Comments from the Financial Services Agency of Japan
for the Insurance Capital Standard Second Public Consultation

The Financial Services Agency of Japan (JFSA) would like to express our strong support for the efforts by the International Association of Insurance Supervisors (IAIS) to develop the Insurance Capital Standard (ICS) as a common international capital framework. The JFSA also wishes to express its respect for the contributions by experts from the IAIS's member jurisdictions to date.

As senior officials from multiple authorities have already stated, the social and economic environment surrounding financial institutions has been rapidly changing over the last few years. In the developed countries in particular, structural changes such as the aging populations combined with low birth rates as well as the persistent low-growth and low-interest rate environment are having a significant impact on the management and profitability of insurance groups. In light of these changes in the environment that are related to the insurance regulatory regime, the JFSA would like to express its own views taking advantage of this opportunity to comment for the ICS Second Public Consultation. At the same time, the JFSA wishes to highlight several points to which special attention should be paid in designing the solvency regime.[1]

The ICS for Internationally Active Insurance Groups (IAIGs) aims to provide the authorities of each jurisdiction with a consistent view on various risks in the future held by insurance groups in terms of economic-based value.

It is extremely important for insurance groups to control risks and make managerial decisions from a long-term perspective in order to respond appropriately and swiftly to the changing environment and maintain sustainable business models. Globally active insurance groups in particular are making progress in measures to control risks and sustain the profitability of their entire business lines through enhancing enterprise risk management (ERM). Against these backgrounds, in developing the ICS, it is important for the new regulatory framework not to hinder such efforts by each insurance group and not to be excessively complicated, while maintaining its core objective to appropriately address future risks.

[1] The JFSA wishes to refrain from expressing its views regarding the individual issues directly raised at this Public Consultation in order not to prejudice the feedback from the industry.

Under the current increasingly difficult environment surrounding insurance groups, there may be cases where ratios measured by the ICS would not be appropriate indicators expressing the actual solvency of insurance groups and would pose various unintended impacts, depending on some factors such as its definition of capital or its detailed valuation methodologies for liabilities that will be ultimately adopted. In this regard, the JFSA would like to draw your attention to the following points.

(1) Unintended impact on the solvency of insurance groups

In designing the solvency regime, it is not sufficient to merely conduct point-in-time impact analysis based on the current state of assets and liabilities of insurance groups. We need to determine methodologies for calculating solvency ratios taking into account the results of comprehensive and dynamic analysis of how the new regime would affect the groups' behavior and how their risk-taking or profits would be changed after its implementation.

For example, under a method in which temporary interest rate shocks are directly reflected in the discount rates for liabilities, the resultant solvency ratio could be an extreme figure that is distant from the genuine value based on a long-term perspective, since an interest rate shock has an effect on the entire remaining period of liabilities. In order to avoid such a situation, some insurance groups may adopt overly risk-adverse behavior in their asset management or product portfolio, and may be able to regain solvency in the short run. However, this strategy would squeeze their profitability and damage their solvency in the long run.

(2) Unintended impact on the financial market

It is essential in developing a solvency regime to examine the possibilities of its unintended impact on the financial market, given that insurance groups are its important players through their asset management activities. Insurance groups may alter their ALM in response to changes in the solvency regime. Therefore, sufficient ex-ante analysis is needed regarding the possible impact on the financial market caused by the accompanying reallocation of their asset portfolios.

Also, as mentioned above, if each insurance group resorts to excessively risk-averse behavior or a number of insurance groups take similar investment strategies simultaneously in the face of immediate shifts in the market, a regulatory framework may run the risk of becoming the source of further turmoil in the market.

(3) Unintended impact on the social role of insurance groups

Since the solvency regime would have an impact on the product portfolio or asset management of insurance groups, and further on the financial market, as mentioned above, we need to be mindful of the social role that insurance groups are expected to play in designing the solvency regime.

To date, insurance groups have supported the activities of corporations and individuals, who bear respective responsibility in the real economy, and contributed to economic growth and development by providing insurance products to undertake risks for the players mentioned above. In addition, insurance groups, which have the characteristic of long-term investors, can be regarded as having provided stable financing to infrastructure and other long-term projects as well as having supported market functions, even in the situations of short-term price downturns, through providing liquidity to the market. Therefore, it is important to be mindful of possible adverse effects in the case where insurance groups would not be able to fulfill these roles adequately in response to changes in the solvency regime.

(4) Unintended impact during the transition

Finally, we need to be mindful of extra burdens and adverse effects during the transition period to the globally harmonized solvency regime.

In the case where hasty changes to the existing valuation method for capital and liabilities in each jurisdiction are sought, global comparability among IAIGs could be enhanced in a short period of time. However, discrepancies of risk management or supervisory practices from those which have taken root in each jurisdiction could come out. During the transition period, for example, the shape of the optimal portfolio for an insurance group or the appropriate measures for supervisors to be taken based on a solo-entity based regulation could differ from those based on the ICS, leading to confusion about how best to deal with each case. Therefore, the development and implementation of the ICS should be conducted in a careful and gradual manner while being mindful of such unintended consequences during the transition period.

The JFSA is looking forward to active discussion in the IAIS towards the finalization of the ICS Version 1.0, the development of Version 2.0, and the ultimate goal that lies beyond them. In that regard, it goes without saying that the JFSA is committed and prepared to actively contribute to future discussions regarding ICS development.