ERM in Life Insurance Industry and The Trends in Supervising for Japanese Life Insurance

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Introduction

- Nobuyasu UEMURA, Ph.D.
  - Former Financial Services Agency (FSA Japan),
    Senior Specialist for ERM left in October 2012
    (Insurance Business Division)
    - Monitor and encourage enterprise risk management (ERM) of life and non-life insurers.
    - Risk analysis of insurance industry
  - Before joining FSA in 2010, I was with Rating Investment Information, Inc. (R&I), the largest rating agency in Japan, as a credit analyst, both life and non-life insurance industry, for more than ten years.

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Development of Solvency Regulation

- "convoy system" to current system
  - Before new insurance business law (-1995)
    - Regulator had great authority.
    - But they could not prevent from worsening life insurer's solvency.
  - Current regulatory system
    - self-discipline
    - solvency regulation
    - market discipline

Development of Solvency Regulation

- Introduction of Solvency Margin Ratio (1996)
- Implementation of Prompt Corrective Action system for insurance companies (1999)
- Report by project team on the solvency margin regime (2007)
  - Near-term : improving reliability under the current framework
  - Mid-term : considering the implementation of economic value-based solvency regime

- Financial crisis (2008-)
- Revision of Solvency Margin Ratio (2010)
- Field test (2010)

Solvency Margin Ratio

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

Prompt corrective action

200% and more	No action → **Early warning system**
less than 200% and 100% or more	FSA issue a business improvement administrative order to the company.
less than 100% and 0% or more	FSA order … – Submission of plans to increase the capability of paying claims – Prohibitions of payment of dividends – Restraint on operating expenses – Prohibitions of new business etc.
Less than 0%	FSA order suspension of business

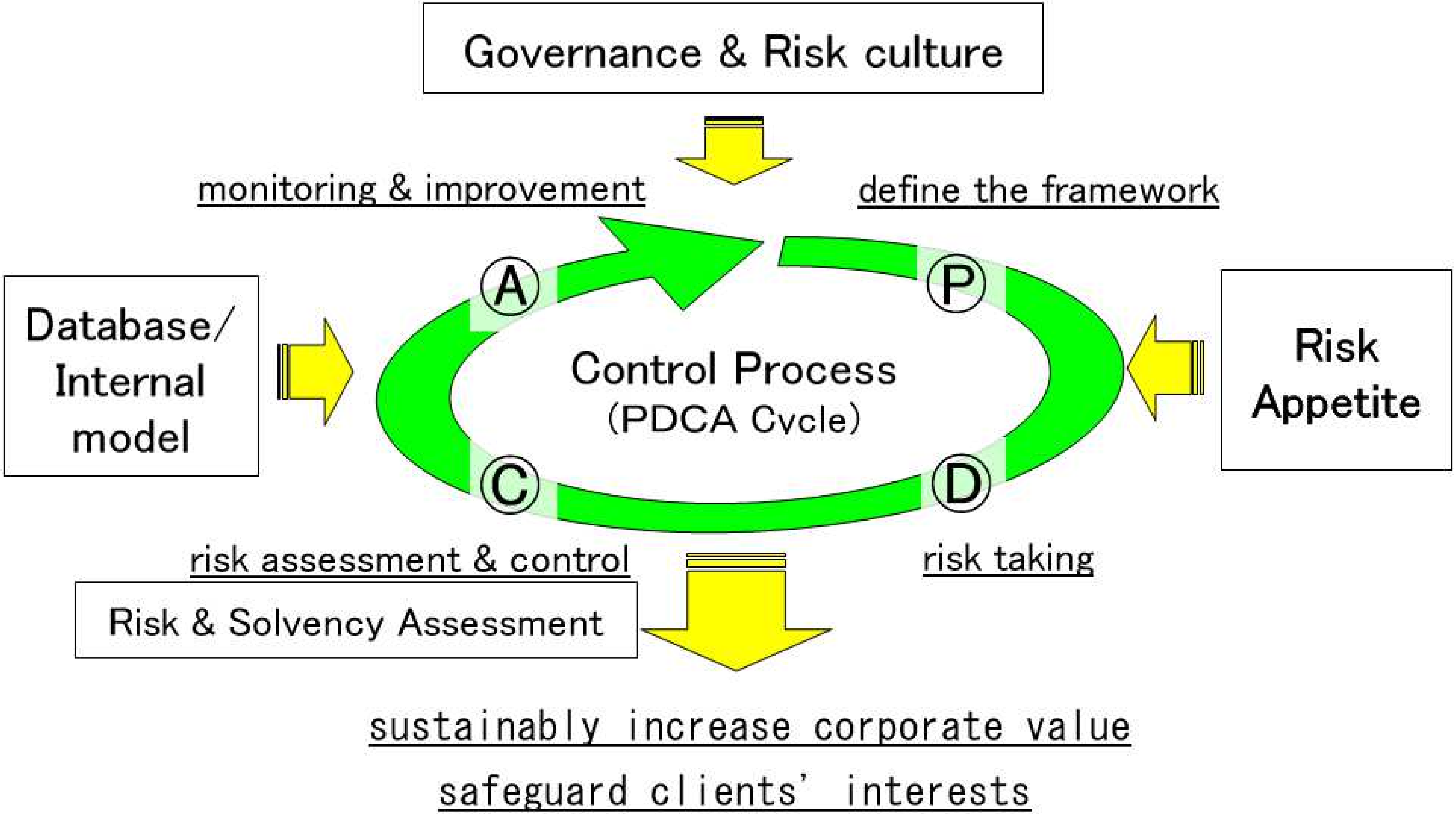
Enterprise Risk Management (ERM) of Insurers

- Regulatory Developments
  - Supervisory Guideline for Insurance Companies
    - Newly-created for Integrated Risk Management
    - Promoting the sophistication of risk management in an annual Supervisory Policies for Insurance Companies
  - Revision on Insurance Inspection Manual
    - Newly-created checklist for 'Comprehensive Risk Management'
  - ERM interview
    - It will be effective to not only set the minimum capital requirement under the solvency regime but also use a framework in which the FSA checks the status of insurers' own risk and solvency assessment.

Enterprise Risk Management (ERM) of Insurers

- General concept of ERM
  - All relevant types of risk
  - Comprehensive coverage
  - Enterprise-wide management depending on their Risk Appetite
  - Continuing and group-wide activity
    - meet a strategic goal
    - sustainably increase corporate value
    - safeguard clients' interests

whole picture of ERM

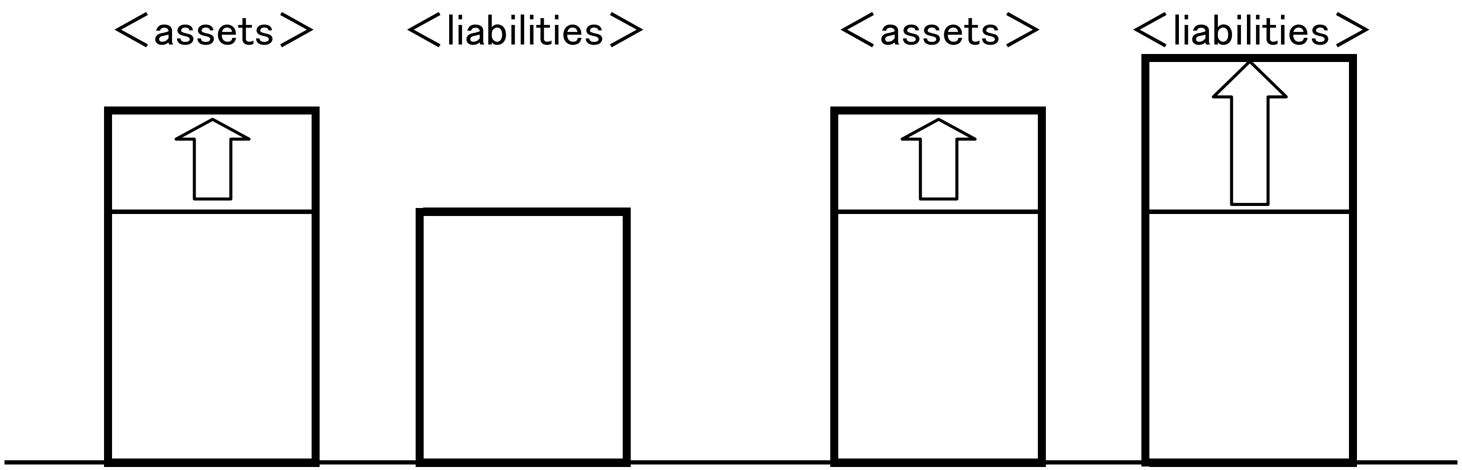


Enterprise Risk Management (ERM) of Insurers

- as compared to Bank
  - Wide variety of risk category
    - some risks are difficult to classify
  - Non-financial related risks
  - Developing valuation technique
  - Long-term liability, especially life insurance
  - Large difference between current system and economic value-based system

Mismatch between the locked-in liability and the economically valued assets

Effects of declining interest rates



＊By current accounting plinciple

＊Actually …
(If DuR of liabilities is greater than Dur of assets)

Enterprise Risk Management (ERM) of Insurers

- Why do FSA focus on insurers' ERM ?
  - The purpose of ERM is to enhance corporate value sustainably, with keeping their soundness
    - Essentially, ERM should be put into practice by insurers themselves, should not be pushed from outside.
  - FSA recognize to enhance corporate value sustainably, to contribute to protect policyholders
    - My book "Bankruptcies Caused by Lack of Governance – Reality of the Insurance Crisis in the Heisei Period"
      - Insufficient corporate governance increased bankruptcy risk.
      - Even if companies adopted excellent risk management framework, it does not mean that they implemented risk management properly if such a framework or figures are not used in business operations.