

Monitoring Report For IAIGs

1. Purpose of the Report

Recently, Japanese insurance companies have been confronted with a severe profit environment characterized by the possible shrinkage of the domestic insurance market due to a long-term population decline and the ongoing low interest rate environment. As a result, in order to secure new sources of profit, major Japanese insurance groups have expanded their group to include their foreign business operations. Forming an “international insurance group” is expected to help improve management efficiency and enhance the quality of services through risk diversification and mitigation and business synergy within the group. Attention should be paid to the need for a governance function capable of dealing with the possible materialization of new risks associated with forming the above group, including risk transfer and concentration within the group, and the increased complexity of the business and organizational structures. Therefore, when forming an international insurance group, it is important to enhance the control environments for governance and risk management not only at the individual insurance companies’ level but also on a group-wide basis. Meanwhile, as the insurance supervisory authority, the Financial Services Agency (FSA) should construct a supervisory framework suited for group-wide supervision.

As you are well aware, “the Common Framework for the Supervision of Internationally Active Insurance Groups (IAIGs)” (ComFrame) ¹ and “the Holistic Framework for Systemic Risk in the Insurance Sector” (HF) ² were adopted by the International Association of Insurance Supervisors (IAIS) in November last year. ComFrame is intended to provide minimum quantitative and qualitative supervisory requirements appropriate to IAIGs' activities and scales in order to support and coordinate national supervisory authorities' activities to supervise IAIGs. In this environment, the emergence of new risks associated with forming a group, the need for management of such risks and for a governance function capable of dealing with the

¹ Supervisory standards and guidance focusing on the effective group-wide supervision of IAIGs (e.g., appropriate corporate governance and risk management by IAIGs, and supervisory cooperation between national authorities). ComFrame is comprised of "Standards," which are requirements that supervisors should observe, and "Guidance," which is intended to facilitate understanding and application of the Standards.

² A framework for preventing the materialization of systemic risks, which could arise from specific activities or concentration of exposures in the sector as a whole or by specific insurance companies. This is comprised of the supervisory activity of national supervisory authorities and the monitoring activity of the IAIS.

increased complexity of the business and organizational structures are challenges faced by the Japanese insurance groups. As a result, applying supervisory requirements in accordance with insurance groups' respective sizes and characteristics supports the enhancement of group-wide control environments for governance and risk management. Therefore, Japanese insurance groups, regardless of whether or not they are IAIGs, will be required to enhance their group-wide control environments for governance and risk management based on ComFrame and HF in accordance with their respective sizes and characteristics.

In addition to identifying the insurance companies to be designated as IAIGs in Japan for the purpose of group-wide supervision of Japanese insurance groups (particularly major insurance groups), this report summarizes the current status and challenges that have been found through various monitoring approaches and explains FSA's policy for group-wide supervision in the current program year. Through the continuous implementation of those activities, the FSA aims to conduct in-depth monitoring while increasing the transparency of administrative processes of group-wide supervision and to encourage insurance groups to enhance their group-wide governance and risk management system.

2. Insurance Groups Designated as IAIGs in Japan

Under ComFrame, The group-wide supervisor, in cooperation with other involved supervisors, should decide whether or not an insurance group is an IAIG based on consideration of whether the group meets both of the following two quantitative criteria.

- Internationally active:
 - Premiums are written in three or more jurisdictions, and;
 - Gross written premiums outside the home jurisdiction are at least 10% of the group's total gross written premiums.

- Size (based on a three-year moving average)
 - Total assets are at least USD 50 billion, or
 - Total gross written premiums are at least USD 10 billion.

At this time, FSA has decided to treat the insurance groups which the companies listed below are responsible for as IAIGs.

- Dai-ichi Life Holdings, Inc.
- Tokio Marine Holdings, Inc.
- MS&AD Insurance Group Holdings, Inc.
- Sompo Holdings, Inc.

The list of the insurance groups treated as IAIGs in Japan will be reviewed and revised as appropriate in the future.

3. Current status and Challenges for Major Japanese Insurance Groups

In recent years, overseas business expansion, led by major insurance groups, has been regarded as an important measure from the perspective of their business strategy. As a certain period of time has passed since the implementation of these overseas' large-scale mergers and acquisitions (M&A), the major insurance groups have started analyzing the outcomes of the M&A and challenges. From this perspective, FSA has been monitoring their management of subsidiaries and profit management after the acquisitions, focusing on whether their boards of directors, etc. are executing an effective governance.

In the program year 2019, FSA promoted the enhancement of the governance and risk management system as policy initiatives under the "JFSA's Initiatives for User Oriented Financial Services in a New Era - Financial Services Policy: Assessments and Strategic Priorities 2019" and conducted monitoring with respect to the governance and risk management systems of foreign subsidiaries of major insurance groups.

(Reference) Japanese insurance companies' recent large-scale M&A deals involving foreign insurance companies

(As of September 2020)

Insurance company name	Acquired company	Main business	Acquisition closing date	Acquisition value (billion yen)
Dai-ichi Life Insurance	TAL (Sydney)	Life insurance	May 2011	103.5
Dai-ichi Life Insurance	Protective (Tennessee)	Life insurance	February 2015	575.0
Tokio Marine & Nichido	HCC (Texas)	Non-life	October 2015	941.3

Fire Insurance		insurance		
Mitsui Sumitomo Insurance	Amlin (London)	Non-life insurance	February 2016	642.0
Sumitomo Life Insurance	Symetra (Washington)	Life insurance	February 2016	466.6
Meiji Yasuda Life Insurance	StanCorp (Oregon)	Life insurance	March 2016	624.6
Nippon Life Insurance	MLC (Sydney)	Life insurance	October 2016	180.0
Sompo Japan Insurance	SI (Bermuda)	Non-life insurance	March 2017	639.4
Mitsui Sumitomo Insurance	First Capital (Singapore)	Non-life insurance	December 2017	175.5
Tokio Marine & Nichido Fire Insurance	Pure (New York)	Non-life insurance	February 2020	325.5

(Note) Deals with an acquisition value of 100 billion yen or more.

(1) Viewpoints related to monitoring the governance and risk management system of foreign subsidiaries of major insurance groups

- First of all, it is important that a medium to long-term overseas business strategy is appropriately set under a management plan as a prerequisite for an effective governance and risk management system regarding foreign subsidiaries.
- Secondly, it is important to devote efforts to the following measures in a well-balanced manner in order to ensure that an effective governance and risk management system is incorporated into the acquired foreign subsidiaries.
 - (i) Develop and manage a framework for enforcing governance through foreign subsidiaries' boards of directors (supervisory function).
 - (ii) Share the group-wide strategies throughout the cooperation and the decision-making at the group-wide function-specific committees comprised of management-level officials (e.g., executive officers) of the management company and foreign subsidiaries.
 - (iii) Secure the appropriateness of the business operations regarding foreign subsidiaries through the following activities:
 - Develop a group-wide framework regarding guidelines for business

operations and internal control procedures.

- Ensure appropriate involvement of liaison officers related to the management of foreign subsidiaries and relevant divisions of the management company including the business lines.
 - (iv) Identify and manage the items that should be reported to and approved by the management company (e.g., the development of business plans [including capital allocation], periodic reports on financial results, reports on matters of compliance, and revision and abolition of regulations and guidelines).
 - (v) Ensure appropriate involvement of liaison officers related to the management of foreign subsidiaries and relevant divisions of the management company. This includes close examination of the specifics of the items identified in (iv) of the business lines and instructions given to foreign subsidiaries.
 - (vi) Establish a personnel strategy for systematically hiring and training persons who has the ability to manage and operate foreign subsidiaries.
 - (vii) Implement measures to foster a group-wide risk culture (e.g., setting and sharing group-wide values, communicating messages from the top management, and understanding the risk cultures of foreign subsidiaries).
- Thirdly, given that it is difficult in many respects to request a company being acquired to incorporate the abovementioned factors after the acquisition, it is desirable to develop, in advance, control environments related to the factors stated in (i) to (vii) and explain to and obtain consent from the company prior to the acquisition, or implement PMI³ at an early stage after implementing the factors.

*The above are only examples. It is important for insurance groups to develop an appropriate control environment for governance for their overseas business operations in accordance with their respective scales and characteristics.

(2) The results of monitoring (the current status and challenges)

As a result of FSA's monitoring conducted from the viewpoints listed in (1) above,

³ The acronym for Post Merger Integration. It refers to post-merger integration processes such as management, operational and cultural integration.

the followings are the current status and challenges of the major insurance groups' governance and risk management system with regard to their overseas business operations:

[Current status]

Among the seven major insurance groups in Japan, the three non-life insurance groups have conducted multiple large-scale acquisitions abroad earlier than the four life insurance groups. As the non-life insurance groups has been expanding their overseas businesses, it has become one of the pillars of their group businesses.

- Currently, the three non-life insurance groups are trying to enhance the control environment for managing foreign subsidiaries as part of their group wide governance system. Their management method varies from group to group. For example, one group has established a function-specific committees in order to facilitate effective collaboration among various functions on a group-wide basis and develop a system to conduct management through an intermediary holding companies established in each region. Based on this system, the management teams of the management company and foreign subsidiaries cooperate in implementing an effective governance system including the business lines as necessary, by setting and operating specific risk appetites and guidelines. Another group has explored an optimal management structure in light of the status of overseas businesses after acquisitions and has shifted from intermediary holding companies management to centralized management by the management company's headquarters. The third group has shifted to centralized management by transferring the management of foreign insurance businesses to one subsidiary insurance holding companies within the group. All groups are also enhancing governance, for example, by establishing, at the management company level, a committee including senior managers of their foreign subsidiaries as a member.
- The four life insurance groups have also implemented large-scale acquisitions, the strategy adopted and the progress have been different from non-life insurance companies. One group has implemented multiple large-scale acquisitions with the aim of developing the acquired businesses as one of the pillars of group businesses. This group is enhancing the management of foreign offices by establishing a system where the regional headquarters supervise their foreign subsidiaries in their respective regions and are responsible for overseeing the progress of PMI. Another group regards overseas businesses as a diversification to the profits earned from domestic businesses, and the headquarters in Japan is

directly overseeing governance of the foreign subsidiaries while contemplating the possibility of continuously expanding overseas businesses.

[Challenges]

- Both life and non-life insurance business environment has been changing dramatically. The major insurance groups have been affected by the changes of the global economic situation due to the increased weight of foreign businesses in their overall businesses portfolio and also because of other factors such as the COVID-19 pandemic and the increased frequency and severity of natural disasters. As a result, the groups' insurance businesses, including foreign businesses and profits may be affected by global economic stagnation, stock prices fall, increase in payments of insurance benefits, and changes in customers' needs. Therefore, these conditions should continue to be closely monitored.
- With regard to the three non-insurance groups, it is necessary to closely monitor the effectiveness of their governance function—focus mainly on the groups that have implemented substantial management system reforms, such as shifting to centralized management by the management company or through intra-group subsidiaries holding companies—in terms of whether the management and control system for foreign subsidiaries are implemented in a timely and appropriate way through smooth communication among the management companies and foreign subsidiaries and cross-regional management while taking into consideration changes in the environment surrounding overseas' businesses.
- With regard to the four life insurance groups, which are utilizing a generally decentralized governance system and conducting PMI, there is a group facing issues related to the effectiveness of management systems among foreign subsidiaries, including the failure to take action in a timely matter while the profit and financial positions of foreign subsidiaries are deteriorating. Another group had deficiencies in its control environment for the sharing of important information regarding the management and financial results of foreign subsidiaries with the headquarters.

For those groups, it is pivotal to gather information of the financial position and the risk status, and develop an effective governance system among the foreign subsidiaries. This includes the development of internal control (including internal audit) and risk management systems, the evaluation by the management company of the status of the internal control functions at foreign subsidiaries, collecting important information such as business plans of the foreign

subsidiaries by the management company, and an appropriate involvement of the management company in the execution of business by foreign subsidiaries.

4. Policy for Group-wide Supervision in the Current Program Year

As explained above, one imminent challenge for major insurance companies is to consider how to respond to new risks arising from changes in the surrounding environment, such as the spread of the COVID-19 pandemic, including foreign countries where the impact has been greater than in Japan. In this situation, in order to meet the needs of customers who prepare for various future contingencies, it is important for insurance groups to review the current business model from the viewpoints of the design of products and services, group-wide governance appropriate to their respective characteristics, risk management, and business operations.

From this perspective, while closely monitoring the impact of the COVID-19 pandemic on overseas businesses, FSA will revise the guidelines for group-wide supervision in the current program year in light of the international guidelines adopted by the IAIS in November last year with respect to group-wide governance, including the management of foreign subsidiaries, and encourage insurance groups to enhance their group-wide governance and risk management system appropriate to their respective sizes and risk profiles.

Specifically, FSA will follow up on issues identified through the monitoring conducted in the previous program year with respect to insurance groups and conduct monitoring based on the abovementioned supervisory guidelines (specific supervisory viewpoints are as described below). Moreover, FSA will assess insurance groups' group-wide risks in terms of whether the groups' business operations are managed appropriately in accordance with relevant laws and the capital regulation (refer to ComFrame 9 and 23) and, as necessary, consider supervisory measures in cooperation with relevant foreign authorities (refer to Comframe10).

[Specific viewpoints of monitoring]

- The status of the development of a control environment to obtain information on foreign subsidiaries' business plans (including capital allocation), periodic reports on financial results, risk information, compliance matters and the revision and abolition of internal regulations and guidelines in a timely manner, and to ensure that relevant divisions of the management company closely examine the specifics of the obtained information and report and share the situation of foreign subsidiaries in a responsible, appropriate and timely manner (refer to ComFrame

7).

- The status of development of a control environment to ensure that relevant divisions of the management companies and liaison officers can be appropriately involved in foreign subsidiaries' management and business plans and execution of business operations after appropriately collecting important information regarding the foreign subsidiaries (refer to ComFrame 7).
- The status of the development of internal controls concerning foreign subsidiaries necessary for securing the appropriateness of the foreign subsidiaries' business and financial figures (refer to ComFrame 8).
- The status of development of a group-wide control environment for risk management through the formulation of group-wide guidelines for business operations (refer to ComFrame 16).
- The status of enforcement of governance including the business lines through periodic evaluation by relevant divisions of the management company (e.g., the internal audit division) of internal control and risk management developed at foreign subsidiaries (ComFrame 8 and 16).

As for major insurance groups designated as IAIGs in particular, in order to conduct an effective group-wide supervision by enhancing international cooperation, FSA will establish supervisory colleges that include foreign supervisory authorities with respect to individual IAIGs and hold a supervisory college meeting at least once a year (refer to ComFrame 25). At the same time, FSA will share the results of the supervisory assessment, including the assessment of group-wide risks of IAIGs, with foreign authorities at supervisory college meetings and, if necessary, communicate the results to the management companies of relevant IAIGs (refer to ComFrame 9).

As for the development of recovery plans by the management companies of IAIGs, FSA will follow up on activities related to the development of the plans, for example by holding dialogue in accordance with the groups' respective circumstances while taking into consideration the timing of the above supervisory college meetings.

(End)