(Provisional translation)

# The Tenth Meeting of the "Advisory Council on the Economic Value-based Solvency Framework"

The tenth meeting of the Advisory Council on the Economic Value-based Solvency Framework was held in the form of a telephone conference to avoid face-to-face contact, given the coronavirus outbreak.

1. Date and Time: May 20, 2020 (Thursday) 10:00 a.m. to 11:10 a.m.
2. Minutes: The secretariat presented a draft report. Many members supported it, and commented that it appropriately reflected the results of the discussions conducted thus far. In addition, discussions were held as below with respect to expressions in the report, points to be added, and matters for future attention. Finally, it was approved that the chair would check and confirm the revision based on the day's discussions, and the finalized version of the report by the Council would be published.

- My impression is that although there are detailed and meticulous descriptions concerning Pillar 1, there are less descriptions concerning Pillars 2 and 3, for which further discussions are necessary. Given the importance of Pillars 2 and 3, an additional message should be included that we will conduct more detailed study on these pillars going forward.

- Regarding 2) of Section 3 on Page 7 of the draft report, we have already discussed that consideration should be given not only to the viewpoint of how to provide information but also how to promote better understanding among stakeholders, including consumers and market participants. In light of this, how to promote better understanding on the part of information users should also be included as an additional viewpoint.

- Regarding 2) (i) of Section 3 "Impact on insurance companies' behavior" on Page 7 of the draft report, my understanding is that the issue is not the volatility of economic value-based indicators themselves, but a lack of accurate understanding of the volatility on the part of external stakeholders. As another negative side effect, the possibility was pointed out that insurance companies' efforts to enhance risk management may stall if ESR-based regulation is applied in a mechanical manner (Page 9). However, it is unlikely to happen if external stakeholders have an accurate understanding. In that sense, I agree with mentioning the viewpoint of how to promote better understanding on the part of external stakeholders.

- With respect to "Future Study" on Page 11 of the draft report, we, as an insurance company, would like to contribute to discussions to develop better rules, regulations and standards with the proposed timeline in mind.

- Page 12 of the draft report includes a paragraph stating that the FSA should aim to provisionally determine by 2022 the overall framework (the standardized model in particular) of the new framework." Regarding the wording "provisionally determine," I understand that non-technical points may also be included here. Not only should we discuss technical specifications on the premise of introducing the new framework, but also what form the new framework should have, in light of ICS-related developments.

- Footnote 19 on Page 12 of the draft report refers to the impact of the novel coronavirus outbreak. If some problem occurs, it is inevitable that this process will be affected. However, given our consensus that a delay in the introduction of the new framework should be avoided by all means, it is doubtful whether the report should include a note that could be seen as an excuse for a possible delay.

- Including a note like this is fair, because at present, there are many uncertainties over the impact of the novel coronavirus outbreak. On the other hand, the wording "it is necessary to give consideration to the burden imposed on relevant parties" implies that pushing back the timeline may be acceptable. Therefore, it should be changed to reflect a message that the situation should be carefully monitored, although the overall timeline will not necessarily be pushed back.

- Regarding the discount rate of insurance liabilities mentioned on Page 17 of the draft report, there has so far been little discussion on the treatment of spreads. If the addition of spreads to the discount rates is allowed, the amount of capital increases reflecting the decrease in the value of insurance liabilities decreases. However, it is necessary to take due care from the perspective of ERM, which aims at managing the balance between risk, return and capital. If the value of insurance liabilities is underestimated, insurance companies may face managerial challenges in the future, as any excess return over risk-free rates that may be earned from asset investment could be offset by an increase in the value of liabilities. Therefore, the application of spreads under Pillar 1 and whether or not this approach is theoretically appropriate under Pillar 2 should be treated as two independent matters that need be examined carefully.

- On MOCE, which is discussed on Page 19 of the draft report, there is still room for further discussions. As MOCE is part of insurance liabilities, it is good that the consensus is leaning toward not deducting MOCE from capital requirements. Rather than focusing only on reducing the burden by allowing the deduction of MOCE from capital requirements, it is better to first confirm principles from the viewpoint of how to manage the balance between risk, return and capital. From that viewpoint, it should be noted that a lack of clarity over the relationship between risk, return, and capital was cited as a problem related to the percentile method. As points like this may become matters for future discussion, they should be actively examined.

- Regarding use test on internal models, as pointed out on Page 25 of the draft report, it is certainly difficult for all directors and other senior managers to understand all the details of internal models. With that said, I would like to make clear once again that it is necessary for senior managers to have a fairly good understanding of their models.

- Concerning a comment made by a colleague member about spreads, we have not held technical discussions, to be sure, but this is an important point. If variable spreads are allowed, risk management will become difficult, so that will pose a problem from the perspective of their capability to control ESR.

- Regarding internal models mentioned on Page 22 of the draft report, as the ICS is applied globally, it is desirable for international and domestic regulations to be harmonized with respect to IAIGs in particular. Therefore, going forward, domestic discussions on internal models should take into consideration the development of the ICS.

- When discussing the specifications of the standard model, which are mentioned on Page 13 of the draft report, in light of the status of the novel coronavirus outbreak, it is important to examine and verify through a field test what would have happened if economic value-based regulation had been introduced in March 2020. Another important point is how to ensure validity of the estimation of insurance risks, and evaluation of the expansion of spreads on the asset side. These topics should be checked carefully through field tests.

- Regarding starting activities related to Pillar 2 at an early stage, before the introduction of Pillar 1, which is mentioned on Page 32 of the draft report, action should by all means be taken. From the perspective of enhancement of risk management, the effects of Pillar 1 are limited and Pillars 2 and 3 play a more important role. Pillars 2 and 3 may be an answer to a question on Page 9 of the draft report: "Which kind of regulatory framework is suited to encourage proactive enhancement of risk management by insurance companies?" However, we could not have sufficient discussions within this Council. More in-depth discussions should be held going forward.

- The real net assets, mentioned on Page 38 of the draft report, means a stress test which assumes immediate cancellation of all contracts from the standpoint of an economic value. Therefore, if insurance companies are to conduct economic value-based ERM in earnest, using real net assets as an indicator is sure to pose a significant problem.

- When making preparations with 2025 as the target year, there are concerns as to whether we can successfully achieve the goal of introducing economic value-based regulation while complying with the existing solvency margin regulation, which may run counter to the new regulation. Therefore, we should consider if the existing regulation has some elements that can be modified to make it more consistent with an economic value-based approach.

- From the perspective of economic value, it is better to discontinue the use of real net assets. On the other hand, we need to discuss whether or not it is appropriate that only economic value-based indicators are available when the market shows very volatile movements, for example, when interest rates plunge after shooting up. This issue should be examined from multiple angles, although this may be seen as a transition process issue.

- Going forward, it goes without saying that dialogue between the FSA and insurance companies is important. However, as it is also important to hold discussions with external stakeholders on various topics, it is better to make more explicit reference to the importance of doing that.

- Although 40-year bonds are also available in the JGB market, insurance cash flows will arise in an even longer horizon due to the duration structure of life insurance companies' liabilities. Therefore, if tools to cover the longer-term are available, it will become easier for insurance companies to shift smoothly to an economic value-based framework. It is also necessary to encourage efforts to further develop capital markets.

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