

APRIA 2023 Annual Conference
July 31, 2023

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Challenges in Insurance Supervision

Opening

Good morning and welcome to Japan. It is my great pleasure to speak before such distinguished experts from the insurance sector. Let me start by expressing my best wishes for the Annual Conference of the Asia Pacific Risk and Insurance Association, APRIA, which is being held in Japan for the first time in 12 years.

At the time of the last Conference in Japan, which was held in 2011, the Great East Japan Earthquake occurred while the impact of the Global Financial Crisis remained, and the Japanese economy as a whole including the insurance industry was facing many challenges.

In 2023, the environment is changing dramatically. The insurance business is facing various transformations in the environment, including the COVID-19 pandemic, the acceleration of digitalization triggered by the pandemic, and a rise in interest rates.

“Insurance” plays a very important role in society with the aim of enhancing national welfare, it enables and drives economic activity by protecting lives and property against risks. For example, insurance provides protection and support in the face of any unexpected risks in economic and social activities, supplements public security, and provides compensation for accidents. Therefore, the purpose of our insurance supervision is not only for individual insurance companies to conduct sound business, but also to improve the overall insurance market in Japan and eventually to realize an insurance market that contributes to the sustainable growth of the Japanese economy. From this perspective, in addition to enhancing insurance companies' risk management and ensuring policyholder protection, it is important to promote innovation and set an environment in which insurance companies can provide better services to their customers.

Today, I would like to talk about two issues --- how insurance companies are trying to respond to changes in the environment, and how we, as Japan's insurance supervisor, will deal with them --- particularly from the viewpoints of business models, financial soundness, and promotion of innovation.

Insurance Business Models and Supervisory Approach

First, I would like to talk about the business models of insurance companies in Japan.

In light of changes in business environments, such as the aging society with low birthrates, the frequent occurrence and increasing severity of natural disasters, and the shrinking automobile insurance market, insurance companies are required to build sustainable business models through efficient business operations and the development of products that meet changes in customer needs.

For example, looking at the earnings structure of life insurance companies, the recent financial conditions were affected by the COVID-19 pandemic, but looking at the past decade or so, the so-called "negative spread" has largely disappeared, and gains from mortality rate margin have been solid. However, considering demographic trends, we expect insurance payments to continue increasing as the number of elderly people increases while the number of young people decreases. It is also pointed out that competition is intensifying and profit margins are declining for medical insurance that caters to living benefit needs. Given these circumstances, it is clear that life insurance companies will not be able to continue operating under the same business models they have adopted thus far. Building a sustainable business model

capable of responding to future changes in the environment has become an urgent issue.

The same can be said for non-life insurance companies. An examination of underwriting profits at non-life insurance companies over the past decade reveals that losses from fire insurance are being offset by earnings from other insurance businesses, such as automobile insurance. On the other hand, the automobile insurance market is expected to shrink in the medium to long term due to technological progress, and the aging society with a low birthrate. Given these circumstances, it is clear that the current earnings structure of non-life insurance companies is not sustainable. Building a sustainable business model that can adapt to changes in the business environment in the future is an urgent issue, just like life insurance companies.

In anticipation of these changes in the business environment, some insurance companies are endeavoring to diversify their businesses and earnings sources beyond life and non-life insurance in Japan by strengthening their overseas business, including overseas expansion, and advancing into businesses closely related to insurance, such as healthcare and risk consulting. In addition, by promoting digitalization, some insurance companies are providing insurance services using digital platforms, the so-called

“embedded insurance,” and insurance services using big data in addition to making existing operations more efficient.

There is a growing need for each insurance company to formulate and implement management strategies from a medium - to long-term perspective, taking into account not only short-term issues but also the size and characteristics of the company. The top management of each company will be further required to demonstrate originality and ingenuity in order to evolve their business models. In addition, in order for such business models to become truly sustainable for society as a whole, it is desirable that the services provided by each company contribute to solving social issues, such as the aging society with a low birthrate and the frequent occurrence and increasing severity of natural disasters. Typically, health promotion insurance and telematics insurance can be said to contribute to solving social issues if designed appropriately. The insurance coverage rate in Japan is high compared to other countries, so when the insurance business develops soundly and contributes to solving social issues, the benefits will be extremely large. We will encourage insurance companies to make steady progress in their initiatives based on their originality and ingenuity through our supervision.

So far, I have talked about business models in general. The main theme of this conference is "Resilience and

Sustainability in the Risk Society." Therefore, I will talk about responses to natural disasters, which will be discussed in the following sessions.

As you all know, in recent years, natural disasters and abnormal weather have occurred one after another around the world, including in Japan. In Japan, insurance payouts increased in fiscal 2022 due to typhoons No. 14 and No. 15 and the hail disaster in June. Overseas, natural disasters also occurred, including Hurricane Ian in North America, which was the second-largest hurricane ever. Natural disasters, as well as rising interest and inflation rates around the world, led to significant reinsurance premium rate increases of 30% to 40% in Europe and the United States, which also had a significant impact on the Japanese reinsurance market.

In the case of non-life insurance companies, in order to diversify risks in preparation for the occurrence of multiple natural disasters, there are cases of promoting diversification of risks other than reinsurance, such as business diversification and geographical diversification, and cases of reviewing underwriting policies for direct policies. As described above, we believe that it is becoming increasingly important for each company to upgrade its Enterprise Risk Management (ERM) system in line with its own circumstances, and to review the coverage and premium rates based on the

needs of customers and actual risk conditions. In the future, insurance companies are expected to develop insurance products that can respond to risks in a more detailed manner, such as by subdividing water disaster insurance rates.

In addition to providing post-disaster protection, it is also important to take measures to reduce disaster risks from the viewpoint of strengthening the functions of society as a whole. Specifically, some non-life insurance companies are taking steps to reduce risks themselves, including offering disaster prevention and mitigation support and risk consulting to businesses.

As can be seen from the above, private insurance companies are taking a two-pronged approach, not only optimizing coverage and premium rates by enhancing risk management, but also reducing risks themselves. We will also continue to monitor non-life insurance companies' efforts to address natural disaster risks. On the other hand, in terms of how to deal with natural disaster risks, it is important to raise resilience not only by private insurance companies but also by society as a whole, including the public sector and capital markets. I expect that in-depth discussions will be held from such a perspective in other sessions of the Annual Conference.

Supervisory Measures for Financial Soundness

Next, I would like to talk about financial soundness.

Life and non-life insurance companies in Japan reported a year-on-year decrease in the current period net profit basis due to COVID-19 and natural disasters in Japan and overseas. On the whole, however, we recognize that they have solid financial bases, and their current Solvency Margin Ratio, SMR indicates that they are securing sufficient levels.

Also, when we talk about the financial situation of insurance companies these days, we cannot ignore the trends of the financial market. Life insurance companies in particular have been selling hedged foreign sovereign bonds and increasing their investment in super long-term JGBs in response to a rise in U.S. interest rates. This also means promoting duration matching between assets and liabilities. In addition, from the viewpoint of improving profitability, there have been moves to increase investments in overseas credit assets and alternative assets.

We are monitoring these trends in asset management. Looking at the impact of these rises in overseas interest rates on SMR, a typical financial soundness indicator, there were cases of significant deterioration in SMR of insurance companies, particularly those that hold large amounts of foreign bonds as trade securities. However, even for such

companies, if they are conducting ALM properly, they have been stable under Economic value-based Solvency Ratio, ESR. The difference is due to the fact that under the SMR, liabilities are carried at book value while they are carried at market value under the ESR. As such, there are cases where the recognition of risks differs significantly between SMR and ESR. However, from the viewpoint of enhancing risk management, we believe that financial soundness should be assessed based on ESR.

We are currently engaged in detailed discussions with relevant parties aiming at the implementation of ESR in 2025. The implementation of the ESR will change the way we assess the financial soundness of insurance companies. This is the first major update in nearly 30 years since the current SMR was introduced in 1996. In addition, the ESR will not only change the calculation method of the soundness indicator but also change the supervisory methods and disclosure rules based on it. In doing so, we will consider a variety of factors, including consistency with international agreements, the state of regulatory situations in other countries, and issues unique to Japan.

We would like to make ESR regulation useful for insurance companies in enhancing their risk management on a global basis. At the same time, we intend to make regulations that

contribute to enhancing our supervision itself.

Supervisory Measures for Responsible Innovation

Finally, I would like to refer to the utilization of InsurTech, which applies financial technology to insurance services, and the promotion of innovation that brings about technological progress, as I understand that the utilization of financial technology is included in the main theme of this Annual Conference.

As I mentioned at the beginning, the objective of our insurance supervision is not only for each insurance company to conduct sound business, but also to improve the overall insurance market in Japan and eventually to realize an insurance market that contributes to the sustainable growth of the Japanese economy as a whole. To this end, it is important not only to ensure policyholder protection and the soundness of each insurance company, but also to develop an environment that promotes innovation.

Japanese insurance companies have a long history of providing insurance services to Japanese people and building relationships of trust with them, and it can be said that the percentage of Japanese people buying insurance is high compared to other countries. On the other hand, we have a

long legacy. I think that the application of technology to insurance services, or InsurTech, is still in the early stage in Japan. On the flip side, I think that there is still a lot of room for the development of insurance services in Japan through InsurTech. In addition to making business operations more efficient by overcoming the legacy through the utilization of technology, if we can easily provide more detailed and personalized insurance products to users with embedded insurance, along with the use of big data, it will contribute to the realization of financial inclusion in a broad sense. In addition, if digital assets based on block-chain technology are utilized throughout society, insurance services on Metaverse or Web 3.0 will naturally be created. Generative AI, which has recently gained much attention, is also likely to lead to the further development of insurance services, assuming sufficient risk management. From this perspective, we welcome the collaboration between insurance companies and InsurTech start-ups, as well as the use of InsurTech by insurance companies.

In order to make the Japanese insurance market more attractive, it is important to balance policyholder protection and the promotion of innovation at a high level. To this end, we continue to pursue the best combination of rules and principles, but I think the faster the pace of technological development, the more likely industries may encounter grey

areas of regulations. Under these circumstances, it is important for industries and regulators to identify issues through close exchanges of views and to engage in constructive discussions. We established FinTech Support Desk as a legal consultation desk in December 2015. Since its establishment, the Desk has received more than 2000 consultations, including those on insurance-related matters.

Although we are still in the middle of the road, by promoting "Responsible Innovation" that ensures policyholder protection, we will change the environment of the insurance market in Japan into one in which new insurance services are born and protection functions so that users can conduct economic activities with peace of mind, with InsurTech as the core.

Closing

The APRIA Annual Conference is being held for the first time in 12 years here in Japan. It's a milestone year because other big conferences will also be held in Japan, the PRI Annual Conference in October, followed by the IAIS Annual Conference in November. I understand that this year's APRIA Annual Conference will feature discussions on a wide range of insurance-related topics, including the protection gap, the aging society with a low birthrate, and the application of data science technology. Each of these issues is extremely

complex and difficult, and in order to resolve them, cooperation among multiple stakeholders, including academia, insurance companies, and financial authorities, is essential. I would like to conclude my remarks by expressing my hope that constructive discussions aimed at resolving these issues will bear fruit in the future. Thank you very much for your attention.