(Provisional translation)

**The First Meeting of the "Study Group on the Economic Value-based Solvency Framework"**

1. Date and Time: June 26, 2019 (Wednesday) 4:00 p.m. to 5:50 p.m.

2. Venue: Special Conference Room No. 1, 12th Floor, Central Government Building No. 7

3. Minutes: Following the introduction of the members and a presentation by the secretariat, the discussions among the members were held as below.

- There is a view that Solvency II affected European insurers in several ways, such as by having impacts on competitiveness, investment management, provisions for long-term products, and mergers and acquisitions, which may have narrowed the range of options available to consumers. We should take that into account, and may need to prepare responses to deal with such potential unintended consequences.

- After the FSA's "Study Team on Solvency Margin Standard" published their report in 2007, I expected a prompt transition into an economic value-based solvency regime to facilitate enhanced risk management, but this did not happen. This may be partly because no clear roadmap towards the implementation of a new regulatory regime was presented.

- The current domestic regulations and accounting standards do not sufficiently reflect the interest rate risk stemming from long-term products, which should be captured through appropriate measures. It should not be ignored if certain products are unprofitable when they are assessed based on other appropriate measures. Regulatory arbitrage may stem from risks that are not adequately captured by the regulatory and accounting standards. That might lead to more significant unintended consequences (than ones that might be caused by an economic value-based solvency regulation).

- Risk management practices and regulations should not be modified to justify the current practices that allow for excessive risk-taking. One such example, which I think is risky, is using the Ultimate Forward Rate (UFR) for extrapolation of the yield curve. The regulation should be aimed at ensuring that insurers are able to continue their businesses in 50 or 60 years.

- Some insurers have been developing their own economic value-based approaches in the context of internal risk management. I am concerned that they might terminate those efforts because of the introduction of an economic value-based regulation. Taking into account that possibility, I think it is important to consider what kind of role the new regulation is expected to play. For instance, it would be beneficial for the supervisor to discuss the differences in individual insurers' views on their own risk profile and risk management, while referring to a standardized regulatory model as a benchmark.

- Some insurers voluntarily disclose economic value-based indicators, including their ESR. Market participants use such information to assess their profitability and solvency. However, comparability is limited due to differences in measures and models used by individual insurers. I understand that, with the introduction of economic value-based regulation, it has been discussed whether or not insurers should continue providing long-term products in Germany. This is a good opportunity for Japan to think about such issues as well. I expect that steps towards the introduction of an economic value-based regulation will be taken in an appropriate manner.

- While we may consider some transitional measures to introduce an economic value-based regulation, we should not make our discussion overly backward-looking in fear of unintended consequences. Ideally, insurers with strong risk management should gain trust from the market and policyholders, and it would encourage other players to follow suit. From that standpoint, it makes sense to design a prudent regulation to be consistent with an economic-value based approach.

- Disclosed information on insurers' internal risk management is not sufficient. More granular information, including assumptions on a yield curve as well as other parameters, could be made available to market participants, although additional disclosure might be costly for insurers. With regard to internal models, we should consider incentives for insurers to use internal models in solvency regulation, as well as a time frame we should have in mind.

- If the Unites States takes steps towards a different direction from the current ICS and their domestic rule is not fully consistent with those in the other jurisdictions, it might give rise to regulatory arbitrage. We should take note of such a possibility.

- Corporations, including insurers, are being required to make more contributions and take more responsibility for the sustainability and development of all society. For instance, there is an idea that environmental risks which might materialize in the future should be incorporated into balance sheets, although that might be out of the scope of discussion for this meeting. It is important to think about a regulatory framework that could incorporate such dimensions, while monitoring discussions at the IAIS.

- Even though consumers' demand for long term products is still strong in face of their longevity risk, I think the number of options for insurance products that properly meet such needs has declined recently. I am concerned that the introduction of an economic value-based regulation might affect provisions for long-term products, even if interest rates move up in the future. I would appreciate case studies of other jurisdictions, such as on the effects of economic value-based regulations on issues related to consumer protection and the options of products available.

- Even if there is a strong demand for long-term products from the consumers' side, we do not want to see insurers fail as a result of assuming uncontrollable risks. We need to recognize that first and then find realistic solutions.

- While I fully understand the importance of interest rate risk, I wonder if there is any way to provide whole-life protection at a reasonable level of premium. I would like to see efforts by life insurers in this regard, as they are the only providers of whole-life protection.

- We first should agree upon the time frame for looking at the stability of the financial system.
- National supervisory authorities have been working on RegTech (utilization of technologies for regulatory and supervisory purposes). A possible application example would be the timely collection and analysis of data related to capital adequacy regulations. It will be critical to invest early on improving the efficiency and effectiveness of supervision, utilizing AI and big data.
- Even if there is a demand for whole-life products, assuming excessive risks cannot be justified from a managerial standpoint. I understand the aim of this Study Group is to introduce a tool to measure such risks in an appropriate manner. The market for ultra-long-term bonds is small, meaning that there is a limit in ALM. Whole life products would be attractive both for consumers and for insurers if there was no need for ALM, but that is not the case in reality. I expect that transition into economic value-based regulations provides an opportunity to rethink the current management strategies of the insurers.
- Some life insurers have already adopted economic-value based approaches in their internal management that are incorporated in their products and investment strategies. With that said, once ESR is introduced as a regulatory requirement, they might be required to look at risks in a substantially more rigorous manner to avoid falling below 100% (regulatory minimum) in any situation. This would be a drastic change for them. Life insurers have made efforts to meet consumers' needs for whole-life protection, including devising various investment strategies. We should carry our discussion forward while keeping in mind how such unintended consequences may materialize.
- While there are various stakeholders involved with life insurers, we should not forget that the most important objective of insurance regulations is policyholder protection. We need to find ways to overcome unintended consequences, not necessarily in a backward-looking manner, while examining issues related to consumer protection and

insurance products that have occurred in other jurisdictions.

- It is important to consider risks that are possibly being overlooked as of now, taking into account the fact that some insurers have begun providing coverage for cyber risks and information leaks.

- Policyholder protection is indeed important for society. With that said, the aim of economic value-based risk management would be to ensure insurers' ability to fulfill obligations even several decades later. This is important for policyholder protection. It is difficult to completely match assets and liabilities. Roughly 80% of yield curve movements are, however, parallel shifts. This means that investments within shorter maturity ranges could also partially be effective in mitigating interest rate risk. Insurers should be equipped with such sophisticated risk management strategy to the extent that various risks could be hedged or covered by capital buffers. Only insurers with such robust risk management should be eligible to provide long-term products.

- Emerging risks such as cyber, liquidity and reputational risks are not explicitly incorporated in ICS. We need to discuss how they should be treated within Pillar 1 and/or Pillar 2.

- When dealing with economic value-based valuation, the inputs of assumptions for insurance liabilities are critical, particularly for life insurers. While ICS and Solvency II have requirements related to the governance of calculation processes for insurance liabilities, there are no granular rules regarding the assumptions. This makes for a stark contrast with the current domestic regulations in Japan. Examinations and audits of economic value-based liabilities may be challenging, but we should recognize the importance of inputs and modeling on the liability side, in addition to internal models for risk measurement.

- It is natural for insurers to meet demands from consumers. On the other hand, risk-taking that results from such underwriting activities is not always observable to outsiders. Economic value-based regulations would be meaningful in that they would enhance the visibility of risks assumed by insurers.

- In addition to the validation of insurance liabilities, some non-insurance liabilities (e.g. retirement benefit obligations) and asset items may pose difficulties as well. We may want to include this in our scope.

- While the measurement of risks is certainly a key element in economic value-based valuations, inappropriate calculations of current estimates would make the ESR itself irrelevant. Thus, it is critical to ensure the reliability of insurance liability.

- When considering the regulatory regime that may be introduced in Japan in the future, we should take note of issues related to calculations under a low interest rate environment, as well as potential differences in insurance product portfolios between Japanese insurers and those based in the United States and Europe (e.g., protection-type products). Due to differences in the environments, some issues and approaches discussed in Solvency II might not directly apply to the Japanese context. We may need to discuss approaches that are more suitable for the situation in Japan.

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