■The LIAJ comments on the IAIS public consultation on Holistic Framework for Systemic Risk in the Insurance Sector

No.	Question	Comment
1	Is the list of key exposures that may lead to a systemic impact and its description appropriate? Please elaborate.	The LIAJ believes that the list of key exposures might be inappropriate. We welcome that it is mentioned asset liquidation regarding liquidity risk however we also suggest some modifications to the list, for example, to make clear that the fixed benefit guarantees are not a source of systemic risk in the same way. We discuss more specific answers in each question. These might not direct answers for Question 1, but we highlight the following points for consideration. General comments ・While we agree to consider the framework for systemic risk with a view of prevention of financial crises, we ask the IAIS to properly take into account following points that are not appropriately discussed in the consultation paper. ・In our understanding, in comparison with the banking sector, which provides critical function in the financial system such as settlement function through interconnected network of financial institutions, main function of the insurance sector is generally to underwrite insurance risk which is not correlated to financial market risk and systemic risk intrinsic to the insurance sector has relatively less significance; therefore the policy measures applied to the insurance sector should be eased proportionally. ・It might be overregulation if policy measures of the same kind and level as those applied to the existing G-SIIs for risk supervision of entity’s bankruptcy are applied under the holistic framework. When applying policy measures, as stated in paragraph 66, we strongly note that it should not be applied extensively beyond its necessity, but it should be applied only if policy measures are commensurate with risks. ・Traditionally, insurers have provided stability and predictability of future cash flows by undertaking certain parts of risk on behalf of individuals. This makes it possible for individuals to make their stable future life expectations. As a result, a virtuous cycle that the excessive savings by individuals are avoided and active consumption behaviors are created. ・If insurers find it difficult to undertake these risk under the overregulation, systemic risk arising from insurers might be avoided, however as a consequence, the risk is just transferred to other entities. It does not lead to the reduction of the total systemic risk as a whole. Instead, insurers hold a lot of illiquid liabilities, so when compared with other entities, it is unlikely that sudden trading behavior by insurers will occur even under crisis situations. In other words, underwriting risk by insurers has an aspect that stabilizes the financial system. In particular, as a result of the excessive regulations on insurers and other financial institutions, other entities undertake risk to the financial market, it should be noted that the possibility of a financial crisis rises due to oversensitive sales behaviors against market fluctuations. Liquidity risk · In paragraph 34, it is stated that some products offered by insurers (which contain provisions whereby a policyholder can withdraw cash from the policy with little notice or penalty) contain high liquid liability; however, this description is too simplified and inappropriate since it does not properly take into account the reality of insurers’ business. According to the IAIS’ policy document “Systemic Risk from Insurance Product Features” released on 16 June 2016 states, in subsection 4.24, the liquidity of surrender value should be assessed in a holistic manner where due consideration is paid to broader aspects including the

purpose of the insurance contracts, substantial economic penalties embedded in high guaranteed rate contracts, the feature of retail and non-retail and policyholder protection schemes and mechanisms.

・The matrix of Table 5 in Annex 1 does not explicitly reflect such holistic assessment. In addition, the rationale for the weightings in Table 5 is not clear and some of the proposed weights could give rise to significant cliff effects. Therefore it is not appropriate as an important indicator.

・If an insurers do not match liquid liabilities with sufficient liquid assets; it might have liquidity risk. However, if an insurance company holds sufficient liquid assets, it would not be a source of systemic risk. Therefore it should be evaluated taking into consideration the liquidity of the asset side.

・In Japan, the legal framework that provides for liquidity support by the Deposit Insurance Corporation of Japan to the broader financial sector including insurers subject to the determination that the financial system including the financial markets is at the risk of significant disruption in order to avoid such disruption. In assessing liquidity risk, due consideration should be paid to such framework contributing to suppressing systemic risk.

Macroeconomic exposure risk

・It is stated in paragraph 37 that fixed benefit guarantees expose insurers to the macroeconomic exposure risk.

The IAIS policy document "Systemic Risk from Insurance Product Features" released on 16 June 2016 (hereinafter "the policy document") provides, in subsections 4.6, with regard to the extent to which a benefit feature could expose the insurer to macroeconomic risk, two steps: (i) the step to identify whether a material benefit guarantee applies, thereby transferring a risk from the policyholder to the insurer, and; (ii) the step to determine whether the insurer is able to invest the assets backing the guarantee in a manner that matches the benefit cash-flows of the applicable guarantee.

・As provided in subsection 4.12 of the policy document: insurers usually have the capacity to match cash-flow to the guarantees they offer and would not satisfy the second step above. In terms of duration mismatch, guarantees could pose a risk when insurers allow cash-flow mismatch by; however the risk posed actually is the risk of yield fluctuation in the reinvestment phase in the future. However, such risk can be contained by applying countermeasures in medium to the longer timeframe and accordingly it is not appropriate to identify fixed benefit guarantees through guarantees written as a source of systemic risk.

・It should be taken into consideration as the IAIS policy document "Activities-based Approach to Systemic Risk" released on 8 December 2017 states, in paragraph 50, "It is important to note that insurance guarantees are not inherently systemic and represent a fundamental aspect of insurance business model"

・It is understandable to recognize the potential loss caused by fixed benefit guarantee amid a downward trend for interest rate. However, it is not inherent to the product feature of fixed benefit guarantee; it rather is created by offering higher guaranteed rate deviated from the market price or risky speculative investment; therefore, such loss can be avoided should governance arrangement function effectively. As such, this is a matter of micro-prudential supervision, and fixed benefit guarantee should not be considered as a potential source of systemic risk. In terms of the Japanese experience, as provided in examples in practice, Japan witnessed seven small- or mid-sized insurers' insolvency cases in the period from 1997 to 2001. Most of those insurers had written policies with high guaranteed rate as many as to wipe-out returns on assets;

		therefore, they plunged deeper into risky investment in order to gain excess return. This is not inherent to the product feature of fixed benefit guarantee; it rather is a result of poor risk management and governance, and it is necessary to be noted that those seven insurers could not originate systemic risk. ・Even when fixed benefit guarantee is included in the scope of policy measures, systemic risk can be contained through micro-prudential supervision and PPS. ・Where jurisdictions have in place sound policyholder protection scheme, such scheme serves to dis-incentivize policyholders to surrender; as a result, PPS could contribute to mitigating risk contagion through macroeconomic exposure. It deserves careful attention that sound PPS could contribute to mitigating systemic risk. ・Long-term fixed guarantee rate offered in fixed benefit guarantee is the core to the insurance business, and it should be noted that restricting freedom to decide guaranteed rate that are consistent with market trend would involve potential to make it difficult for insurers to fulfill its expected role in the society. Other sources of systemic risk ・In the holistic framework, even cyber risks and climate risk that are not originated from insurance sector and whole financial sectors, are included in the sources of systemic risk. However it possibly results in too broad scope and needs to carefully consider their calculating measures or treatments. Therefore, at present, these risks should not be treated equally to the other risks such as liquidity risk. ・For product mispricing in the approach to the new insurance business, where the legal framework has in place a requirement for product approval by the financial supervisory authority, such requirement should be assessed to be effective for the purpose of avoiding mispricing; therefore, it should be taken into consideration for further discussion.
6	Do you agree with the proposed scope of application and of the practical application of the proportionality principle as described above? Please elaborate.	・No ・In the LIAJ's understanding, in comparison with the banking sector, which provides critical function in the financial system such as settlement function through interconnected network of financial institutions, main function of the insurance sector is generally to underwrite insurance risk which is not correlated to financial market risk and systemic risk intrinsic to the insurance sector has relatively less significance; therefore the policy measures applied to the insurance sector should be eased proportionally. ・It might be overregulation if policy measures of the same kind and level as those applied to existing G-SIIs for risk supervision of entity's bankruptcy are applied under the holistic framework . When applying policy measures, as stated in paragraph 66, we strongly note that it should not be applied extensively beyond its necessity, but it should be applied only if policy measures are commensurate with risks. ・Since policy measures give a huge impact to insurers' business, it should need more detailed analysis, and it should be ensured that insurers have predictability for the future applying.
9	Do you agree with the above proposal to amend the Standards and Guidance on macroprudential surveillance? Please elaborate.	・No ・With regard to data collection on macro prudential surveillance, the LIAJ believes that it should collect as much appropriate data as needed for the purpose and should avoid an unnecessary collection exercise. ・It is stated in paragraph 75, the data collection, the analysis thereof and the publication of data provide the underpinning of macroprudential surveillance, however, on it needs that data collection and its criteria are appropriate as implementation assumption. It is stated in paragraph 77, for example, that the supervisor should collect information on the surrender value however the liquidity of surrender value should be assessed in a holistic manner where due consideration is paid to broader aspects including the purpose of the insurance contracts, substantial economic penalties embedded in high guaranteed rate contracts, the feature of retail and non-retail and policyholder protection schemes and mechanisms. From this point of view, we disagree with

		the matrix ofTable5: combination of time restraints and economic penalties in the existing G-SIIs methodology of Annex1. ・From this point of view, the second bullet in paragraph 77 should be amended as follows, "such as penalties or delays in the ability to access the cashvalue of a policy, the maturity or redemption structure of non-insurance liabilities, the degree of liquidity of the assets, purpose of the policy, loss of guarantees, the feature of retail and non-retail and policyholder protection schemes and mechanisms". ・Moreover, as described in paragraph 34, If insurers do not match liquid liabilities with sufficient liquid assets, it might have liquidity risk. However, if an insurance company holds sufficient liquid assets, it would not be a source of systemic risk. Therefore it should be evaluated taking into consideration the liquidity of the asset side. ・We would like to give an opinion on the details when the relevant Standards and Guidance are stipulated in ICP24 in June 2019.
１０	Do you agree with the above proposal to amend the Standards and Guidance on macroprudential surveillance? Please elaborate.	・No ・Paragraph 79 states that the supervisory stress test should be specified in the Guidance of the ICP 24.However, this should be decided by the supervisors to implement according to the particular circumstances in each jurisdiction. Therefore this should not be specified in ICP uniformly.
１２	Is the development of an Application Paper on macroprudential surveillance deemed useful? Please elaborate.	・The LIAJ welcomes that the stakeholders will have the opportunity to send their inputs in the planned consultation of Application Paper in the future.
１３	What elements could be addressed in such an Application Paper?	・Following the previous answer in Q9, it should be clarified that the surveillance for liquidity risk assessment should be implemented in a holistic manner.
１４	Are the proposals on macroprudential surveillance as described in section 3.2 appropriate? Please elaborate.	・In paragraph 80, it is stated that ICS Version 2.0 would represent a global risk sensitive metric for the measurement of macroeconomic exposure. However, since ICS would not be finalized during the monitoring period, such criteria should not be applied as a metric for stress testing. · The LIAJ would like to give an opinion on the details when the relevant Standards and Guidance are stipulated in the relevant ICPs in June 2019.
１５	What are the expected costs and benefits of the proposals on macroprudential surveillance as discussed in section 3.2?	・With regard to data collection on macro prudential surveillance, the LIAJ believes that it should collect as much appropriate data as needed for the purpose and should avoid an unnecessary collection exercise and incurring additional costs.
１６	Do you agree with the above proposal to amend the Standards and Guidance on ERM? Please elaborate.	・ No · In paragraph 90, more detailed guidance on liquidity planning and management are presented. However, it is overregulation for insurers who hold adequate liquid assets. Therefore it should be clarified that these guidance would not be applied to insurers who hold adequate liquid assets. · Even in cases where liquidity planning and management are required, it is clear that the characteristics of liabilities and assets held in each jurisdiction are different, and uniform requirements should not be applied, and proportionality should be considered.
１７	Do you agree with the above proposal to apply the more detailed requirements on liquidity planning and management to IAIGs, and other insurers as necessary? Please elaborate.	・No ・Following the previous answer in Q16.
１８	Do you agree with the above proposal to amend the Standards and Guidance on disclosure? Please elaborate.	・ No · With respect to the liability liquidity disclosure, the calculation method of liquidity might be different depending on the business characteristics of insurers. If insurers disclose according to the uniform standard, it might lead misunderstandings. Therefore, since it might cause the unintended consequence, it should not be added as Standard. ・It would give a sense of security if it could disclose that liquidity is properly managed according to fully adjusted standards. On the other hand, once a concern arises due to environmental changes, it should be noted that even if the change is temporary, disclosure might have an adverse effect and might lead to an irreversible vicious circle.
２０	Are the proposals in 3.3.1 on liquidity risk appropriate? Please elaborate.	・It is inappropriate as following the previous answers in Q16 and Q18.
２３	Do you agree with the above proposal to amend the Standards and Guidance on counterparty exposure? Please elaborate.	・ No

		· Regarding counterparty risk and asset concentration risk, the market environment differs greatly with jurisdictions (especially between developed countries and emerging countries). There are already existing regulations that work sufficiently. Each risk management done in each jurisdiction should be respected, and if individual risk managements were done properly in each jurisdiction, we think the risk management as a group would be also done sufficiently. Therefore, it is unnecessary to set the group-wide standard uniformly.
２５	What are the expected costs and benefits of the proposals on on-going supervisory policy measures as discussed in section 3.3?	・With regard to implementing policy measures, the LIAJ believes that it should be appropriately implemented as needed for the purpose. It is important to note, where policy measures are unnecessarily implemented, insurers might have opportunity loss and huge additional costs. ・Even when policy measures are appropriately developed for the purpose; there is a possibility that policy measures incur additional cost. Therefore cost-benefit analysis should be sufficiently made. For example, since the management systems of insurance contracts/asset management differ in each jurisdiction, it is conceivable that the code system for aggregating exposures is not unified in each company across the jurisdiction. In this case, introducing policy measures as a group-wide level requires huge costs and personnel.
２７	Do you agree with the proposals on recovery planning? Please elaborate.	・No ・As paragraph 114 states, the proposals on recovery planning should be closely correlated to an insurer’s risk profile, nature or complexity of business, or more broadly its systemic importance. It should not be required that all insurers develop a recovery plan that is equivalent to the G-SIIs.
２８	Do you agree with the proposals on resolution planning? Please elaborate.	・No ・Developing a resolution plan is a policy measure that only the G-SIIs are required to develop under the existing framework. It should be sufficiently analyzed necessity and relevance to risks for application of the resolution plan. It should be applied subject to the proportionality principle then should not be required insurers to develop a plan that is equivalent to the existing G-SIIs framework.
２９	Are the proposals as discussed in section 3.4 on crisis management and planning appropriate? Please elaborate.	・With respect to the recovery plan and the resolution plan, it should be considered to the proportionality principle then should not be required insurers to develop these plans that is equivalent to the G-SIIs.
３０	Do you agree with the above proposal to amend the Standard on powers of intervention based on macroprudential surveillance? Please elaborate.	・No ・Powers of intervention for supervisors should be the last resort to use where insurers’ business is inappropriately operated, the build-up of systemic risks is clearly detected, and there are no measures left to mitigate. Therefore, it should be clarified how it is implemented and ensure insurers’ predictability.
３１	Do you agree with the above proposal to amend the Standards and Guidance on preventive and corrective measures? Please elaborate.	・No ・A report on the management of systemic risk stated in paragraph 124 is inappropriate because it expands an application target of Systemic Risk Management Plan (SRMP) which is mandatory to the G-SIIs under the existing framework. ・The LIAJ agrees that the supervisor should require the increase in capital only when it mitigates identified systemic risk and as stated in paragraph 126 the supervisor should clearly document the rationale for the requirement. However, it should be noted that the increase in capital is not always an appropriate direction even when the requirement of increase in capital is limited to the identified systemic risk. And also, if it is not limited to the identified systemic risk, it would impose capital enhancement on activities not related to the systemic risk.
３３	What are the expected costs and benefits of the proposals on powers of intervention in section 3.5?	・With regard to implementing the intervention, the LIAJ believes that it should be implemented as needed for the purpose. It is important to note, where it is unnecessarily implemented, insurers might have opportunity loss and huge additional costs.
３４	Are there any further considerations on Section 3? Please elaborate.	・In general, with regard to policy measures, it is overly rule-based, the LIAJ believes that this should be amended that more principles-based. ・Applying policy measures should involve careful consideration so as to avoid duplication; those tools that jurisdictions have in place, such as rules on governance and investment and policyholder protection scheme, that function effectively for the purpose of mitigating systemic risk should be respected. For example, Japan has been able to limit interconnectedness among financial institutions to a certain extent by having a rule to apply a large exposure cap on group consolidated basis and by imposing margin requirements for derivatives. ・Moreover, in Japan, the legal framework that provides for liquidity support by the Deposit Insurance Corporation of Japan to the broader financial sector including insurers subject to the determination that the financial system including the financial markets is at the risk of significant disruption in order to avoid such disruption. In assessing liquidity risk, due consideration should be paid to such framework contributing to suppressing systemic risk.

		・Also, where jurisdictions have in place sound policyholder protection scheme, such scheme serves to dis-incentivize policyholders to surrender; as a result, PPS could contribute to mitigating risk contagion through macroeconomic exposure. It deserves careful attention that sound PPS could contribute to mitigating systemic risk. ・It should also be noted that applying policy measures might be a source of systemic risk, for example, an introduction of too straightforward requirements based on market value would have a potential to amplify macroeconomic risk by facilitating procyclical behavior.
３５	Do you agree with the approach to the global monitoring exercise as described above? Please elaborate.	・No ・Appropriateness such as validity and robustness of each indicator is highly required to determine policy measures applying to outliers through the focus to the specific indicator in the assessment of collected data. Where the appropriateness of the indicators is not ensured, it might fundamentally mislead supervisory scope. ・in particular, we have a concern regarding the assessment of liquid liability. It is stated in paragraph 77, for example, that the supervisor should collect information on the surrender value however the liquidity of surrender value should be assessed in a holistic manner where due consideration is paid to broader aspects including the purpose of the insurance contracts, substantial economic penalties embedded in high guaranteed rate contracts, the feature of retail and non-retail and policyholder protection schemes and mechanisms. ・In addition, we have another concern.As described in paragraph 34, If insurers do not match liquid liabilities with sufficient liquid assets, it might have liquidity risk. However, if an insurance company holds sufficient liquid assets, it would not be a source of systemic risk. Therefore it should be evaluated taking into consideration the liquidity of the asset side. From this point of view, we disagree with the matrix ofTable5: combination of time restraints and economic penalties in Annex1.
４０	Are the proposed changes to the Level 3 assets indicator appropriate? Please explain.	・Measuring outstanding of Level 3 assets is not appropriately reflected asset liquidation risk. There is no material risk, for example, where insurers hold Level 3 assets matching illiquid liabilities. Therefore, we suggest deleting the indicator.
４２	Are the proposed changes to the Short term funding (STF) and Liability Liquidity (LL) indicator appropriate? Please explain.	・The LIAJ agrees to exclude from the STF the securities collaterals whose re-hypothecation or reuse is contractually explicitly prohibited. When an insurer does not reinvest or reuse collateral received in securities lending, the insurer is capable of returning posted collaterals swiftly if its counterparty runs to recover those collaterals and will not be forced to sell less liquid assets, and therefore such situation should not be considered as a source of systemic risk as well. ・In addition, in paragraph 34 “Securities lending transactions,” it is stated that if the collateral is reinvested in illiquid assets, securities lending transaction might be considered a factor of systemic risk. However, it is inconsistent between paragraph 34 and Table 3 since the STF indicator in Table3 is not measured how much collateral is reinvested in illiquid assets out of total reinvestments. Therefore, Table3 should be amended that the measurement procedure on the STF indicator is consistent with the statement of paragraph 34.
４７	Do you agree with the move towards a more absolute approach to the assessment of systemic risk stemming from the failure or distress of individual insurers? Please elaborate.	・No ・Although we understand the move towards absolute approach at a certain degree; we would like to make a comment in detail after the standard to be set become apparent. Although the IAIS is to consider on the standard in detail in 2019, we request to have an opportunity for stakeholders to submit comments.
５０	Do you agree with the move away from setting a (fixed) threshold that results in a binary classification of insurers as either systemic or not? Please elaborate.	・We agree to suspend from the binary approach which is based on a certain threshold.
５１	Are there any considerations on the criteria that may be used to trigger further analysis or specific discussions within the IAIS? Please elaborate.	・On setting criteria, the IAIS should take into consideration of aspects such as appropriateness, cliff effect and so on.The criteria set by the IAIS might limit the business activity of insurers, and therefore the IAIS should sufficiently consider the opportunity loss of insurers. Although the IAIS is to consider on the criteria in detail in 2019, we strongly request to have an opportunity for stakeholders to submit comments.
５２	Do you support the development of a quantitative metric to measure liquidity risk? Do you have suggestions for the development of such a metric?	・Yes ・Since the LIAJ understands that the IAIS intends to assess liquidity risks comprehensively, we partially agree with developing ancillary indicators by the IAIS to assess liquidity risks. As stated in paragraph 162, when developing these metrics, it should be sufficiently tailored for characteristics of insurance business rather than introducing tools developed for bank directly. For example, the liquidity of surrender value should be assessed by using numeric factors in a holistic manner where due consideration is paid to broader aspects including the purpose of the insurance contracts, substantial economic penalties embedded in high guaranteed rate contracts and policyholder protection schemes and mechanisms. In addition, for liquidity sources, cash in-flow arising from level premium income should be considered.

		・We request to have an opportunity for stakeholders to submit comments when considering in detail.
５７	Do you have additional suggestions on how to identify levels and trends for the sector-wide assessment of systemic risk? Please elaborate.	・In paragraph 171, it is stated that the IAIS may use the data such as data collection coordinated with ICS Field Testing in order to limit the burden to the industry. From the viewpoint of mitigation of burden of the insurers, the LIAJ agrees with paragraph 171. On the other hand, it might lead to a false assessment because ICS is originally not a standard that assesses systemic risk. Therefore the IAIS should use those data with caution.
６２	Do you agree with the proposal for the transparency towards participating insurers and the public? Please elaborate.	・To ensure transparency, the LIAJ agrees that the IAIS inform the participating insurer of their score in private.
６４	Do you agree with the proposed implementation assessment as described in section 5? Please elaborate.	・From the viewpoint of level playing field, the LIAJ agrees to a transparent implementation assessment. For implementations assessments, it should be appropriately considered to ensure proportionality within each jurisdiction in addition to the consideration of current effectively functioning policy measures.
６６	Is the table above from the 2016 G-SII methodology still appropriate? Please elaborate.	・The liquidity of surrender value should be assessed in a holistic manner where due consideration is paid to broader aspects including the purpose of the insurance contracts, substantial economic penalties embedded in high guaranteed rate contracts, the feature of retail and non-retail and policyholder protection schemes and mechanisms. We disagree with the matrix of Table5: combination of time restraints and economic penalties in the existing G-SIIs methodology. The matrix of Table 5 in Annex 1 does not explicitly reflect such holistic assessment. In addition, the rationale for the weightings in Table 5 is not clear and some of the proposed weights could give rise to significant cliff effects. Therefore it is not appropiriate as an important indicatior. ・Moreover, as described in paragraph 34, If insurers do not match liquid liabilities with sufficient liquid assets, it might have liquidity risk. However, if an insurance company holds sufficient liquid assets, it would not be a source of systemic risk.Therefore it should be evaluated taking into consideration the liquidity of the asset side. ・In terms of legal frameworks, for instance, Japanese case that provides for liquidity support by the Deposit Insurance Corporation of Japan to the broader financial sector including insurers subject to the determination that the financial system including the financial markets is at the risk of significant disruption in order to avoid such disruption. In assessing liquidity risk, due consideration should be paid to such framework contributing to suppressing systemic risk.