent of units in charge of model development and measurement verifies internal models.
- ✓ Risks, including risks that are difficult to quantify, are extracted comprehensively in a bottom-up approach. The importance of the risks is assessed and analyzed, and measures against significant risks are considered.
- ✓ Extensive efforts, such as a hearing survey targeting corporate officers, etc., are made to identify emerging risks, etc. Identified emerging risks are monitored continuously.

○ Application to Business Management

Mainly in large-scale non-life insurance companies (groups) and some life insurance companies (groups), the assessment identified the following advanced practices, showing that ERM is utilized in business management through capital allocation, etc. However, ERM at many insurance companies remains focused on financial soundness,

[5] Risks arising from unusual causes and changes in the external environment, which may seriously impact insurance companies.

and is not adopted in their business management.

[Advanced practices]

- ✓ Simulations are performed over a 3- to 5-year time horizon, regarding solvency margin ratios (both the existing regulation and economic-value bases), including profitability indices that incorporate risks. The results of simulations are reflected in decision making.
- ✓ The amount of capital allocation to each group subsidiary is adjusted using risk-return indices, improving the group- or company-wide financial soundness and profitability. Actions such as the above are also contributing to the enhancement of group- or company-wide governance.
- ✓ Profitability indices incorporating risks, such as ROR (Return on Risk), are utilized to balance risk and return associated with insurance products, which are reflected in sales strategies and insurance premium ratings.

4. Challenges for the future

The FSA's ERM assessment is not just a quantitative and uniform assessment of the financial soundness of insurers; rather it is a framework that also assesses active risk taking by insurers that have developed appropriate risk culture/governance, as well as sophisticated risk management systems. The FSA will continue to promote ERM sophistication and encourage insurance companies to grow in an appropriate manner, while maintaining financial soundness.

Further, through the ERM hearing and ORSA reporting, the FSA intends not only to assess the static financial soundness of insurance companies at a certain point in time, but also to conduct an analysis covering the dynamic financial soundness in the future, and better align its insurance supervision with the real situation.