Trend in Solvency Regulations in Japan

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- Managing Director, Capitas Consulting Corporation
  - Consultation based on experience analyzing and assessing insurers as a credit analyst and regulator over 20 years
- As an analyst at Rating and Investment Information Inc. (R&I), covering mainly insurance industry (1997-2010)
- In FSA Japan, mainly in charge of monitoring and encouraging enterprise risk management (ERM) of insurers (2010-12)
  - Also in charge of upgrading of solvency regulations
- Received Ph.D. in 2008, study of insurers' bankruptcy in Japan
  - *"The Failure without Management: Truths behind the Seiho Crisis in the Heisei Era" published in 2008* [*http://olis.or.jp/publication.html*](http://olis.or.jp/publication.html)
  - *"Principles of Economic Value Based ERM for insurers ", published in 2017*

Today's Agenda

1. Trend in Solvency Regulations in Japan

2. Management on economic value based measure

3. ORSA

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Trend in Solvency Regulations in Japan

1996	Solvency Margin Ratio (SMR) introduced
2000	Daihyaku, Taisho, Chiyoda and Kyoei Life Failure
2007	Reported by a “FSA Review Team of SMR” released
2008	Lehman Shock, AIG’s crisis
2010	SMR revised under the current scheme
	1st. Field testing (for economic value based solvency regime) * 2nd.= 2014, 3rd.= 2016, 4th.= 2018
2012	IMF released an assessment report of FSAP Japan (Requested for economic value based evaluation of liabilities)
2014	Revision of Guideline for Supervision (ORSA related rules established) * ORSA reporting in 2015
2020 ?	Field testing as a formal regulation
2025 ?	Introduction of economic value based solvency regime

Trend in Solvency Regulations in Japan

- Current solvency regime

$$\textbf{Solvency Margin Ratio} = \frac{\text{Margin (Capital)}}{\text{1/2 * Risk Amount}} \geqq 200\%$$

- Based on the Report in 2007 by “FSA Review Team of SMR”, FSA is studying to introduce economic value based solvency regulation.
- Many insurers recognize FSA will introduce new regulation after the increasing field testing frequency and formally requested instead of questionnaire.
- Many insurers pay attention to ICS development by IAIS, because they recognize FSA will introduce new regulation with reference to ICS.

Acceptance of international regulations

- ICP（Insurance Core Principles）
  - IAIS formulates the basic principles concerning insurance supervision in each country.
  - FSA Japan is one of a leading members of IAIS, and reviews domestic regulations as necessary in order to ensure consistency with the ICP.

    ex. ORSA related rules established in 2014 along the ICP 16.

- ComFrame
  - IAIS will formulate the supervisory framework for Internationally Active Insurance Groups (IAIGs).
  - ICS is a part of ComFrame.
  - FSA Japan uses the field testing of ICS for examining domestic new solvency regulation.

ICS and field testing timetable

DATE	MILESTONE
May 2018	Launch of 2018 Quantitative Field Testing
July 2018	Publication of ICS Version 2.0 CD and comprehensive ComFrame consultation
September 2018	Field Testing submissions due
October 2018	Feedback on ICS Version 2.0 CD and comprehensive ComFrame consultation due
April 2019	Launch of final round of ICS Field Testing
July 2019	Data due for 2019 Field Testing
IAIS 2019 General Meeting	Adoption of ComFrame, including ICS Version 2.0 for the monitoring period
Early-2020 to Late-2024	Five-year monitoring period
November 2024	Adoption of the ICS Version 2.0 for implementation as a group-wide consolidated PCR

Economic value based solvency regulation in Japan

- The attitude that the FSA adopts economic value based evaluation for solvency regulation is not shaken.
  - It is contributes to the sophistication of insurers' risk management.

- FSA was paying attention to international accounting standards (IFRS) and the trend of EU Solvency II at first, but now FSA is closely watching the trend of ICS development.
  - FSA 'Assessments and Strategic Priorities 2018' (published in 9/2018)
    - FSA will conduct extensive discussions with relevant parties for the introduction new regulation at the timing not to be late for ICS development.

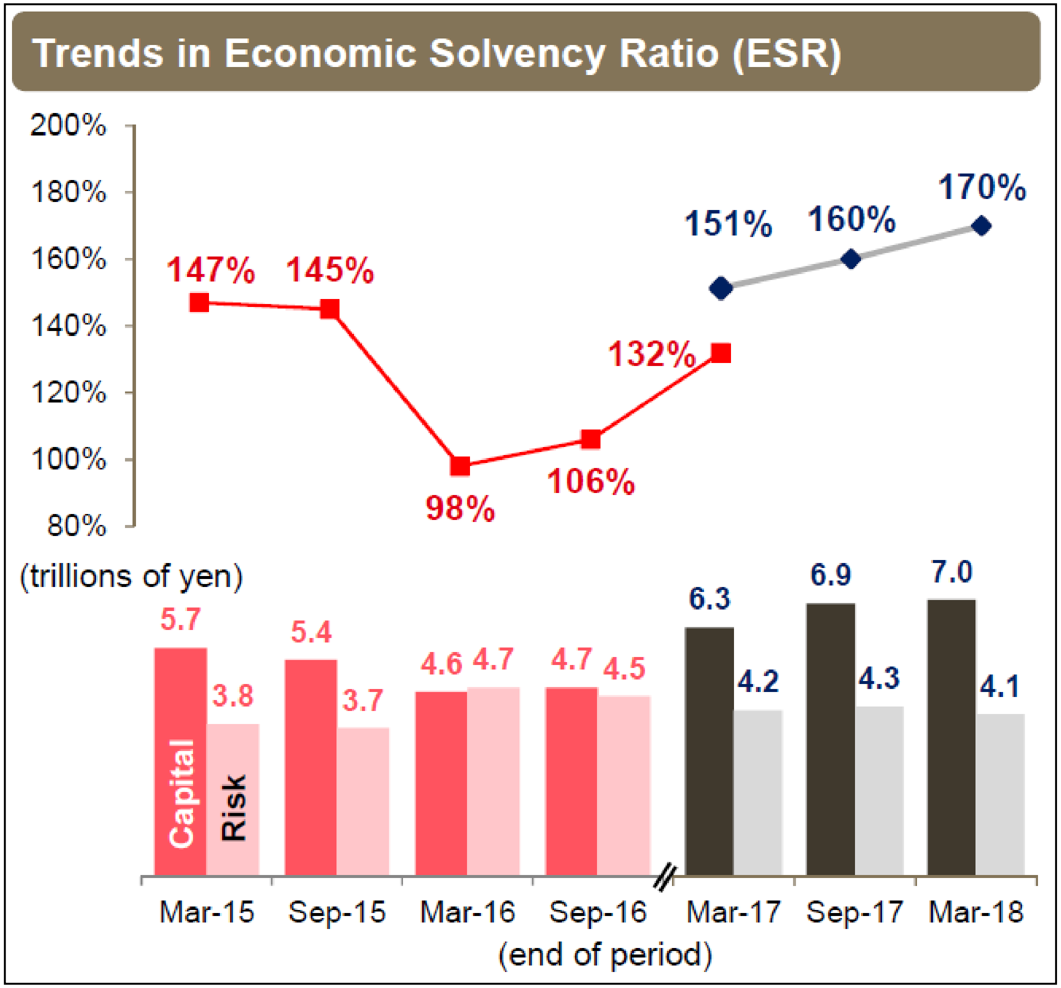
- The framework based on economic value has already been adopted as an internal management method by many insurance companies in Japan.

2. Management on economic value based measure

- We can recognize the financial conditions of insurance companies appropriately by consistently evaluating assets and liabilities based on economic value.
  - There is a large gap between current financial accounting based valuation and economic value based valuation.
- Listed insurance companies disclose ESR, economic solvency ratio.
  - Many unlisted companies including mutual insurance companies use ESR for their internal management.
- Economic value based management is also important in establishing ERM, enterprise risk management.
  - It is difficult to assess the current state of risk taking and the result of taking risks on a financial accounting basis.

Dai-ichi Life HD (IR Materials at May 23, 2018)

"Control ESR within the range of 170-200% in the mid-to long-term"

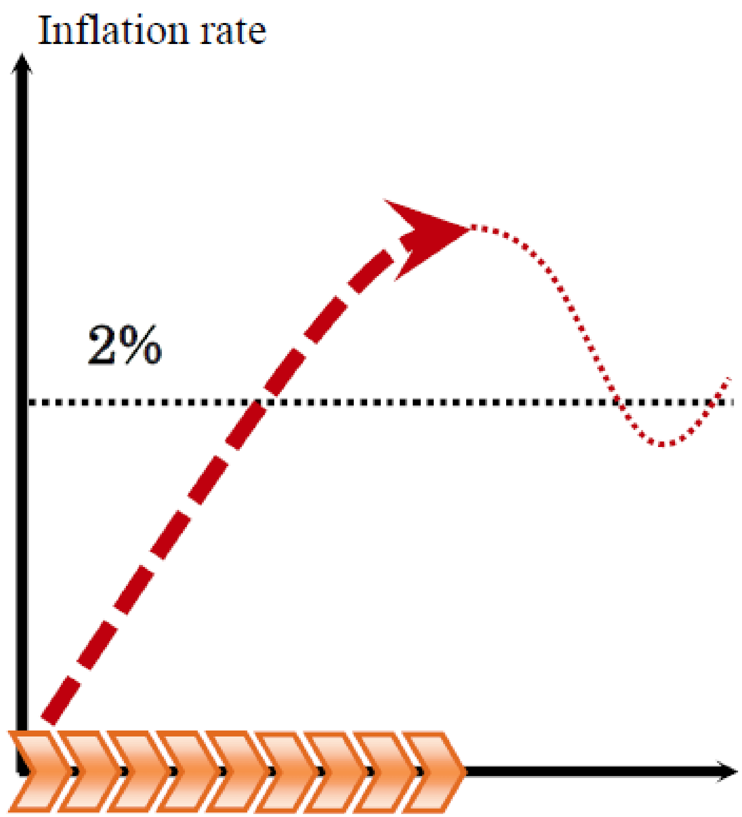


Meiji Yasuda Three-Year Program (March 15, 2017)

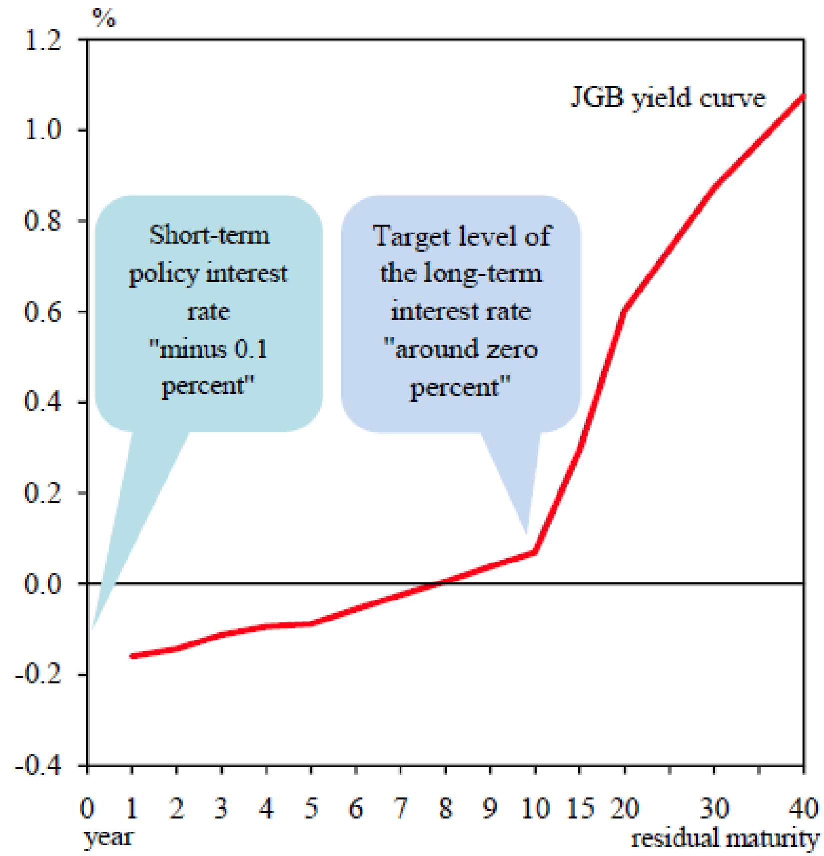
Target figures*[1] for fiscal year ending March 31, 2020 (*Figures shown as an increase in percentage or number are based on the results forecast for the fiscal year ending March 31, 2017.)		
Corporate Value (EEV)*[2]		+ 20%
Annualized Premiums from Business in Force (Individual insurance marketing)		¥2,225 billion
Group Life Insurance from Business in Force (Group insurance marketing)		No. 1 Domestic Share
Annualized New Premiums from Third-Sector Insurance (Individual and Group insurance marketing, Nonlife insurance)*[3]		+40%
Number of Customers	Advisor channel and other channels*[4]	7,000,000 (approx. +260,000)
	Group insurance marketing channel*[5]	4,930,000 (approx. +150,000)
Capital Efficiency Indicator (RoEEV: corporate value (EEV) base*[6])		Stably ensure an annual average of around 6%
Economic Solvency Ratio (ESR)*[7]		Over 160%
On-Balance Sheet Equity*[8]		¥3 trillion

BOJ introduced "QQE with a Negative Interest Rate" in January 2016

Inflation-Overshooting Commitment

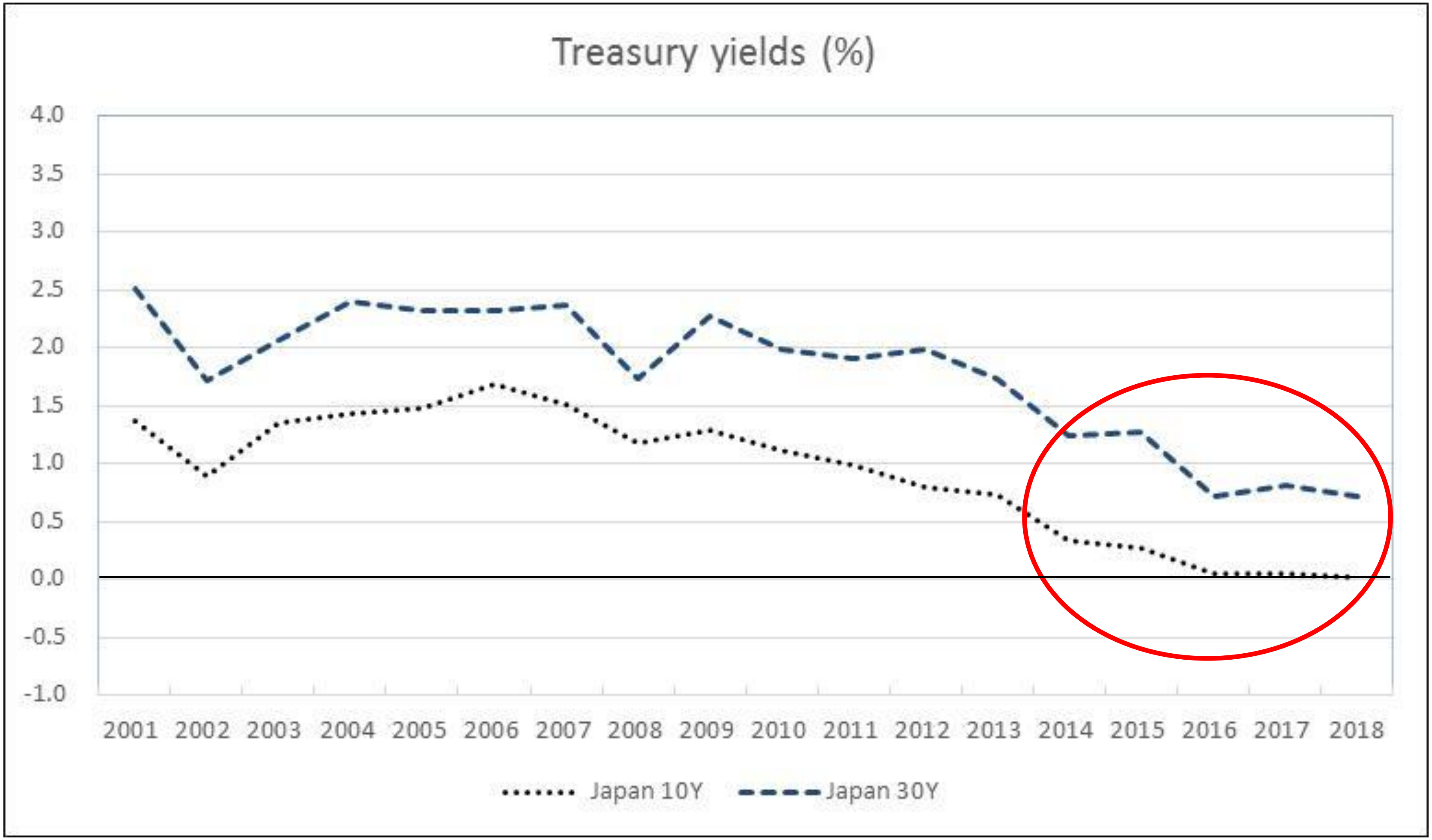


Yield Curve Control



Speech by BOJ Governor Kuroda at the Kisaragi-kai Meeting in Tokyo（2017.12.7）

Decline in Interest Rate



Overview of financial results of major life insurance companies as of March 31, 2016

- After BOJ's negative interest rate policy since January 2016 and declining long term interest rate, the Solvency margin ratio remains high.

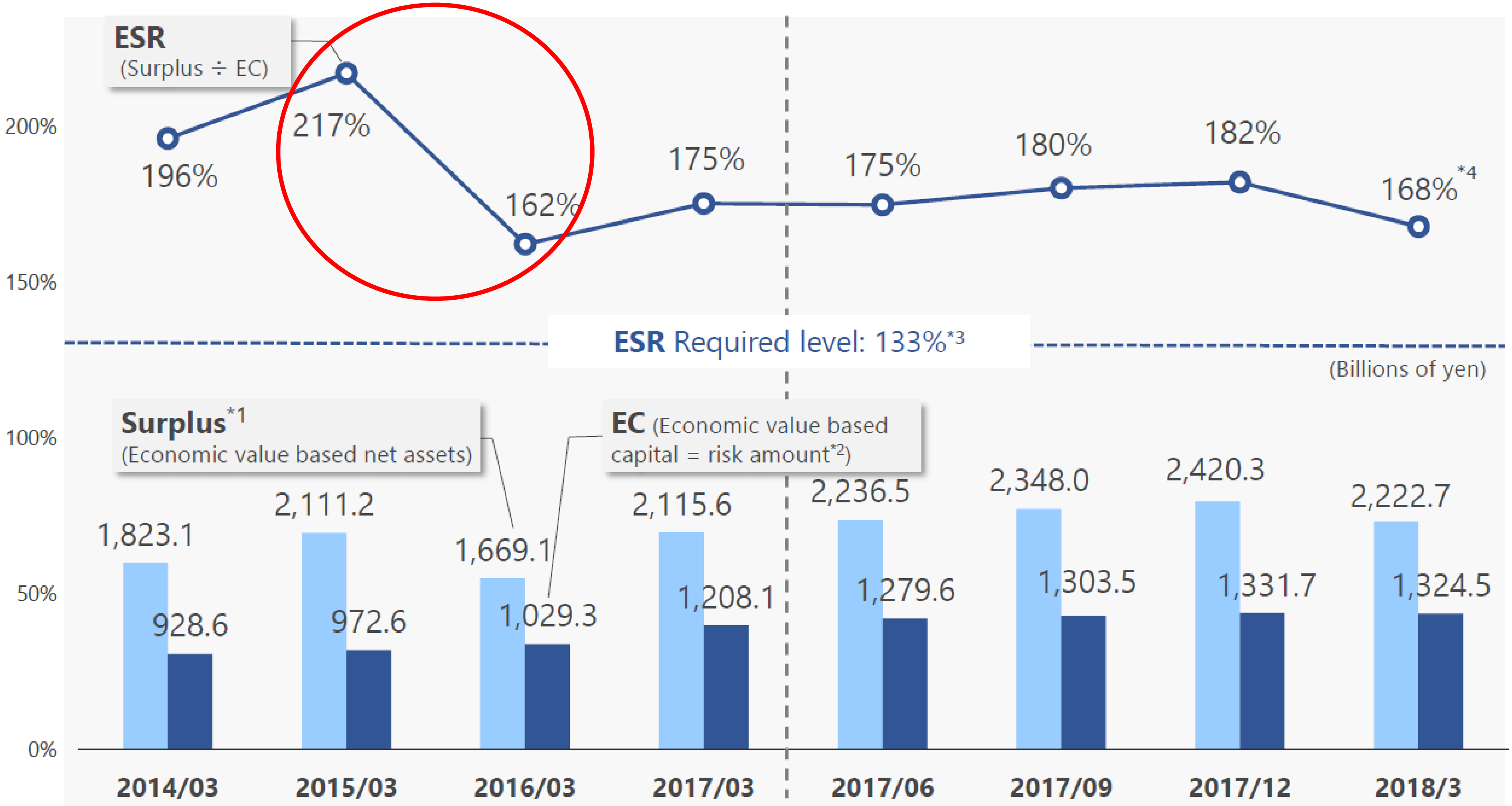
(Unit: 100 million yen, %)

	Fiscal year ended Mar. 31, 2014	Fiscal year ended Mar. 31, 2015	Fiscal year ended Mar. 31, 2016	Compared with previous year
Solvency margin ratio	922.4	1022.6	990.7	(31.9Pt)
Total net assets	169,624	247,195	219,723	(27,471)

* Figures represent the total of 16 life insurance companies (Nippon, Dai-ichi, Meiji Yasuda, Sumitomo, Taiyo, Daido, Fukoku, Mitsui, Asahi, Sony, Gibraltar, AXA, Aflac, MetLife, Tokio Marine & Nichido, and Japan Post).

FSA Japan, June 3, 2016

Status of ESR (T&D HD)



*1 The difference between assets and liabilities evaluated based on economic value. The evaluation of both assets and liabilities are calculated basically based on the same assumptions of MCEV. The cost of capital for risk margin is 5% from the end of March 2017. It has been set referring to the Insurance Capital Standard (ICS) which the International Association of Insurance Supervisors (IAIS) is considering. The cost of capital for risk margin was 6% on and before the end of March 2016.
*2 Risk amount is based on an internal model (99.5% VaR, 1-year) after diversification effects. Required capital for MCEV is calculated using the same internal model.
*3 Represents the capital level needed to cover VaR 99.93%, assuming the current risk profile.
*4 ESR as of end of March 2018 applying UFR was approximately 183%.

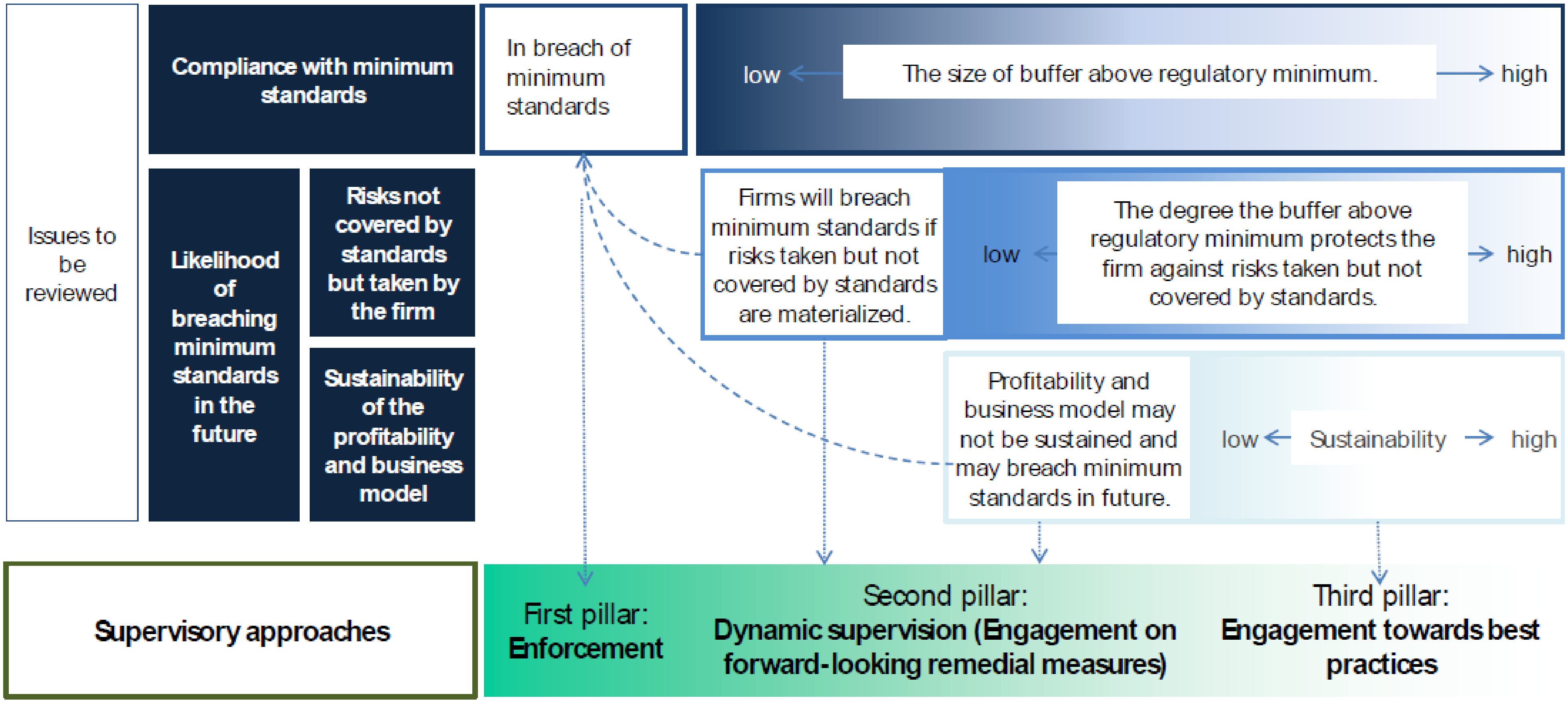
Capital raising by major insurers in recent years

Nippon Life	Jan-16	Subordinated debt	USD 1.5 bn
	Apr-16	Subordinated debt	¥100 bn
	Nov-16	Subordinated debt	¥90 bn
	Apr-17	Subordinated debt	¥100 bn
	Aug-17	Kikin	¥50 bn
	Sep-17	Subordinated debt	USD 0.8 bn
	Apr-18	Subordinated debt	¥100 bn
	Sep-18	Subordinated debt	¥120 bn
Dai-ichi Life	Jul-16	Subordinated debt	USD 2.5 bn
	Mar-19	Subordinated debt	¥85 bn
Sumitomo Life	Jun-16	Subordinated debt	¥100 bn
	Dec-16	Subordinated debt	¥105 bn
	Sep-17	Subordinated debt	USD 1.34 bn
Meiji Yasuda Life	Oct-15	Subordinated debt	USD 2.0 bn
	Aug-16	Kikin	¥100 bn
	Dec-16	Subordinated debt	¥115 bn
	Aug-17	Kikin	¥50 bn
	Oct-17	Subordinated debt	¥100 bn
	Apr-18	Subordinated debt	USD 1.0 bn
Japan Post	Jan-19	Subordinated debt	¥100 bn

3. ORSA（Own Risk and Solvency Assessment）

- ORSA ≒ ERM
  - By FSA, ORSA is defined ‘A process where insurance companies self-assess their capital adequacy, etc., by comparing current and future risks against available capital, etc., and comprehensively verifying the validity of their risk-taking strategies’.
- Past movement
  - ‘ERM interview’ since 2011
  - Revision of Guideline for Supervision in 2014
  - ORSA reporting requirement since 2015
- New supervisory approaches
  - FSA adopts the concept of evaluating assets and liabilities based on economic value as a ‘dynamic supervision’.

“Dynamic supervision”



JFSA’s supervisory approaches, June 2018

After introduction of ORSA

- Discussion at the annual meeting of the Institute of Actuaries of Japan in 2018
  - The work load is increasing and the person in the risk management department are exhausted.
    - The number of pages in ORSA report is increasing year by year, although FSA is not asking for thick reports.
  - We make ORSA report for the purpose of the report itself.
    - We do low need analysis for the report with the interest of FSA.
  - ERM is a framework for ourselves, not for FSA.
    - It is easy to become a formal response.
- It is important not to respond to the authorities formally, but to discuss with them deeply.
  - Insurance companies should make more use of ORSA.

Thank you !