



Asia-Pacific  
Economic Cooperation

**APFF**

ASIA-PACIFIC FINANCIAL FORUM



# **ASIA-PACIFIC FINANCIAL FORUM**

## **Overview of the work of the APFF Insurance and Retirement Income Workstream**

**With focus on regulatory issues  
when promoting long-term investments  
in Asia Pacific region**

Brunei, November 26 2014

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Nippon Life Insurance Company

## APFF: Public-private collaboration in developing financial systems

- Importance of regional public-private collaboration:
  - Legal and regulatory frameworks
  - Financial market infrastructure
  - Financial market integration
- APFF: informal, inclusive and advisory public-private platform for collaboration in the development of common strategies for developing sound, efficient and integrated Asia-Pacific financial markets
  - Governments and regulatory bodies
  - Private sector
  - International organizations (IFIs, SSBs, others)

## APFF WORK STREAMS:

- **Insurance and retirement income**
  - Lending infrastructure
  - Trade and supply chain finance
  - Financial market infrastructure(FMI)  
/cross-border practice
  - Capital Markets
- + *Linkages and structural issues*

- This year, **ABAC submitted an Interim Report to APEC Finance Ministers**, recommending concrete undertakings across the broad financial sector that can yield tangible results within two or three years. The report was officially endorsed on October 22 in Beijing.
- This report drew from discussions undertaken by more than 270 senior representatives and experts from 137 major private and public institutions.
- The interim report contains **12 action plans** which are clustered around two major issues:
  - **Promoting capital market depth and liquidity and long-term investments**
  - **Expanding financial access** of enterprises and individuals to financial services

- 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**

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

- Executive Summary

<https://www.abaonline.org/v4/download.php?ContentID=22611923>

- Full report

<https://www.abaonline.org/v4/download.php?ContentID=22611921>

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

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

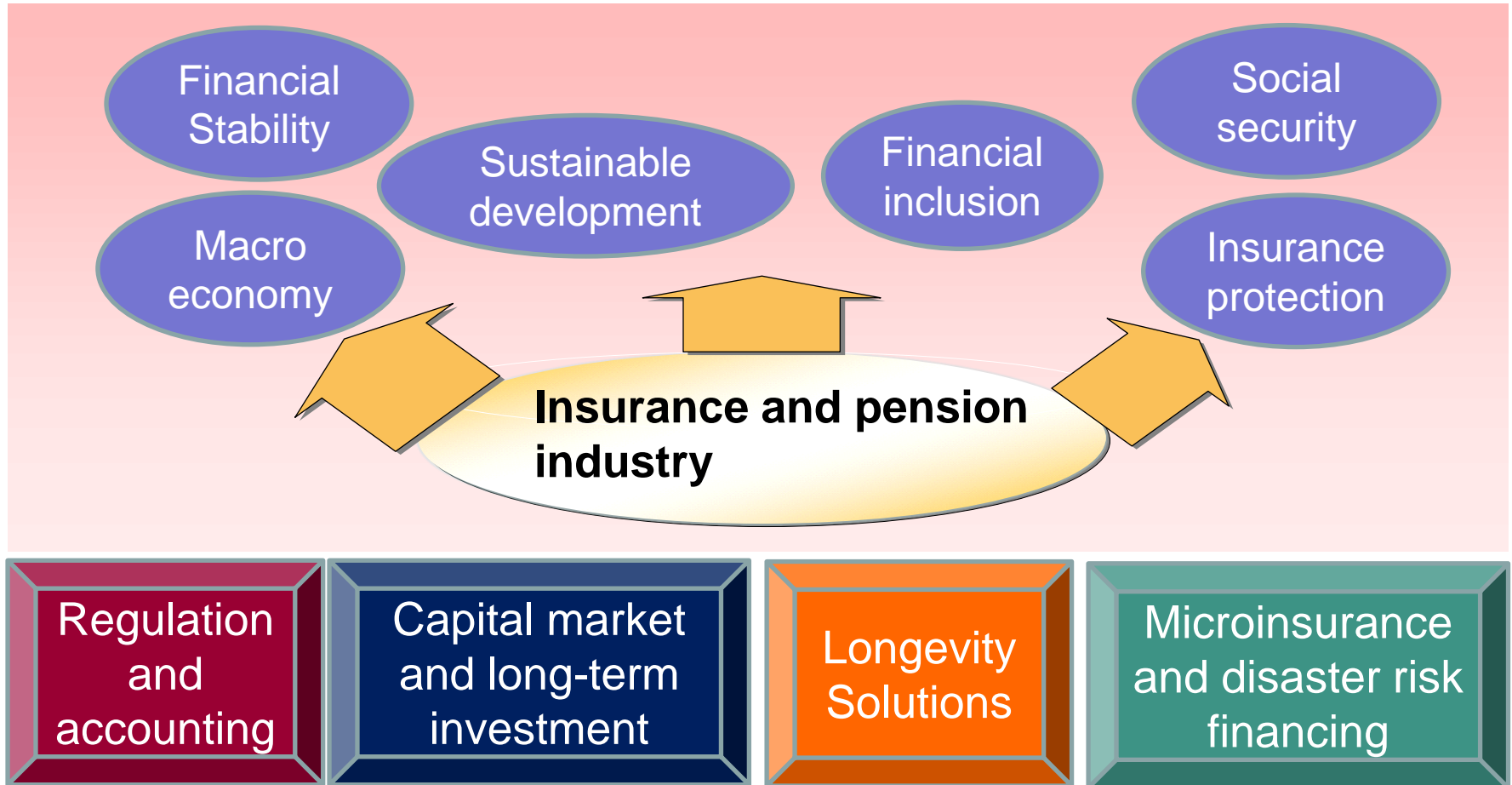
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- **High-level issues and recommendations**

(regulatory, accounting, market and operational issues) as a basis for discussion with policymakers and regulators

# 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



## Composition of the workstream

- Participants include experts from the insurance, pensions and financial industries, academic specialists and policymakers and regulators
  - Participants (as of 1 October 2014): Nippon Life ([Sherpa](#)), Jardine Matheson ([Vice Sherpa](#)), ADB, AIA Group, ASEAN Insurance Council/WanaArtha Life, ASEAN Secretariat, Asociación de Aseguradores de Chile, Association of Insurance Supervisory Authorities of Developing Countries/Association of Insurers and Reinsurers of Developing Countries, Australian APEC Study Centre at RMIT University, Australian Super, Australian Treasury ([liaison with G20 Australian Presidency](#)), Barnert Global([regulatory and microinsurance](#)), Canadian Pension Plan Investment Board Asia, Cathay Life, Citigroup, Great Eastern Life, HK-APEC Trade Policy Study Group, IAG, ING Bank Singapore, International Insurance Society ([special advisor](#)), Life Insurance Association of Malaysia, Manulife, MetLife([capital market](#)), Nomura Securities, OECD ([liaison with Institutional Investors and Long-Term Investment Project](#)), OJK Indonesia, PIMCO, Pramerica Financial Asia([longevity solution](#)), Prudential Corporation Asia, Samsung Life ([accounting, and liaison with AOSSG](#)), Sun Life Financial, Tokio Marine, ASIFMA ([observer and liaison with other relevant worksterams](#))



- Current and future work of the workstream:
  - Active participation in international discussions (providing inputs as needed and appropriate) and dialogue with policy makers and regulators
  - Gap analysis: through a survey and/or case studies on insurance, investment, pensions, accounting, and regulations
  - Collaborate with interested authorities, consultants, and regional/international organizations (i.e. World Bank, OECD, ADB, ASEAN) and other relevant workstreams

## 2014 activities relevant to the workstream

- G20/OECD High-Level Roundtable on Institutional Investors and Long-Term Investment, Singapore, June 4
- OECD Roundtable on Regulatory Factors Affecting Insurer Long-Term Investment, Paris, June 5
- APEC Finance Ministers' Process Seminar on Disaster Risk Financing in the Asia-Pacific Region, Jogjakarta, June 18-19
- APEC/OECD Seminar on Long-Term And Stable Financing for Infrastructure Development, Dalian, June 26-27
- APFF Symposium, Seattle, July 7
- Asia-Pacific Financial Corporation Seminar, Seoul, August 29

## 2014 activities relevant to the workstream (*cont.*)

- ASEAN Insurance Summit, Bali, Singapore, October 1
- OLIS-LIAM-MII Life Insurance Seminar, Kuala Lumpur, October 8
- APFF Conference, Beijing, October 23
- East Asian Insurance Congress, Taipei, November 2-6
- APIP Infrastructure Dialogue and APEC PPP Experts Panel Meeting, Jakarta, November 24
- Dialogue with ASEAN Insurance Regulators, Brunei, November 26
- OECD Roundtable: Long-term Investment, Annuity Regulation and Risk Management, Impact of the Low Interest Rate Environment, Paris, November 26, December 3-4

## 2015 activities relevant to the workstream

- APFF Roundtable on regulatory issues, Hong Kong, January 27
- APEC PPP Experts Advisory Panel Meeting, Clark SEZ, Philippines, February 9-10
- Asia-Pacific Inclusion Forum – Micro-insurance and disaster risk finance sessions, Tagaytay City, March 16-18
- ABAC meeting, open to possible APFF insurance-related event, Mexico City, April 20-23
- APEC Financial Ministers Process Infrastructure Financing Seminar, Legazpi City, Philippines, July 23-24
- ABAC meeting, possible APFF event/open to possible retirement income-related event, Melbourne, August 10-13
- APEC Finance Ministers Meeting – open to possible APFF event, Cebu, Philippines, September 9-11

### ■ 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

### ■ Insurers are not like banks

- Different business models
- Different regulatory models

Relative importance of risk management for insurers, and that of capital requirements for banks



# Constraints and recommendations

## Bank-centric regulations

- **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**

# Constraints and recommendations

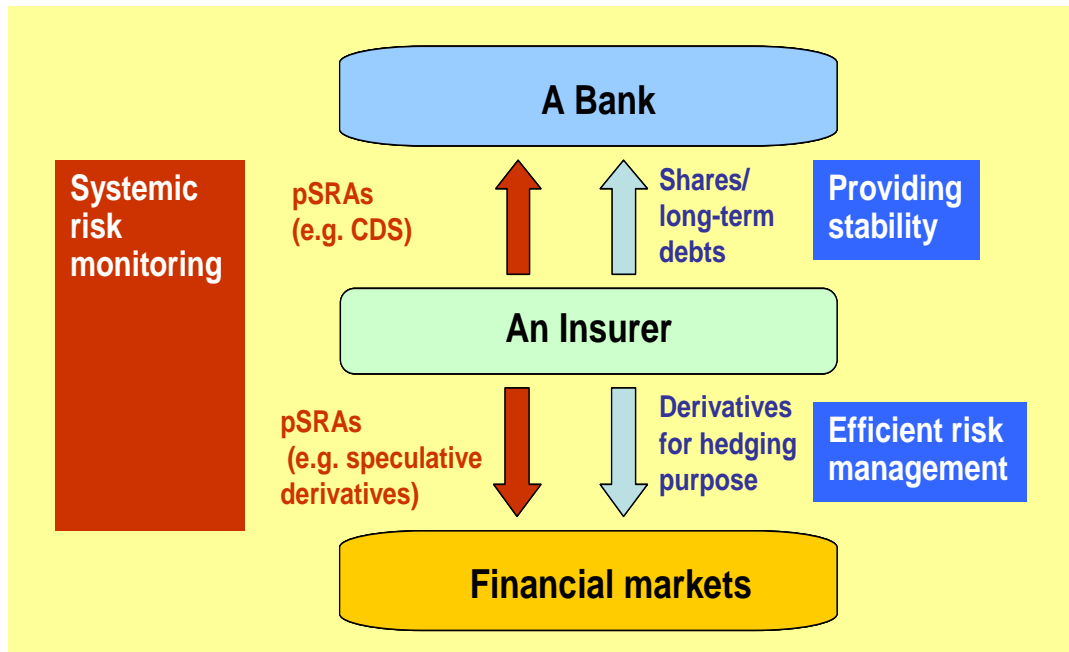
## Bank-centric regulations (*Cont.*)

- **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



(Note:pSRAs = potentially systemically risky activities)





- **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



(Photo – Santiago, Chile)

# 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

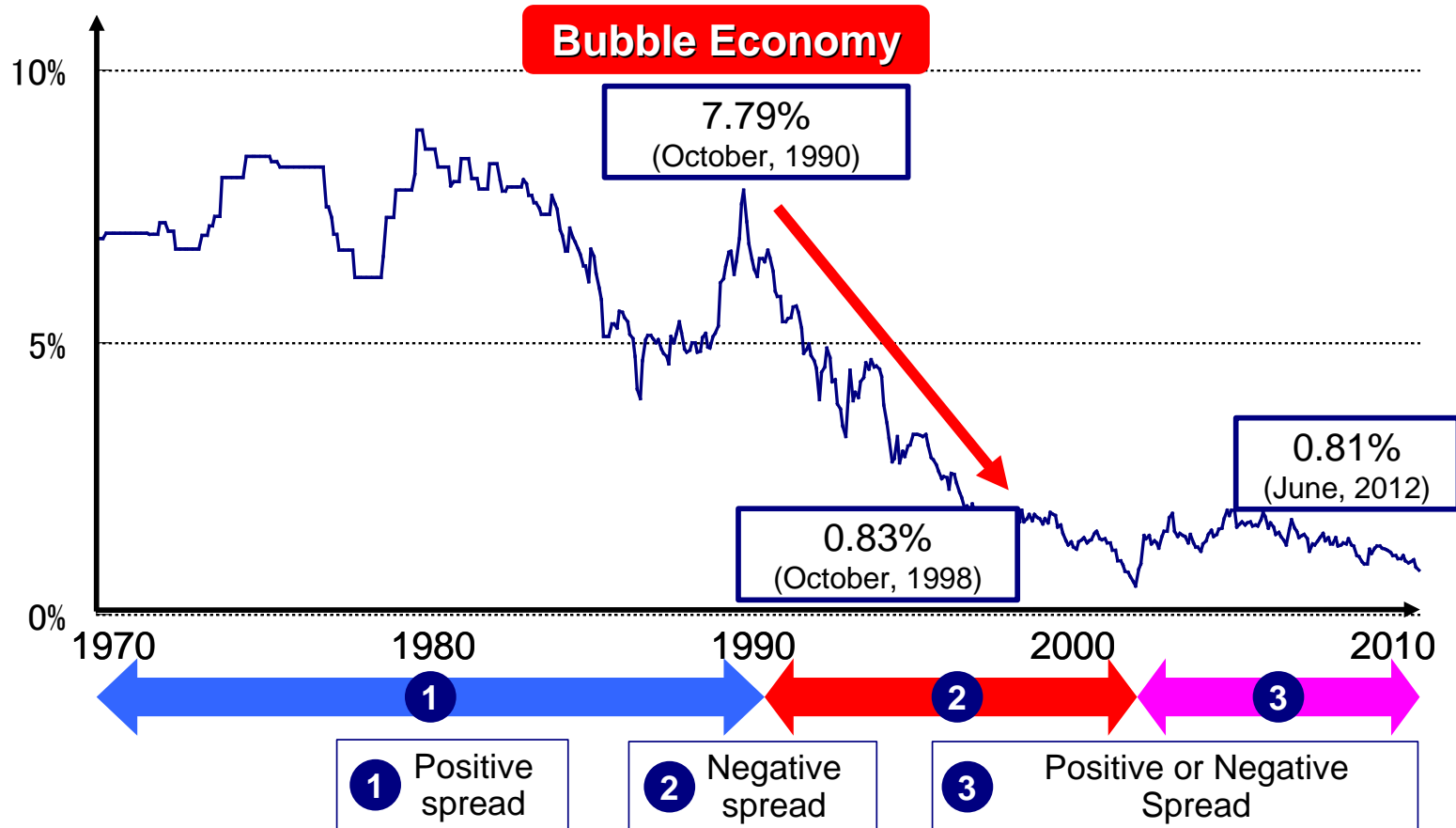
## Short-term oriented economic regime (*cont.*)

- **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  
(See also Accounting issues)

# Lesson from Japan - Negative spread problems in 1990s

- After the collapse of the bubble economy, Japan experienced a long-lasting, severe investment environment with low interest rates and poor performing stock prices. This, combined with a market dominated by long-term insurance products with high guaranteed returns, led to negative spread problems in the mid 1990s, although most Japanese life insurers endured the severe business environment.

## 10-year Interest Rate in Japan



(Source – Nippon Life Insurance Company)

# Lesson from Japan -Recovery from negative spreads

- After more than a decade struggle, negative spread problems almost overcome:  
**Investment return > Average guaranteed interest rate**

## Measures to reduce Negative Spread

Reduced  
guaranteed  
interest rate

Secured  
mortality  
profit

Reduced  
expenses

Changed investment  
strategies, and  
enhanced risk  
management

Accumulated  
additional policy  
reserves and  
enhanced capital

- For the purpose of internal management, both an RBC model (**early warnings**) and an economic model (**long-term vision**) were developed and used.

## Regulatory Requirements and Internal Management

### Regulatory Requirements

RBC model

- Ordering early remedial actions
- Confirming whether business activities can be continued for one year

### Early warnings

RBC model

- Assessing the amount of risk stricter than regulation requires

### Long-term vision

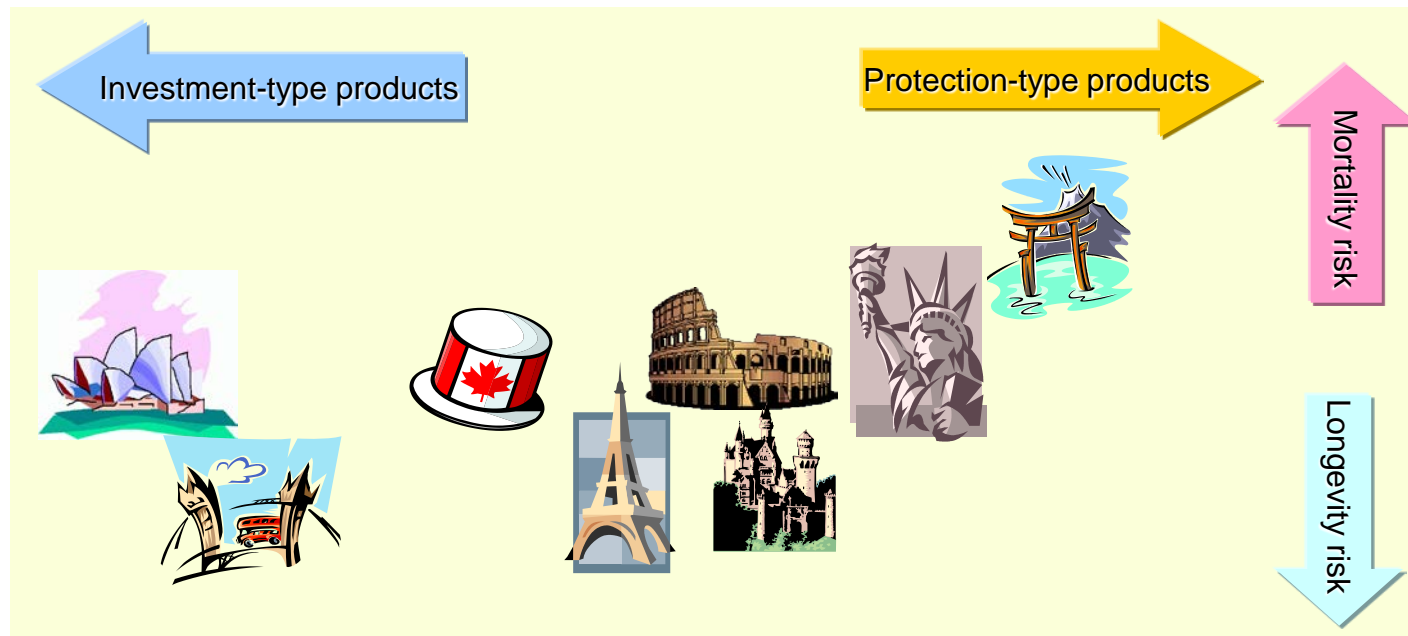
Economic model

- Ensuring appropriateness of ALM policies from medium- and long-term perspectives

Internal  
Management

## Regulatory issues "One-size-fits-all" models

- **"One-size-fits-all"** models would not work
- Different business models by jurisdiction
  - Consumers' **risk preference**
  - **Expected roles** of the insurers
  - State of **development of financial markets**



# 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



# Constraints and recommendations

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

- **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





## ■ Volatility in the balance sheet

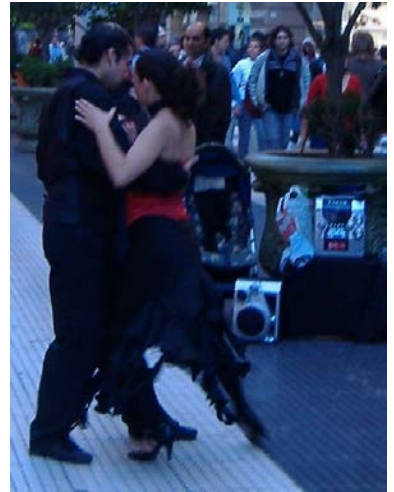
- Short-term fluctuation should be avoided
  - Assets-liabilities interaction should be reflected for a wide range of products sold in the region
  - Discount rate should reflect the business model

## ■ 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



(Photo – Buenos Aires, Argentina)

# Lesson from Japan - Treatment of future profits/expenses

- As a result of the inconsistent treatment between treatment of changes in estimated cash flows and that of discount rates, economic realities would not be presented on the balance sheet when applying the 2013 ED proposals over a long period. It would be particularly misleading for users to apply the proposals retrospectively at transition, presenting unrealized profits/expenses separately on the balance sheet.

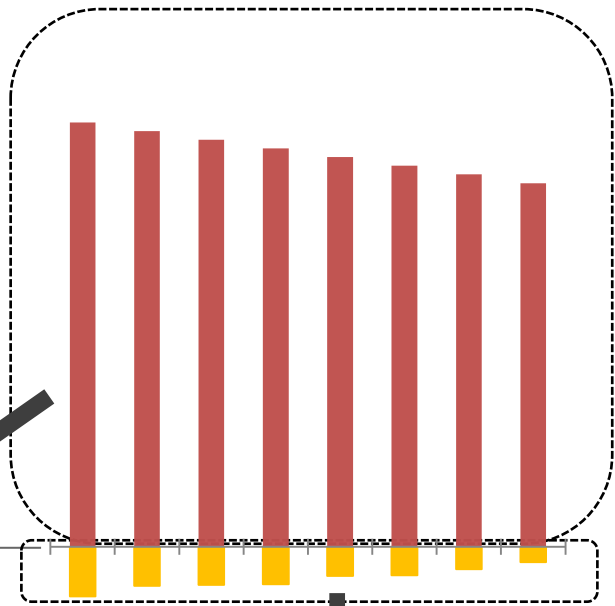
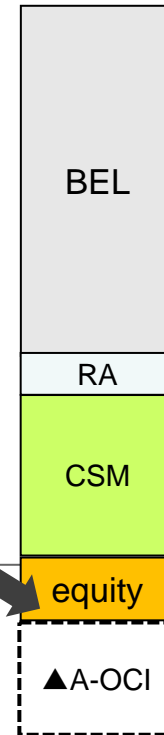
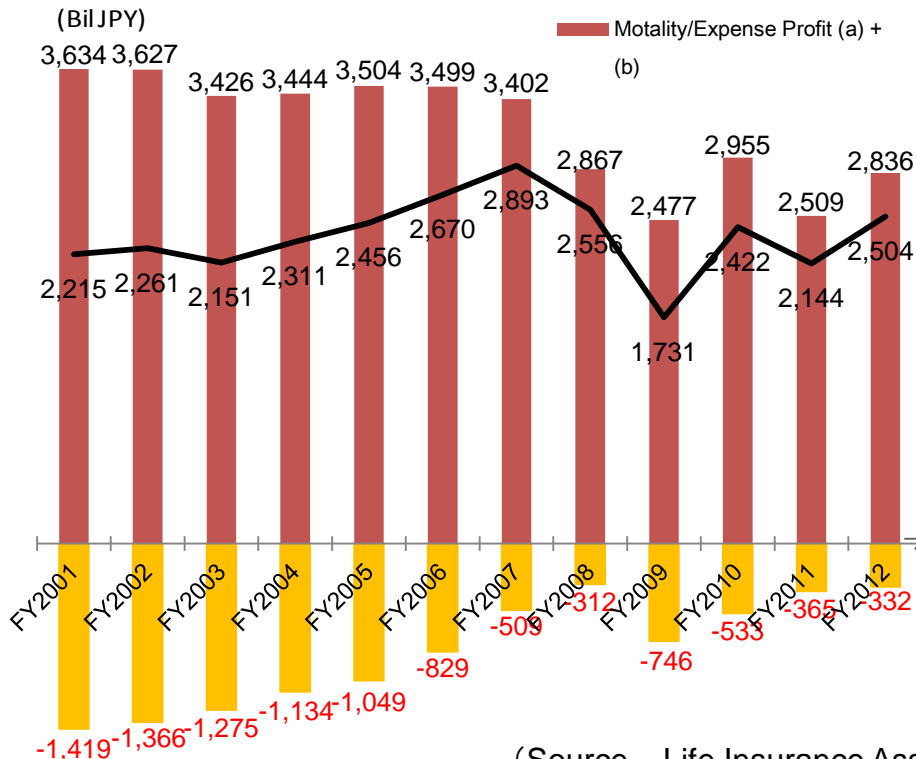
Realized profit before transition

At transition

Unrealized profit after transition

Total gain from 3 profit sources goes to retained earnings in equity

PV of mortality and expense gain goes to CSM



PV of expected investment loss from negative spread goes to negative A-OCI in equity

(Source – Life Insurance Association of Japan)

## 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)

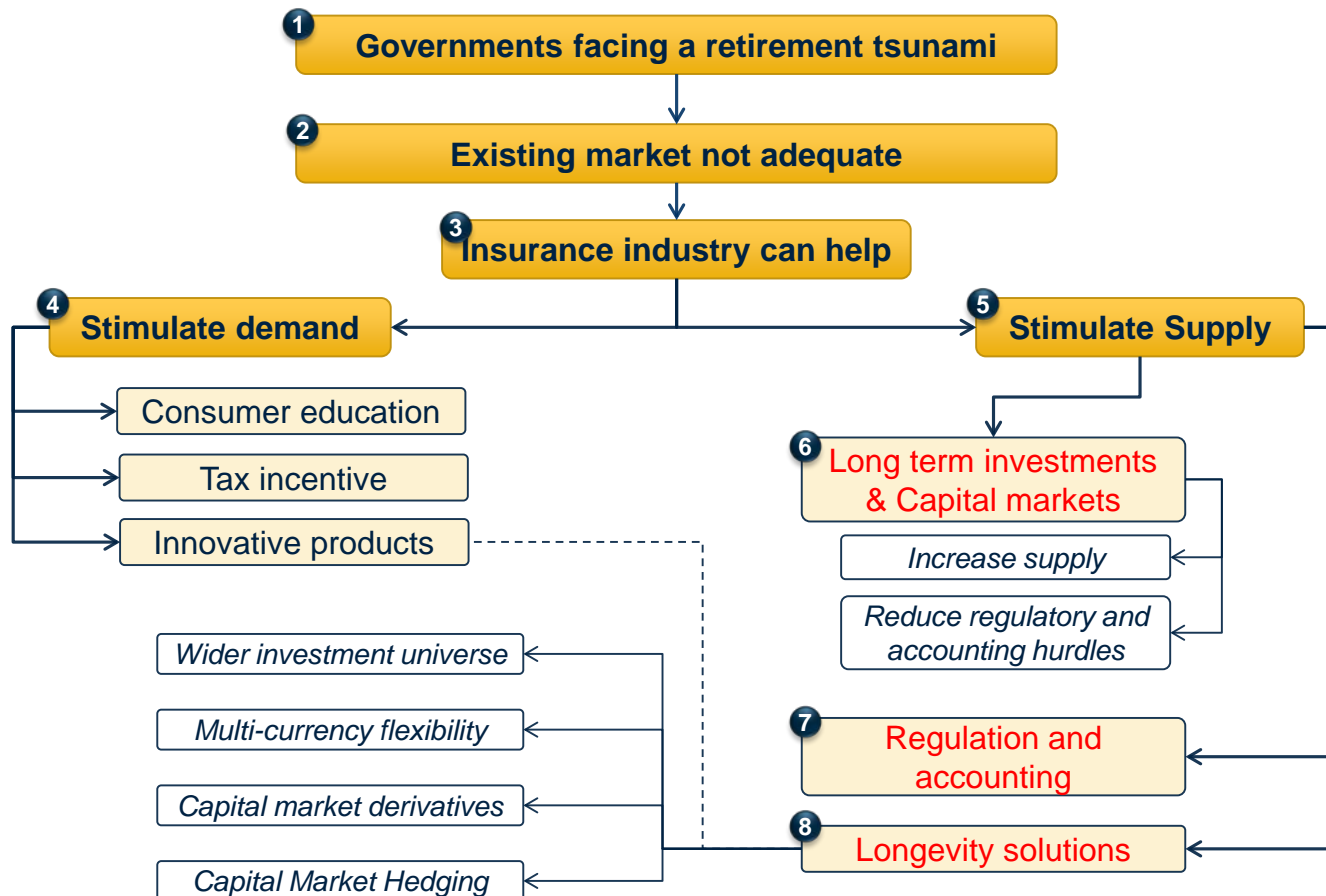


(Photo – Auckland, New Zealand)

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

- 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



- **Have a holistic vision**
- **Be aware that the world is cyclical**
- **Don't go to the extreme, otherwise you will fall**
  - Bring the balance of yin and yang to the universe
- **In order to manage the world, you should control yourself**
  - In order to implement international standards, you should first know your own country



(Photo – Tao Garden, Chang Mai, Thailand)

# Overview of the work of the Asia Pacific Financial Forum (APFF) Insurance and Retirement Income Work Stream

Makoto Okubo, Nippon Life Insurance Company



The screenshot displays the MackGlobe.com website. At the top, there is a search bar and a navigation menu with options: Home, Insurance/Finance, Language/Essays, Travel/Photography, and Theater/Entertainment. Below the navigation is a large banner image of a sunset over a body of water with silhouettes of trees and structures. The main content area is divided into three columns. The left column features a 'Asia-Pacific' section with a globe icon and a sub-section for 'Insurance/Finance'. Below this is a 'Recent Posts - Asia Pacific' section with two bullet points: 'APEC Finance Ministers officially endorsed the APFF interim report, Beijing, October 22, 2014' and 'Mack participated in the ASEAN Insurance Summit in Singapore, October 1, 2014'. The middle column contains two main articles. The top article is titled 'APEC Finance Ministers officially endorsed the APFF interim report, Beijing, October 22, 2014' and includes a 'Read more' button. The bottom article is titled 'Mack participated in the ASEAN Insurance Summit in Singapore, October 1, 2014' and also includes a 'Read more' button. The right column has three sections: 'Members Only' with a list of 'APFF Insurance and Retirement Income Workstream' and 'ABAC PWG'; 'Resources' with a list of 'National Center for APEC: The 2014 Asia Pacific Financial Forum' and 'ABAC (APEC Business Advisory Council)'; and 'Links' with a list of 'Insurance-Finance.Com - Mack's comprehensive research site on insurance and finance'.

Any questions? email to [m-okubo@nliinter.com](mailto:m-okubo@nliinter.com)  
or visit [mackglobe.com](http://mackglobe.com)