The LIAJ comments on the IAIS public consultation regarding the Development of Liquidity Metrics Phase 1 – Exposure Approach

Question	Comment
Q1. Do you agree with the IAIS' plan for the development of liquidity metrics for monitoring? If not, please explain what changes you recommend and why.	➢ The Life Insurance Association of Japan (hereafter the "LIAJ") appreciates the opportunity to submit public comments to the International Association of Insurance Supervisors (or the "IAIS") regarding the Development of Liquidity Metrics Phase 1 – Exposure Approach. ➢ We, however, do not agree with many points in this consultation document. ➢ Since the systemic risk of the insurance sector is relatively low, the application of regulatory measures for liquidity risk should not extend beyond what is required and should be based on the risk. ➢ The LIAJ believes the assessment of liquidity should not only focus on liabilities, but also consider the liquidity of assets. The current proposal on the Development of Liquidity Metrics has aspects of the liquidity metrics assessment that are too simplified, and the IAIS should consider the reality of life insurers' businesses when developing these metrics.
Question 5: Do you agree with the proposed factors for liquidity sources? If not, please	➢ Regarding liquidity resources, we do not agree since the rationale behind calculating the haircut ratio is not clearly stated. ➢ In general, the liquidity needs of insurance liabilities are relatively lower than bank deposits. As developing excessively conservative set of metrics would become an impediment to a life insurer's asset management from a long-term perspective, we propose the haircut ratio applied to the insurance sector should be less strict than the banking sector.
Question 6: Do you agree with the treatment of investment funds? If not, please explain and suggest an alternative treatment.	➢ We do not agree with the proposal that most investments in investment funds will not qualify under these definitions for inclusion in the ILR. ➢ The consultation document states an investment fund's market liquidity is an issue during a crisis and it is excluded from liquidity resources. However, since investment funds can be redeemed and provide liquidity even during a crisis, we propose funds that are readily redeemable and are able to secure liquidity within the fund should be included as liquidity resources. ➢ This is because many of Japanese life insurers hold funds that are constantly readily redeemable (by dissolving the fund and selling the assets within it). Moreover, these investment funds invest in highly liquid assets and at least half of the assets are redeemable on a weekly basis (on a daily basis for domestic mutual funds).
Q7. Do you agree with the treatment of	➢ The consultation document has many references related to banking regulations; however, the characteristics

premiums? If not, please explain how premiums and excluded expenses should be treated in the ILR.	related to liquidity risk of an insurer, who has a stable cash inflow from level premiums, are very different from the business model of a bank. Therefore, premiums need to be considered as liquidity resources as well. ➢ Therefore, as stated in 3.2, the IAIS should continue to consider how premiums should be treated.
Q8. How should instruments issued by financial institutions be treated within the ILR?	➢ There is a possibility that excluding instruments issued by other financial institutions from liquidity resources will have a negative effect on maintaining appropriate liquidity. ➢ Since insurers set risk limits for each counterparty considering the exposures to counterparties and marketability of each asset, the treatment should not be differentiated only because instruments are issued by a financial institution.
Question 9: Do you agree with the inclusion of certain encumbered assets as liquidity sources within the ILR or should the IAIS alternatively exclude these encumbered assets and measure the related liquidity needs on a net basis?	➢ We do not agree. ➢ Assets that were transferred to counterparties through repo trading and lending transactions are illiquid. In addition, those liabilities secured by those assets are considered to have the same period of grace as the repo trading and lending transaction. Therefore, those assets should be excluded from liquidity resources and those liabilities should be excluded from liquidity needs. ➢ This treatment is in line with accepting the off-balance sheet disposition right of encumbered assets in Table 2 (please refer to our comment for Question 20 for more detail).
Q10. Do you agree with the treatment of liquidity risk from surrenders and withdrawals from insurance products in the ILR? If not, please explain how this could be improved.	➢ We disagree with this proposal. ➢ The liquidity assessment of insurance liabilities is based on economic penalty and time restraint metrics (Tables 4 and 5). However, this is too simplified. It should be comprehensively assessed based on a wide range of perspectives such as the purpose of the insurance policy, the existence of an actual economic penalty for policies with high assumed interest rates, the characteristics of insurance types and the existence of insurance policyholder protection schemes. ➢ We propose particularly consideration of the following three perspectives. i. Regarding the factor level, it should be considered that our actual surrender rate is much lower than 50% (for individual insurance). — In Japan, the highest mass surrender rate in the past was 25% (Toho Mutual Life Insurance Company's 1997 decrease ratio of individual insurance and annuity), which was far below 50%. — As demonstrated in the IAIS' ICS data collection, Japanese life insurance sector's surrender rate is stable and the 50% level is very atypical from reality.

	ii. Insurers run their business based on the characteristic of their national markets so the metrics should consider that reality. Specifically, we would like to propose that there should be a difference in factors between protection-based products and savings-based products, as well as the surrender penalty being market value based. For surrender penalty, since data related to “Row 33.A.5 disincentive” have been submitted in G-SIIs Data Collection Exercise, we would like to propose that these factors are reflected. －The consultation document states economic penalty is only the surrender penalty. However, the scale of economic loss, which is beyond the loss from the surrender penalty should be considered. In Japan, the economic loss of surrendering a high yielding product is large when comparing the past high yielding products (approximately 5%) to the current assumed interest rate (approximately 1%). －For protection-based products, it is less likely to be surrendered because the protection will be lost when cancelled. iii. For the time restraints of Japanese insurance policy surrender, we would like the IAIS to consider making it possible to categorize for three months or more during an event of crisis. For this consultation, only the surrender results during normal times are considered. However, we understand that liquidity metrics consider insurers’ situation during a crisis; therefore, time restraints for surrenders should also consider situations during a crisis. －As for Japanese surrender results, time restraints are considered low (less than a week). But the reason is because of the early payment of normal times since if the payment of cash surrender value is not made by a certain time, the insurance company is required to pay overdue interest. On the other hand, since this payment period is not guaranteed to customers and if a lack of capital occurs, it is possible to extend the payment period after paying the overdue interest based on the policy’s terms and conditions. Therefore, we propose the cash surrender value and overdue interest be considered as liquidity needs in terms of liquidity risk management, and the time restraints during an event of crisis to make it possible to categorize it for three months or more. －As for corporate policy, even if it historically experienced a short payment period after receiving the claim, the administrative process will occur by practice. Even if the surrender period is agreed to beforehand with the policyholder, the actual time restraints is generally longer than a week.

Question 11: How should the IAIS capture liquidity needs from policy loans? Should these be incorporated into the ILR or be an alternative metric?	➢ We believe policy loans do not need to be separated and captured. ➢ This is because policy loans are limited to certain products, and the amount of the policy loans is capped at a certain ratio based on the cash surrender value. Additionally, the liquidity needs of the cash surrender value are already captured as the methodology is the cash surrender value to be paid less the amount of the policy loans,
Q12. Do you agree with the factors applied to retail insurance products being half of the factors applied to institutional products? How should the factors applied to retail and institutional policies differ?	➢ We do not agree with a part of the proposal. ➢ We believes its comments were reflected and welcomes the statements for the surrender risk factor of individual insurance and group insurance that sets the individual insurance risk factor at one half of the group insurance risk factor. This statement is the same as the statement in the IAIS document "Systemic Risk from Insurance Product Features" (July 16, 2016) Paragraph 4.24, which considers the features of different types of individual insurance and group insurance. ➢ On the other hand, as stated in our comments for Q10, the IAIS should continue to further consider a comprehensive assessment based on a wider perspective regarding liability liquidity.
Question 19: Do you agree with the treatment of derivatives? If not, please explain and suggest an alternative treatment.	➢ We do not agree. We propose only derivatives to be settled within the next year be included as liquidity needs. ➢ This is inconsistent because all derivative liabilities are included in the ILR despite this consultation document stating "Insurers should maintain liquid assets sufficient to settle derivative liabilities within the next year (in Table 7)". ➢ In general, derivative liabilities held by life insurers have long settlement periods (not one year, but several years or even 10 years) so there are many that do not become liquidity needs. Therefore, it should be limited to derivatives that are to be settled within the next year.
Question 20: How should the ILR treat debt with financial covenants that may be triggered under stress?	➢ In Japanese accounting practices, securities lending is settled off balance sheet for both assets and liabilities. ➢ We understand that Table 2 does not include off balance sheet assets as well as collateral assets with disposition rights. It is our understanding that off balance sheet liabilities are not included although the liquidity needs are stated in Table 8 Row 43.4 as "Gross fair value of recognised and non-recognised securities lending liabilities," and Row 43.4 is within the scope of GA and SA. Off balance sheet assets and liabilities are approximately the same amounts. Therefore, they should not be included in liquidity resources and liquidity needs. ➢ On the other hand, if off balance sheet assets are not included in the liquidity resources, but off balance sheet liabilities are included in the liquidity needs (Row 43.4) then it is not consistent. We propose off balance sheet liabilities be excluded from the liquidity needs.