

Suggestions on Insurance Capital Standard

12 May, 2015

The General Insurance Association of Japan

- We support “Comparability” in the sense of “Almost the Same ICS ratios for the same risk profile, regardless of IAIGs’ Home Jurisdictions”.
- “Comparability” is a prerequisite for:
 - Assessment of capital adequacy among insurance groups
 - Securement of a level playing field
- Inconsistent ICS figures for the same risk profile would lead to:
 - An unlevel playing field among IAIGs
 - Regulatory arbitrage

- We expect the ultimate goals of ICS to be:
 - Consistency between standards for IAIGs and non-IAIGs
 - Consistency between standards on a group basis and a single entity basis
- We expect an additional ICS Principle:
 - ◆ “The ICS is consistent with standards for non-IAIGs/G-SIIs and those on a single entity-basis, except for where necessary in light of its purposes.”
 - If not possible in ICS 1.0, this should be included in ICS x.0 in the foreseeable future.

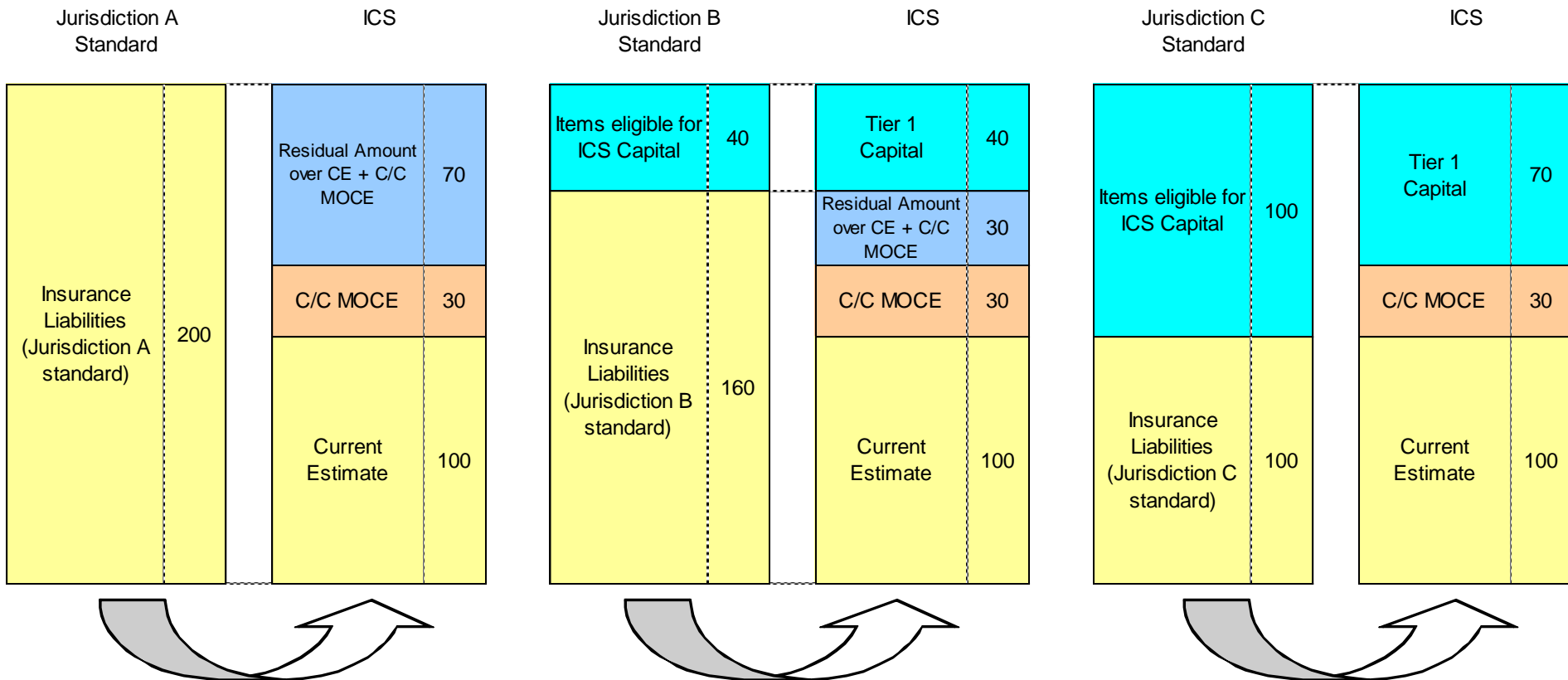
- We suggest using ICS as:
 - “Early Warning Indicator” (*not to use as an intervention point*)
 - “Communication Facilitator” in supervisory colleges
- Advantages of introducing ICS as an EWI
 - Facilitate understanding of IAIGs in supervisory colleges
 - Promulgate the global standard as a target to be pursued by respective local solvency regulators
 - **Reliability and robustness of the standards can be enhanced over time**, without causing unintended consequences.

- We support an economic valuation of insurance liabilities
 - More effective risk management
 - **Consistent with ICP 14.4**
- Margins for uncertainty inherent in cash flows should be included in insurance liabilities on an economic valuation basis.
- However, margins included in insurance liabilities on a GAAP basis differ according to local accounting regimes and thus are not comparable.
 - In order to make capital of insurance groups comparable with each other, the margins should be consistent and comparable in nature.

- Margins within insurance liabilities on an economic valuation basis are consideration for uncertainty of cash flows associated with insurance contracts.
 - “Margin to recognize transfer value” is more appropriate than “margin for prudence”.
- Cost of Capital method is plausible, as:
 - Results of calculation are market-consistent
 - Simple & transparent (third parties can assess appropriateness)
 - Consistent with ICS Principles 1 (comparability) & 8 (risk sensitivity & simplicity)

- We do not feel it necessary to adopt GAAP+ for all jurisdictions
 - ✓ The more jurisdictions the IAIG operates in, the heavier its workload. In addition, it is difficult to secure comparability
 - ✓ Some jurisdictional GAAP may differ greatly from Market Adjusted Valuation approach in assessment methodology.

- Residual amount of GAAP insurance liabilities over CE + C/C MOCE should be recognized as capital:
 - ✓ To be transferred to gains as the firm is released from insurance obligation
 - ✓ Has the **nature of unrealized gains included within insurance liabilities**
 - ✓ Homogenous in loss absorbing capacity with unrealized gains included within financial instruments
 - Firms in jurisdictions with **more prudent GAAP insurance liabilities are required to prepare additional capital** resources.
 - Potential **lack of neutrality as to choice of jurisdiction**



- Suppose 3 IAIGs with the same risk profile are based in jurisdictions A, B and C where prudence levels are different, and the required capital for ICS is 60. If the residual amount is not counted towards capital resources,
 - ✓ IAIG in jurisdiction A needs 60 and IAIG in B needs 20 of additional capital procurement.
 - Firms with more prudent liabilities are required to prepare more capital resources.
 - Potential lack of neutrality as to choice of jurisdiction

- Largely different valuation methods from IFRS could impose sizeable additional costs in lots of jurisdictions with little additional value.
- Taking into account the above, the possibility of adopting the same principles as the IFRS where possible and appropriate should be explored.

- While it is established to prepare for certain types of risks...
 - ✓ Can be deemed as an “Unrestricted Reserve”, as it can be drawn down by filing with the supervisor
 - ✓ Superb in the 5 characteristics as to quality as capital

- Set aside as an “additional” reserve accumulated over years for risks to which the Law of Large Numbers does not work within a single year
 - No obligation to anyone except for policyholders to be protected against relevant events
- In the case of a winding-down, the firm in question will be released from the obligation to set aside the reserve; it is used to absorb losses once insurance liabilities at that point are fixed.
 - No obligation to anyone will remain.
- It is treated as liabilities in J-GAAP, but accumulated by income.
 - Always available to absorb losses
- It does not constitute actual liabilities at the moment, but rather, is set aside to absorb losses in the future when a catastrophe occurs.
 - Has the same characteristics as capital

Catastrophe Reserve – (3) Loss absorbing capacity, (4) Permanence, (5) Absence of encumbrances, etc.

- Reserve system to secure claim payment ability, to be utilized in stresses of catastrophe events
 - Adequate loss absorbing capacity
- Not limited to cover natural disaster risks, but an “additional” reserve accumulated over years for risks to which the Law of Large Numbers does not work within a single year
 - Can also be utilized for insurance event situations other than natural disasters, and has adequate loss absorbing capacity
- No drawdowns other than to absorb losses and redemptions
 - It has permanence.
- No encumbrances and mandatory servicing costs
 - It should be deemed as capital of “high quality” based on the 5 characteristics above.

- Measurement of catastrophe risks is one of the challenges to achieving ICS comparability.
 - ✓ Type, magnitude and severity of relevant perils vary by region.
 - ✓ Difficult to calibrate the target criteria (or the definition of stresses) to a similar level across different regions
 - ✓ Difficult to measure with a uniformed approach, as risks vary widely by each respective firms' portfolio
 - Difficult to reflect the reality under a stress or a factor approach
- We strongly support the IAIS's proposal of the utilization of models within the standard method of ICS.

- Regions or perils for which no engineering model exists:
 - ✓ Difficult to provide reliable data, or
 - ✓ Impossible to assess by models at the moment
 - Scenario and simplified factor-based approaches are necessary as an option.
- Possible solution as to difference in relevance of perils by jurisdiction
 - Jurisdictional supervisor who is knowledgeable about the actual conditions of the jurisdiction to decide the perils to be included
- Possible solution as to challenges about partial models in terms of comparability
 - Jurisdictional supervisor who is knowledgeable about regionally unique and relevant risks to secure the comparability by implementing examination and approval process

- Use of full internal models has advantages in both cost/benefit
 - ✓ Facilitates IAIG's robust risk management
 - ✓ Enables consistent management with internal management
- Supervisory approval process is necessary for securement of comparability. However, there are:
 - ✓ Difference in status of approval system by jurisdiction
 - ✓ Difference in criteria for approval by jurisdiction
 - These differences could lead to an unlevel playing field among IAIGs.
- Standard approach in general with partial internal models for catastrophe risks is appropriate.
- We expect a framework with supervisory approval process to enable full internal models will be established in the foreseeable future.