



International Association for the
Study of Insurance Economics

Études et Dossiers

Extract from

Études et Dossiers No. 344

The 24th PROGRES International Seminar
“Towards a Global Architecture for Insurance
Regulations and Supervision”

3-4 April 2008
Geneva, Switzerland

April 2008

Working Paper Series of
The Geneva Association

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The Geneva Association Working Paper Series “Études et Dossiers” appear at irregular intervals about 10 - 12 times per year. Distribution is limited.

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Converting Challenges into Opportunities - Impact of Solvency Reforms on the General Insurance Companies

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OUTLINE

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1. Current Solvency Margin Scheme in Japan

- RBC-based
- Introduced in 1996 concurrently with the deregulation
- Ongoing upgrades and revisions

2. The IAIS Common Structure for Insurer Solvency -- Our View

This is a Big Challenge with positive momentum for:

- Strategic shift toward more focus on the quality of management and services rather than quantity of premium revenue
- Enhanced risk management and risk mitigation toward ERM

The solvency framework presents an incentive to insurers to better compete in the market by implementing innovative risk management.

- Efficient capital allocation

2. The IAIS Common Structure for Insurer Solvency -- Our View

The driving forces of enhanced quality management

- Empowered consumers and the increasing importance of corporate accountability

- Increased responsibility of management with the shift to principle-based regulation and better regulation. From a "Is this compliant?" mindset to a "Is this the best way?" mindset.

2. The IAIS Common Structure for Insurer Solvency -- Our View

Driving forces of enhanced quality management

- Emerging risks and catastrophic risks demand more sophisticated risk management and capital allocation methodologies.

- Revised Corporate Law (2006) and Financial Instrument and Exchange Law (2007) to strengthen corporate governance, risk management, internal control and disclosure.

3. Lessons from the Recent Turmoil of the Capital Market

- Avoid excessive reliance on rating agencies for risk evaluation and pricing
- Importance of forward-looking scenario and stress test
- Limitation on risk pricing that is either based on insufficient data or not tested under stressful market

3. Lessons from the Recent Turmoil of the Capital Market

- Keep vigilant eyes on pricing/underwriting under “originate-securitize-distribute and repackage” business model
- Importance of appropriately managing liquidity risk
- Limitation on internal models and risks not covered by track record

4. Preparation Work in Progress

This is not a compliance exercise!

- Changing corporate culture and structure
From silo to more holistic risk management
- Comprehensive risk analysis and VaR measurement
with a focus on capital cost (Every risk insured is
carrying a capital cost!)
- Improved operational risk management and BCM

4. Preparation Work in Progress

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- Evolving risk mitigation methodology
 - Discussion with rating agencies and strong motivation
to introducing/upgrading ERM
 - Study and refinement of internal model
 - Impact study

5. Challenges

- Develop works in progress and translate them into real value for consumers, policyholders, investors and other stakeholders

- More visible incentive for enhanced ERM: from ERM as risk management to ERM as value/profit creator

- Develop professional human resources in both public and private sectors

5. Challenges

- Despite enhanced risk management and risk mitigation, there remains the question of insurability. We need closer collaboration between the public and private sectors on such risks as terrorism and earthquake.

5. Challenges

- Group-wide solvency framework:

We need paradigm shift from fragmented regulatory regime to internationally harmonized regime in other than Common Structure of Solvency regulations.

International level regulatory playing field and supervisory assessment/intervention have to be realized.

5. Challenges

- Promote free movement of capital. Liberal flow of FDI is one of the best policies to optimize capital allocation and to make insurance/reinsurance markets sustainable.

- Use test: “Eat what you cook” or “Use the living room every day” (by Julie Dickson of OSFI)

- More attention to supervisor's role; mandate, function and achievement

6. How to Address Our Common Challenges, Going Beyond the Risk Management and Solvency of Insurers.

- How to translate a risk-sensitive solvency framework into truly risk-based underwriting; pricing, terms and conditions.
- This is essential for building a sustainable insurance system where policyholders with better risk mitigation and risk improvement efforts are rewarded.

* Non-risk-appropriate insurance prices also wrongly incentivize people to continue investing in highly -exposed area. (Swiss Re, sigma No1/2008)

6. How to Address Our Common Challenges, Going Beyond the Risk Management and Solvency of Insurers.

For this, we have to make further effort;

- Build trust in society and the community
- Promote collaboration with agent, broker and loss adjuster to enhance services, market conduct and their professional qualification

6. How to Address Our Common Challenges, Going Beyond the Risk Management and Solvency of Insurers.

For this, we have to make further effort;

- ❑ Strengthen corporate infrastructure; quality database, IT and actuarial resources
- ❑ Encourage risk awareness in society and empower communities to become disaster resilient

7. Conclusion

- The IAIS Common Structure for Insurer Solvency provides us with a strong impetus to build quality management, services and efficient capital management for the benefit of customers, shareholders and society
- Lessons from capital market must be kept in our mind
- Stronger incentive helps accelerate enhanced ERM

7. Conclusion

- Sustainable insurance schemes through risk-based underwriting with visible rewards to policyholders with enhanced risk management and loss prevention
- Disaster resilient society and economy through wider use of incentive toward risk mitigation, risk improvement and loss prevention built in insurance services. This is one of the important ingredients of our social responsibility.