Comments on a consultative report on
Principles for the Supervision of Financial Conglomerates
- The Life Insurance Association of Japan -

The Life Insurance Association of Japan (LIAJ) is a trade association comprised of all 43 life insurance companies currently operating in Japan. Its aim is to promote the sound development of the life insurance industry and maintain its reliability.

We would like to submit these comments on the consultative report.

＜General＞

・ In applying the Principles, the differences in the nature of the business between banking, insurance, and securities sectors should be appropriately taken into account. We have concerns that applying the same financial regulations to all sectors would undermine diversity, amplify pro-cyclicality, and as a result have a negative impact on financial stability.

・ While the differences between each nature of their business are mentioned only in 14(a), they should be taken into account more widely within the Principles as a whole.

・ The 2009 internal review suggested that the Principles needed updates in order to provide greater focus on the holding companies of financial conglomerates. From this perspective, the Principles should focus on governance and risk management, etc. specific to the financial conglomerates, and it should not require applying either of existing regulations of banking, insurance, or securities sectors uniformly to all those sectors.

・ Especially, in terms of corporate governance, it should be assumed that there are material differences in legal and regulatory frameworks between each country.

・ The Principles should make sure that they do not impose great costs and burdens on the financial conglomerates. In case of imposing excessive costs and burdens on them, it can result in undermining the soundness of the entire life insurance industry, and therefore, it is also necessary to have a perspective to ensure effective supervision as well.

＜8 (c)＞

・ It is stated that "Supervisors should review the consistency of the financial conglomerate's own assessment of its risks at the sector levels as well as on an aggregated basis."

・ However, because of the differences between each sector, such as the differences of characteristics of the liability resulting from the differences in each sector's line of business and whether to have settlement function or not, risks which each sector faces are different. Therefore, it is not appropriate to require the consistency on risk assessments carried out by each sector.

＜10.5＞

・ It is stated that "In the event the local corporate governance requirements are below the group standards, the more stringent group corporate governance standards should apply."

・ However, it is unclear whether the term "the more stringent group corporate governance standards" refers to the requirements specified in the Principles or the requirements in the home country of a parent company.

・ Besides, it is noted that the application of the standards would be exempted "where this would lead to a violation of local law". However, if the exemption is limited only to this case, "the more stringent group corporate governance standards" can overlap with a number of local standards. We are concerned that this duplication can impose great burdens on both supervisors and entities, and therefore, practical judgement should be exercised as a whole so as to apply effective regulations.

＜11 (c)＞

・ Based on the principle of materiality, we believe this paragraph needs a change from "those of unregulated entities" to "those of all material regulated entities" as stated in 10.4.

＜12 (i)＞

- It is required that "individuals who exert a material influence over regulated entities should have the financial soundness to fulfil their role" in this part. In addition, it is pointed out that "financially weak owners may have an incentive to drain financial resources from a regulated entity" in 12(4).
- However, there are some actual cases in the past that certain individuals greatly compensated caused a heavy loss to their entities through their high-risk activities for personal gain. Also, it is inappropriate to require the financial soundness as suitability requirements for individuals from a human rights perspective.
- In case of requiring the financial soundness somehow, we recommend that ones subject to this requirement should not be " individuals " but be limited to "significant owners" from the perspective of impacts of significant owners on their entities.

＜12 (ii)＞

- It is required for supervisors to ensure that the board members, etc. "possess integrity, competence, experience and qualifications".
- However, "experience" and "qualification" are just some of the measures to demonstrate or evaluate their "competence", and therefore, they can fulfil their role and exercise sound judgement without "experience" and "qualification" if they possess "competence". Considering these facts, we believe that the term "experience" and "qualifications" should be deleted from this sentence.

＜12 (c)＞

- It is required that "the board of the head of the financial conglomerate include a number of members acting independently of the wider group (including owners, board members, executives, and staff of the wider group)" in this part.
- However, the concept of governance should be taken into account flexibly based on different situations in various countries and companies. Due consideration should be given in introducing a uniform and formal rule on the appointment of board members as it may disturb the establishment of the governance system which is appropriate for each entity.
- And also, in terms of the requirements for the board, there should not be formal requirements to uniformly limit the application to "members acting independently". Supervisors should carry out substantive assessments on whether the board is exercising appropriate judgement practically.
- Besides, we are concerned that it can be difficult to secure adequate human resources if the formal requirements of the board are made tighter.

＜12.5＞

- It is stated that "Competence can generally be judged from the level of professional or formal qualifications."
- However, as we stated in our comments on 12 (ii), qualification is just one of the measures to demonstrate or evaluate their competence, and the competence to carry out their mandates should be judged in more practical way. Therefore, we believe that this sentence should be deleted.

＜13＞

- It is stated that the board should define the "strategy" and "risk appetite" of the financial conglomerate.
- However, as "risk appetite" is considered as a factor constituting the concept of "strategy" (i.e. one of the components of the "strategy"), we believe that "risk appetite" does not need to be specified independently.

＜14 (a)＞

- In terms of a remuneration policy, it is stated that the objective of the policy "can allow for reasonable differences based on the nature of local legal requirements."
- However, the remuneration policy of each entity was put in place based not only on local legal requirements but also on local practices. Therefore, this sentence should be changed to "(The overarching objective ...) can allow for reasonable differences based on the nature of the constituent entities/units and local legal requirements and practices."

＜15 (g)＞

・ Based on the principle of materiality, we believe this paragraph needs a change from "any unregulated entities" to "all material unregulated entities" as stated in 10.4.

＜15 (h)＞

・ In our understanding, the term "internal capital targets" in this paragraph stands for the" internal minimum capital requirement". Instead, if this term intends to imply high-level internal capital targets, such as optimal level of capital, it would be unreasonable to require establishing practicable plans for, even under stressed conditions, achieving and maintaining these targets. Therefore, we believe that the term "internal capital targets" should be changed to "internal minimum capital requirements".

・ Besides, in our understanding the term "stressed conditions" in this paragraph means conditions with a certain level of stress which the head of the financial conglomerate takes into account in measuring their risks. Instead, if this term intends to mean the excessive stressed conditions under the stress tests which are conducted to supplement the measurement of their risks, this requirement would be overly burdensome from the perspective of capital efficiency.

＜15 (i)＞

・ When its capital position falls below its internal capital target, there may be various possible reasons. Therefore, it should be noted that the identification of pre-determined measures might mislead the management's actions. For example, even if it is specified in advance that "the managements boost their capital by issuing new stocks when its capital position falls below its internal capital target", there may be cases where it is inappropriate to issue the stocks responding to the situation. Therefore, this sentence should be changed to "the managements take appropriate actions, in cooperation with relevant parties when its capital position falls below its internal capital target".

＜16 (a)＞

・ Based on the principle of materiality, we believe this paragraph needs a change from "all entities" to "all material entities" as stated in 10.4.

＜21 (a)＞

・ Based on the principle of materiality, we believe this paragraph needs a change from "in all sectors" to "in all material sectors" as stated in 10.4.

＜21 (g)＞

・ The management of strategic risks is beyond the scope of risk management activity which is a part of internal control systems under the supervision of managers (i.e. which is not independent from managers) as it is equal to the control of the entity's management itself. Therefore, the management of such risks require a system to manage them based on a framework separate from the framework of normal risk management.

＜22 (a)＞

・ We believe that providing staff with risk management training is just one of the measures to promote an appropriate group-wide risk management culture. Therefore, risk management training for staff should be illustrated as an example.

＜22.4＞

・ Based on the principle of materiality, we believe this paragraph needs a change from "at all levels" to "at all material levels" as stated in 10.4.

＜26 (b) (e)＞

・ Although we don’t disagree with the effectiveness of conducting, as a stress test, a broad-ranging analysis, it would not be necessary to require uniform measures and it would be sufficient to take appropriate measures depending on each conglomerate, entity or risk type. Therefore, reverse stress tests should be illustrated as an example of measures to take.

＜26.2＞

- Based on the principle of materiality, we believe this paragraph needs a change from "all risks" to "all material risks" as stated in 10.4.

＜28.2＞

- It should be noted that much of information on insurers obtained through supervisory processes is highly confidential. Although disclosure is necessary for policyholder protection, it should be noted that risks associated with disclosure (such as reputation risks) can seriously undermine policyholders' interest. Considering these concerns, sufficient discussion is required on whether to disclose certain information or not. Therefore, this sentence should be changed to "Supervisors should encourage public disclosure unless such disclosure causes problems with the confidentiality of information or policyholder protection."

＜29.3＞

- Based on the principle of materiality, we believe this paragraph needs a change from" all economic risks" to "all material economic risks" as stated in 10.4.

＜29.4＞

- Based on the principle of materiality, we believe this paragraph needs a change from "all other firm-wide risks" to "all other firm-wide material risks" as stated in 10.4.

＜29.5＞

- Based on the principle of materiality, we believe this paragraph needs a minor change from "all SPE activity" to "all material SPE activity" as stated in 10.4.