ASIA-PACIFIC FINANCIAL FORUM
ROUNDTABLE ON FINANCIAL REGULATION

An Overview of APFF Work Related to Financial Regulatory issues
Insurance and Retirement Income

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APFF Interim Report  12 Action Plans

1) A pathfinder initiative to develop credit information sharing systems
2) A pathfinder initiative to improve the legal and institutional architecture for security interest creation, perfection and enforcement and related workshops
3) Dialogues on regulatory issues in trade and supply chain finance
4) Workshops on emerging facilitators of trade and supply chain finance
5) A pathfinder initiative to develop classic repo markets
6) Workshops to develop strategies to improve legal and documentation infrastructure for the development of OTC derivative market
7) Self-assessment templates on information for capital market investors
8) ARFP (Asian Region Funds Passport) support initiative
9) Workshop series to develop an enabling Asia-Pacific securities investment ecosystem
10) Dialogue series on regulation and accounting issues impacting the long-term business of the insurance industry in Asia Pacific economies and longevity solutions
11) Collaboration with APEC Finance Ministers’ Process in promoting long-term investment, including infrastructure
12) Conference and workshop series on linkages on structural issues
Unintended consequences might occur if banking regulations were copied for insurers

- Insurers play an important role as **long term investors** and in the **social security system**
- **Diversity** needed to support a sound development of the environment

(Economic-based regime should have a long-term vision)

If a short-term-minded economic regime were implemented

- **Significant volatility** for long term products
- Driven to transfer risks over to customers
- Refrain from investing in non-fixed income assets
**Regulatory issues “One-size-fits-all” models**

- “One-size-fits-all” models would not work
- Different business models and existing regulatory framework
  - the application of prescriptive international standards would not ensure the overall comparability or level playing field in the region

**APFF Insurance and Retirement Income Work Stream**

- A holistic framework to support the long-term roles of insurance and pension industry in the Asia-Pacific

- Financial Stability
- Sustainable development
- Macro economy
- Financial inclusion
- Social security
- Insurance protection

- Regulation and accounting
- Capital market and long-term investment
- Longevity Solutions
- Microinsurance and disaster risk financing
For more details on the APFF, visit mackglobe.com or email Makoto Okubo, Nippon Life (m-okubo@nliinter.com)

APPENDIX

You can find APFF Interim Report to the APEC Finance Ministers here:

- Executive Summary

- Full report

E. Insurance and Retirement Income (see page 56-62)

- Annex H: Constrains on Promoting Long-Term Investment in the Asia-Pacific

  - High-level issues and recommendations
    (regulatory, accounting, market and operational issues) as a basis for discussion with policymakers and regulators
Bank-oriented regulations may negatively impact on insurers’ role to provide long-term investments and stabilize the financial system

- Insurance regulations should take into account the specific nature of the insurance business and
- should not apply regulations which are targeted for bank deposits and other financial products with short-term liquidity needs

High risk charges for long-term investment, including infrastructure projects and equities, may discourage insurers and pension funds to provide such investments

- Avoid bank-centric capital-weighted rules and
- consider the characteristics of long-term assets supporting long-term liabilities as well as
- the effect of asset diversification

Capital constraints on traditional long-term products may drive the companies to shift to short-term investment products

- Capital charges should be looked into, for the companies to have incentives to promote long-term products, taking into account the interaction between long-term assets and liabilities

Bank-oriented regulations with focus on systemic risk and interconnectedness may dis-incentivize insurers to stabilize the financial system and market, rather than mitigate systemic risks

- Regulatory framework should holistically promote the role of insurers and pension funds to support macro-economy, sustainable development, social security and long-term insurance protection, and
- pay due care to the issue of pro-cyclicality
Constraints and recommendations

Bank-centric regulations (Cont.)

- It may affect negatively on the equity and long-term debt instruments and efficient risk management tools, such as hedging instruments
  - Regulations should be in designed in a way to promote and incentivize the insurers’ and pension providers’ role to stabilize the financial system and market and its ability to manage risk efficiently

Constraints and recommendations

Short-term oriented economic regime

- Economic valuation may produce significant volatility for long-term business, which may not be relevant to the insurers’ capacity to meet long-term obligations
  - Economic based regime should have a long-term vision
  - Avoid replacing the existing regulatory regimes simply with a regime based on an economic based regulations

- If such regime is used for regulatory interventions, insurers with no concern in solvency positions for the foreseeable future may be forced to take remedial actions, including the exit from long-term business and investments, in response to short-term fluctuations in financial markets
  - Avoid the introduction of a regulatory regime which would require immediate regulatory actions in response to short-term market fluctuations
Constraints and recommendations
Short-term oriented economic regime (cont.)

- Short-term oriented regimes tend to capture the risk assessment with a snapshot and consider long-term business and investments excessive risk taking
  - Long-term nature of the business model and illiquid nature of liabilities should be properly taking into account when designing the regulatory regime

- Short-term oriented economic solvency regimes may incentivize insurers to transfer risks to customers, shift away from long-term protection business and investments, and discourage them from investing assets other than fixed income assets
  - Measures should be taken to mitigate impact on long-term protection business and the assets supporting such contracts

Constraints and recommendations
“One-size-fits-all” models

- Adoption of “one-size-fits-all” regulatory models would not capture the diversity that exists in the region and may produce unexpected negative consequences for insurance/capital markets, and social security system
  - Consider an approach to start from the regulatory framework in each jurisdiction, evolved and tested on its characteristics and harmonize those regimes from a unified point of view

- A model based on one jurisdiction may not meet the regulatory objectives in other jurisdictions
  - Consider the use of the different valuation approaches for different purposes
  - The use of existing regulatory regime in each economy may be an option
Due to the difference in business models and existing regulatory framework, the application of prescriptive international standards would not ensure the overall comparability or level playing field in the region

- International standards should be principle-based and aim to achieve the comparable outcome by taking into account the diversity in the region

**Constraints and recommendations**

*One-size-fits-all* models *(cont.)*

- Volatility in the balance sheet
  - Short-term fluctuation should be avoided
    - Assets-liabilities interaction should be reflected for a wide range of products sold in the region
    - Discount rate should reflect the business model

- Volatility in the income statement
  - The (optional) use of OCI for insurance liabilities and corresponding assets

- The proposed IFRS contains other significant issues for traditional long-duration products
  - Complexity
  - Consistency
  - Transition requirements
  - Presentation
Market and operational Issues

Market issues
- Underdeveloped long-term capital market
- Small number of bankable projects available
- Lack of infrastructure financial instruments
- Lack of market instruments (i.e. derivative, hedging tools) to manage portfolio risk
- Constraints on long-term insurance business (both demand side and supply side)

Operational issues
- Weakness in credit rating
- Lack of experience
- Uncertainty in legal framework (i.e. creditors rights, resolution)

Longevity solutions
- The work on longevity solution will focus on addressing demand- and supply-side issues in the development of lifetime retirement income solutions

Figure: Interrelated Issues in Providing Lifetime Retirement Security

- Governments facing a retirement tsunami
- Existing market not adequate
- Insurance industry can help
- Stimulate demand
  - Consumer education
  - Tax incentive
  - Innovative products
- Stimulate Supply
  - Long term investments & Capital markets
    - Increase supply
    - Reduce regulatory and accounting hurdles
  - Regulation and accounting
  - Longevity solutions

Collaboration with Capital market/FMI/PPP work is the key