(Provisional translation)

The Third Meeting of the "Advisory Council on the Economic Value-based Solvency Framework"

1. Date and Time: September 20, 2019 (Friday) 4:00 p.m. to 6:00 p.m.

2. Venue: Special Conference Room No. 1, 12th Floor, Central Government Building No. 7

3. Minutes: Following presentations by the secretariat, Observer Sunamoto and Member Takeshita, the discussions were held as below.

- Many consumers likely prefer conservative guaranteed products in Japan, partly because financial education has not been sufficient. Even so, we should not force insurers to continue to meet the demands for guaranteed products. We need to explain that investment involves risks, and each consumer needs to decide between investment and savings on their own responsibility.

- A major feature of hybrid products in Germany is that they make effective use of the guarantee fund system. I have an impression that life insurers in Germany are taking full advantage of the preferable treatment of exposures with government guarantees under their regulation.

- After hearing the presentations today, I have come to the conclusion that an economic value-based regulation should be introduced as soon as possible, and that both the authority and insurers should start making preparations for that. I have a concern that the more we wait for its implementation, the greater problems we will have to face going forward, although I also recognize a need for transitional measures.

- It is a responsibility of insurers to meet consumer needs. However, if insurers' solvency deteriorates eventually due to excessive risk taking under the prevailing low interest rate environment, it is consumers who will ultimately have to bear a loss.

- As can be understood from the case in Europe, the introduction of an economic value-based regulation has benefited consumers in the long run, while there have been no major problems in the short term. The key point here is to provide appropriate explanations to consumers on the features and underlying risks of complex products (such as hybrids or unit-linked).

- I have an impression that Germany was one of the last runners when Europe started a project on an economic value-based regulation. They have made significant progress since then thanks to the efforts by both the industry and the authority. I think we should learn from them, and start implementing such efforts and making preparations as soon as possible.

- While there is leeway to consider the treatment of infrastructure investment in Japan, we should not be overly optimistic on the risk characteristics of those exposures.

- Disclosure is an important element and we should introduce it as a regulatory requirement. The challenge would be the timing and the contents. We should not defer it too far ahead. And we should also think about ways to provide adequate education to users of information. We should establish a timeline, so that all the stakeholders, including insurers and the authority can work together towards the implementation.

- We need to examine who ultimately bears the risk from offering long-term guaranteed products. It appears that insurers are bearing the risk on the face of it. If financial assistance from the government is provided to a failed insurer, however, it is the public who will ultimately bear the burden.

- Information disclosure is essential. It is not always the case that general consumers understand complex disclosures. So, there needs to be someone whose role is similar to that of a consultant or intermediary of the information. Consumers' literacy on the structure and features of insurance products will also be required.

- In my view, the so-called unintended consequences of economic value-based regulation are just a legacy from the past. Insurers sold products with overly optimistic features that appeared attractive to consumers as well, which subsequently turned into a huge liability for insurers. Given this, we should introduce an economic value-based regulation as early as possible, and rethink about the optimal responses, including the product design. By doing so, the problems that arose thus far will likely be alleviated and the industry will progress towards the right direction.

- The preferential treatment of infrastructure-related investments may hide actual risks that are inherent in those exposures. It then might facilitate the concentration of investment into the segment and thus cause undesirable unintended consequences.
- Run-off might trigger reputational risks in some cases. With that said, run-off might be an acceptable option if the purpose is to limit the damage to existing and new policyholders.
- Prompt implementation of a new regulation will mitigate the unintended consequences of the ongoing regime, thereby the whole industry will move in the appropriate direction.
- It was pointed out that hybrid products were essential in Germany in dealing with Solvency II and the low interest rate environment. In Japan, the share of variable insurance policies and annuities is currently low. Considering this, we may need a certain transitional period to prepare for potential changes.
- In an economic value-based assessment at a specific point in time, credit risk premiums on bonds will not be recognized, while profits earned will be accumulated in capital later on. Insurers in the US conduct cash flow matching and skillfully handle credit risk premiums while taking into account default costs. I think a regulatory standard should take into account such dimensions. I understand that this is also the reasoning behind matching adjustment and volatility adjustments in Solvency II.
- In an economic value-based assessment, cash flows from different points in time are discounted and added up. When designing a mechanism of supervisory intervention based on ESR, such time dimension of cash flows may need to be taken into account.

- I have an impression that the US opposes the ICS because they still have some positive slope in their yield curve. Should the yield curve completely flatten, as it did in Japan and Europe, there would be no better method other than an economic value-based approach to assess the viability of a company. The prolonged low or negative interest rate environment may slowly erode insurers' solvency, which may prompt them to take excessive risks. We believe that economic value-based risk management is necessary to suggest such a possibility in the future at this point.

- In my view, Allianz was able to adjust their strategy (e.g. launching a product such as Perspektive) because there was already momentum toward EV disclosure. That suggests the importance of Pillar 2 and 3. We cannot rule out the possibility that some pain might be caused by the introduction of an economic value-based regulation, even if we take measures for mitigation. Even so, we need to accept it if the regulation is aimed at avoiding even greater pains in the future.

- Perspektive provides a certain minimum guarantee to policyholders, and it does not seem different from Japan's pension insurance. Although other members commented that the early adoption of the new regulation would drive a change, it is not clear to me whether such a product would actually reduce risks significantly.

- Some insurers have already adopted economic value-based internal risk management, which is also incorporated into the product development process. My point is that the introduction of economic value-based regulation could work as a stricter restriction on insurers' managerial decisions.

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