

The LIAJ comments on the IAIS Public Consultation on draft Issues Paper on structural shifts in the life insurance sector

Question	Comment
<p>Q1. General comments on the Issues Paper on structural shifts in the life insurance sector</p>	<p>The Life Insurance Association of Japan (the “LIAJ”) appreciates the opportunity to submit public comments to the International Association of Insurance Supervisors (the “IAIS”) on the public consultation on draft Issues Paper on structural shifts in the life insurance sector.</p> <p>In general, the Issues Paper provides a balanced description of the benefits and supervisory concerns of alternative investments and asset-intensive reinsurance (AIR).</p> <p>Future discussions on supervisory responses, including the review of ICPs and other supervisory materials of the IAIS, should take into account actual transaction conditions of each jurisdiction and entity, and consider the highly bespoke nature of alternative assets and AIR transactions, which is contingent on local markets and regulatory environments as well as business models of each entity.</p> <p>Even when the IAIS should consider developing globally universal regulatory requirements, including capital and reserve requirements, it should be proportionate to the risks based on sufficient communication between supervisors and insurers, including options such as utilizing Pillar 2 measures.</p> <p>In such case, it is necessary to ensure that: (i) the economic and social benefits of alternative investments and AI are not undermined by excessive regulations, (ii) while paying regard to proportionality, a certain degree of commonness is shared among regulatory practices in each jurisdiction to avoid unnecessary fragmentation, and (iii) regulation in the insurance sector is not excessive compared to other financial sectors such as the banking and securities sectors.</p> <p>As to (ii) described above, a significant difference between jurisdictions could not only impair the level playing field, but also complicate the risks, triggering activities that leverage regulatory arbitrage. As such, the IAIS should ensure that no significant differences in regulatory responses emerge between jurisdictions while respecting the principle of proportionality.</p> <p>With regard to (iii) above, from the viewpoint of mitigating systemic risk to the financial sector as a whole, implementing excessive regulations only for the insurance sector on their alternative asset investments and AIR activities, could potentially increase systemic risk and have a significant impact</p>

	<p>on the broader financial sector, as similar activities may be performed by other businesses such as banks, securities or funds. The IAIS should therefore examine business models and risk management measures in different sectors and ensure that the regulations are not excessive compared to the banking, securities and funds sectors, while avoiding to implement a one-size-fits-all regulation across different sectors.</p>
<p>Q7. Comments on section 3.3 A principles-based classification</p>	<p>The LIAJ appreciates the establishment of a principle-based definition of alternative assets to allow for a flexible treatment in each jurisdiction. However, it should be noted that such vague definition (i.e. assets that display a high degree of either valuation uncertainty, illiquidity or complexity, or a combination of these) could lead to an overly broad range of asset classes, including asset classes that don't genuinely function as alternative assets, to be roughly classified as alternative assets.</p> <p>A possible solution to address this concern is to use a combination of these factors in assessing and determining whether individual assets are classified as alternative assets, as described in the mapping exercise in Section 3.3.3 of the Issues Paper.</p> <p>Furthermore, the LIAJ emphasises that, even with the definition proposed in this draft paper, matters such as actual liquidity levels in each jurisdiction or the state of the risk management framework in each company should be taken into account when considering supervisory and regulatory policies.</p> <p>Also, the IAIS should communicate and coordinate with other regulatory bodies that represent the financial sector (such as the BCBS and IOSCO) so that the proper market environment is not undermined through differences in the definition of alternative assets between sectors.</p> <p>In addition, the Issues Paper states that complexity can arise from structuring in the fifth paragraph of Section 3.3.2. However, the need for structuring may be driven by the relatively high capital charge imposed by the ICS on investments rated Below-IG, leading insurers that comply with the ICS to invest in the IG portion of structured products backed by assets that are Below-IG. Therefore, a possible future review of the ICS could consider the appropriateness of the capital charge for assets rated Below-IG based on the review of insurers' behaviour stated above.</p>
<p>Q8. Comments on section 3.4 Benefits associated with alternative assets</p>	<p>The LIAJ recognises that this section is intended to clarify the benefits associated with alternative assets, as stated in the title. However, comments in Sections 3.4.2 to 3.4.5 seem to overly emphasise risks and concerns, which may overshadow the benefits.</p> <p>While the LIAJ understands these risks and concerns, in the light of this section's purpose, we suggest the IAIS to consider revising the way they are expressed, for example by mentioning them in the footnotes rather than in the body of the text.</p>

<p>Q9. Comments on section 3.5 Supervisory concerns and areas of attention</p>	<p>While Section 3.3 proposes a principle-based definition of alternative assets, rather than seeking to apply a one-size-fits all approach, the focus should be on promoting sufficient communication between supervisors and insurers, for example through actions by supervisors to share good practices and to address the lack of information keeping in mind the characteristics of the local market and regulatory environment, and thus consider appropriate supervisory measures which would include options such as the Pillar 2 measures.</p> <p>Also, even when the IAIS defines alternative assets, it is possible to address the sectoral differences in a progressive manner by adjusting the concrete definition of complexities and then setting a global standard like the ISDA Master Agreement by the International Swaps and Derivatives Association, which aims to standardize the derivative trading.</p> <p>On page 21 of the Issues Paper, the IAIS implies the possibility of addressing the hidden leverage by taking a look-through approach (“Hence, look-throughs and intensive deep dives may be a key option for supervisors”). While the LIAJ understands the IAIS’s stance for adopting this approach, the fund investment is the primary form of alternative investment, so understanding the individual breakdown of the fund poses a significant practical burden and is only possible for limited investors. Therefore, if supervisors are to consider introducing this approach, instead of taking a one size fits all approach, they should consider each insurer’s feasibility as well as how crucial alternative investment is to the insurer’s assets.</p> <p>The statement in Footnote 44 (i.e. the large-scale run scenario is unlikely to occur for traditional long-term life insurance and annuity products) is very important as it illustrates the key characteristics of the insurance business and should be included in the body of the text rather than as a footnote.</p> <p>Potential conflict of interest in the case of PE firms with stakes in reinsurers, described in Section 3.5.4, is a critical issue. As such, the LIAJ supports the implementation of appropriate regulation to prevent this issue of conflict of interest.</p> <p>As to the statement in the last paragraph on page 29 “The Board of an insurer should have a sufficient number of members with relevant expertise in investment analysis and portfolio management, with the ability to apply that knowledge to alternative asset risks”, although we recognize the necessity for board members to have the ability to understand risk-return profiles of alternative investments from a governance perspective, given the broad range of the insurance business, it is overly excessive to require board members to have expert level knowledge in alternative investment analysis and portfolio management,. The LIAJ therefore suggests, for example, revising the latter part of the sentence to “...with relevant expertise in understanding the risk-return profile of alternative investments”.</p>
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<p>Q11. General comments on section 4 Rising adoption of AIR in the life insurance sector</p>	<p>Reinsurance has played a useful and effective role for primary insurers as a means of extending their underwriting horizons and stabilising their profitability. In addition to these benefits of leveraging reinsurance, AIR enhances the capital efficiency, improves asset management returns, and reduces required reserves by transferring a large portion of the insurers' risks including investment risks as summarised in Section 4.</p> <p>When considering supervisory responses to AIR, the responses should be appropriately balanced with these benefits of AIR.</p> <p>The LIAJ would also like to request that the jurisdictional developments around the application of the ICS, adopted in December 2024, is a possible solution to address the jurisdictional differences in capital and reserve requirements, which is specified as a concern arising from increasing AIR transactions, and should also be mentioned in this draft paper.</p>
<p>Q13. Comments on section 4.2 Jurisdictional approaches to reserving, capital requirement and investment flexibility</p>	<p>To avoid any misunderstanding of the intent of Figure 7 in Section 4.2.5, the IAIS should clarify the statement "the figure is a comparative estimate of differences in Total Asset Requirement across jurisdictions, based on a set of common assumptions; it is not intended to carry any normative implications, such as suggesting that these differences should be eliminated."</p>
<p>Q14. Comments on section 4.3 Supervisory concerns and responses</p>	<p>The use of AIR varies depending on the entity's purpose of cession, terms of collateral, and conditions of surrender, as described in the Issues Paper. Therefore, further regulatory and supervisory framework applicable to such transactions should be carefully considered to ensure the framework is proportionate to the risks.</p>
<p>Q17. Comments on section 5.2 Interconnectedness with the broader market</p>	<p>If AIR should have some systemic implications, assessing the systemic importance of AIR transactions of each insurer requires careful discussions given the bespoke nature of the transactions.</p> <p>Also, due to the bespoke nature of AIR transactions, systemic risk varies for each transaction.</p>

	<p>Therefore, the LIAJ believes that “concentration” alone, for example, does not inherently and necessarily lead to a higher systemic risk and suggests deleting the words “in nature” from the sentence “This concentration could make these entities more systemic in nature because of their interconnectedness and size, posing risks to financial stability.”</p> <p>Furthermore, the discussion should consider the outcome of the IMF’s analysis on the difference in systemic risks between insurers and banks (GFSR Report of April 2016) and the IAIS’s transition to the Holistic Framework for the assessment and mitigation of systemic risk in the insurance sector following the suspension of the identification of global systemically important insurers. GME IIM data also shows that systemic risk is not inherently high for insurers. Adequate justification or evidence should be provided for any changes to the recognition of the insurance industry’s systemic importance.</p>
<p>Q22. Comments on section 6.3 Potential areas of enhancement in the IAIS supervisory and/or supporting material</p>	<p>When considering the enhancement of the ICPs to address supervisory concerns related to alternative assets and AIR, it should be based on the understanding of actual transactions in each jurisdiction and entity, considering the highly bespoke nature of alternative assets and AIR transactions, which depends on local markets and regulatory environments as well as business models of each entity.</p> <p>Even when the IAIS considers developing globally universal regulatory requirements including capital and reserve requirements, these should be proportionate to the risks based on sufficient communication between supervisors and insurers.</p> <p>For example, enhancements to ICPs 9 and 20, that may require additional supervisory review and enhanced requirements for quantitative disclosure of metrics such as sensitivities to risks for ceding insurers and to regulations/legislation, may result in increased practical burdens. In considering reporting content and frequency, the IAIS should be cautious to take a balanced approach taking into consideration limitations of data and practical burdens. Additionally, reinsurance contracts are related to life insurance pricing and include sensitive pricing information. In enhancing ICPs 9 and 20, the IAIS should also take note of the confidentiality of such information.</p> <p>Also, as to the risk management of assets associated with AIR agreements and potential concentration risks, which are identified as potential areas of enhancements to ICP 13, AIR transactions, especially cross-border transactions, it should be discussed with a balanced and holistic approach since various stakeholders beyond the ceding insurer is involved in such transactions.</p>

Q24. General comments on section 8 Next steps	Upon further discussions on the supervisory concerns and responses, the IAIS should consider the highly bespoke nature of alternative assets and AIR transactions, which are dependent on local markets, regulatory environments, and business models of each entity, and should adequately capture the actual state of transactions in each jurisdiction and entity.
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