



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**

**For OECD Roundtable on annuities  
regulations and risk management**

Paris, December 3 2014

Makoto (Mack) Okubo 大久保 亮

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*

- 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

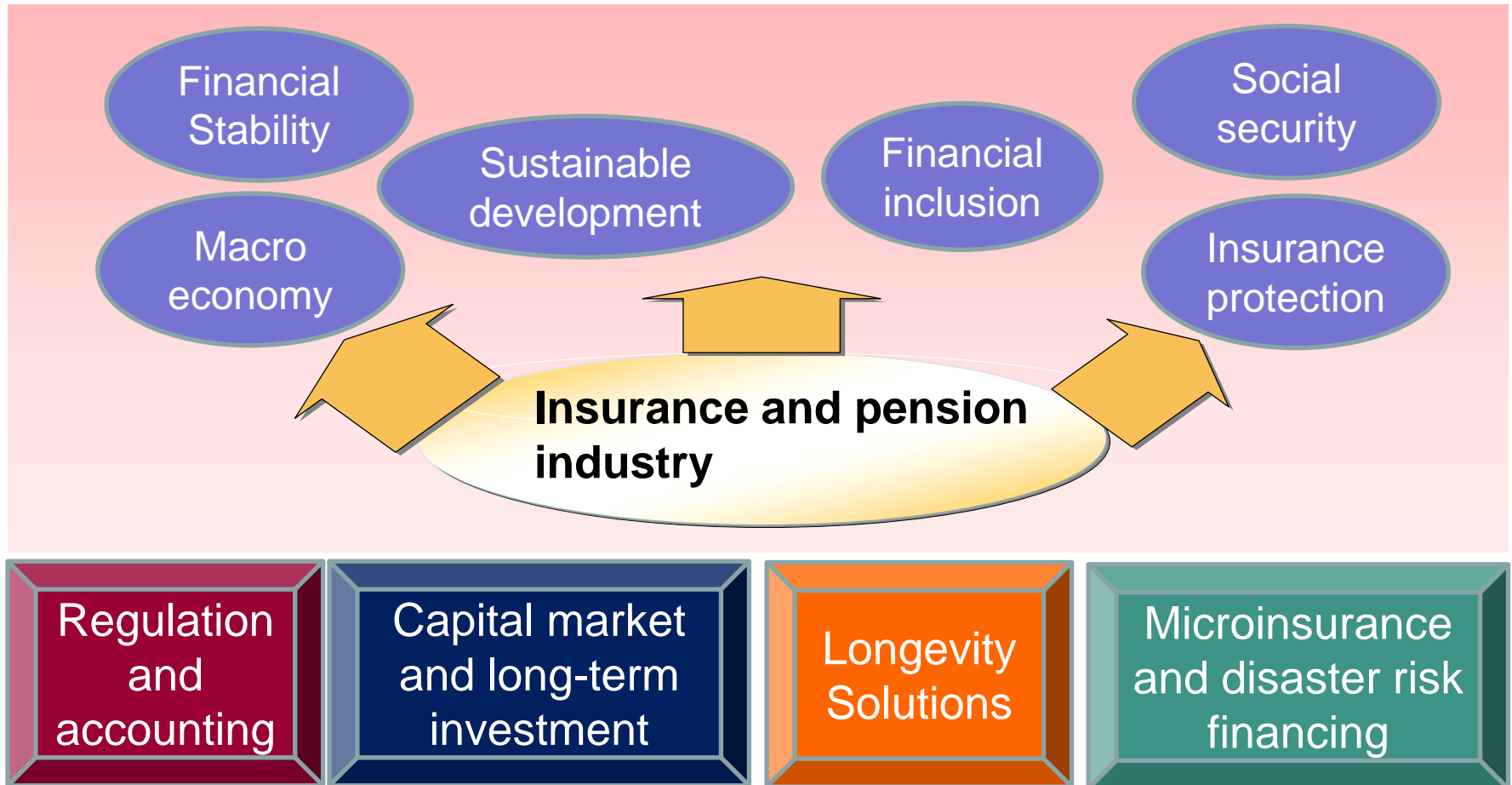
<https://www.abaonline.org/v4/download.php?ContentID=22611898>

- **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



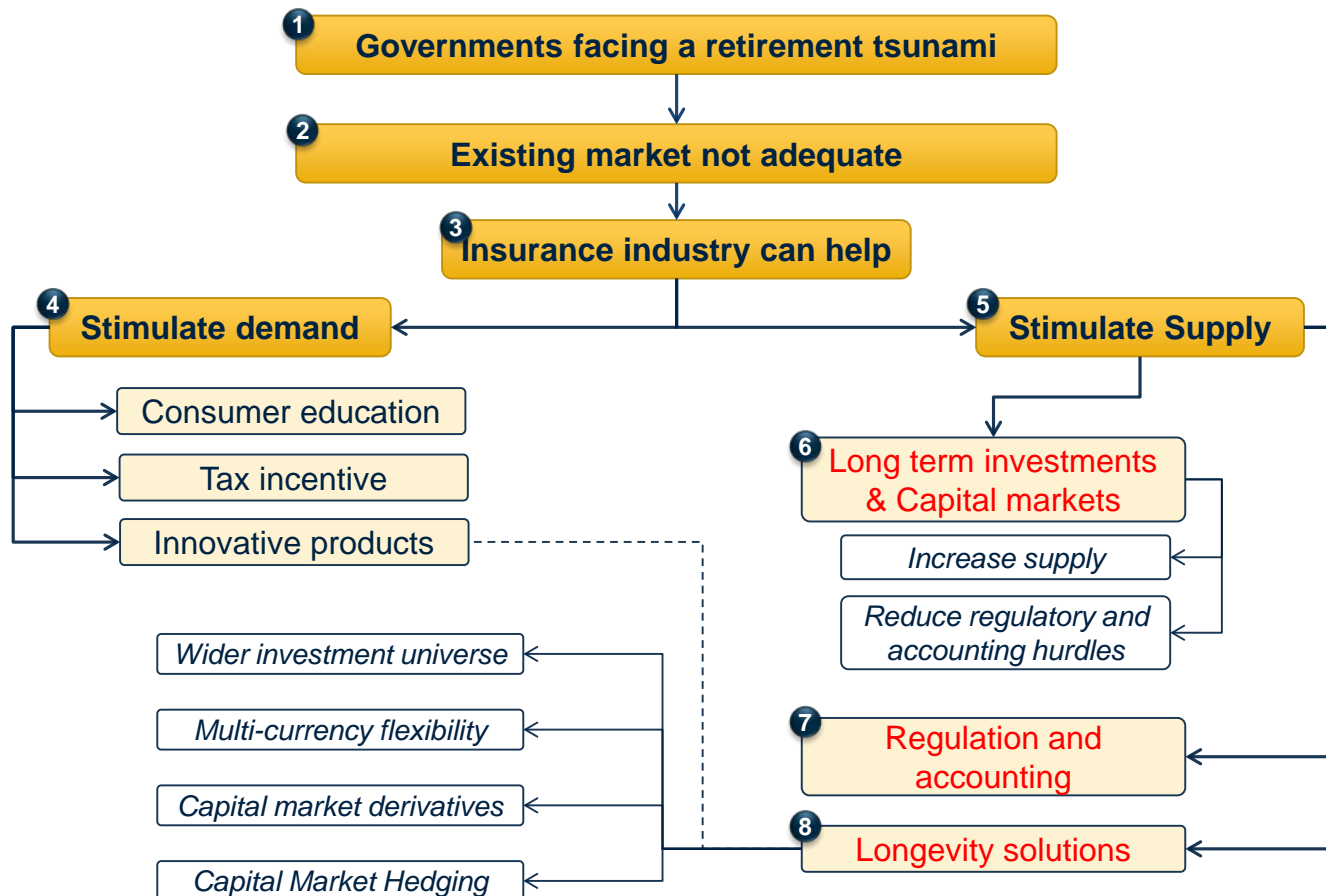
# Composition of the workstream

- 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](#))

# The work on longevity solution

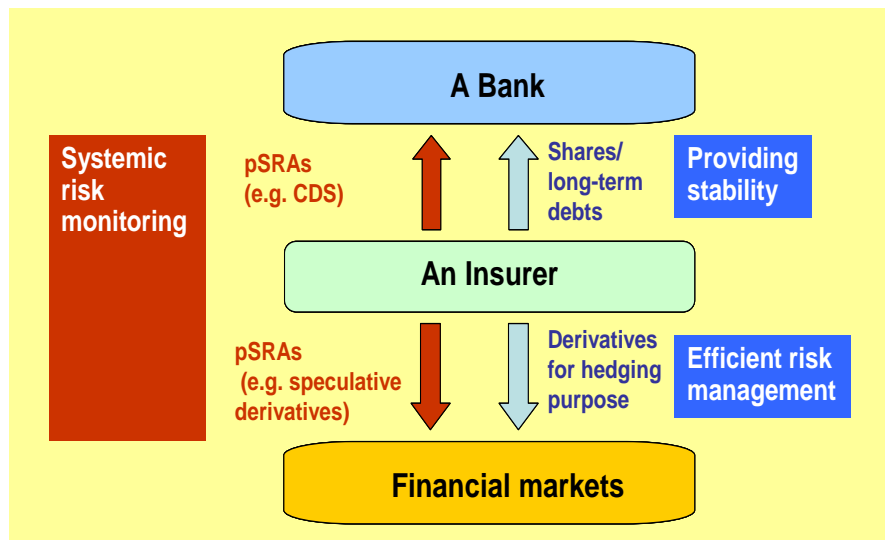
- The work on longevity solution will focus on addressing demand- and supply-side issues in the development of lifetime retirement income solutions

Figure: Interrelated Issues in Providing Lifetime Retirement Security





- 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



(Photo – Sydney, Australia)

(Note:pSRAs = potentially systemically risky activities)

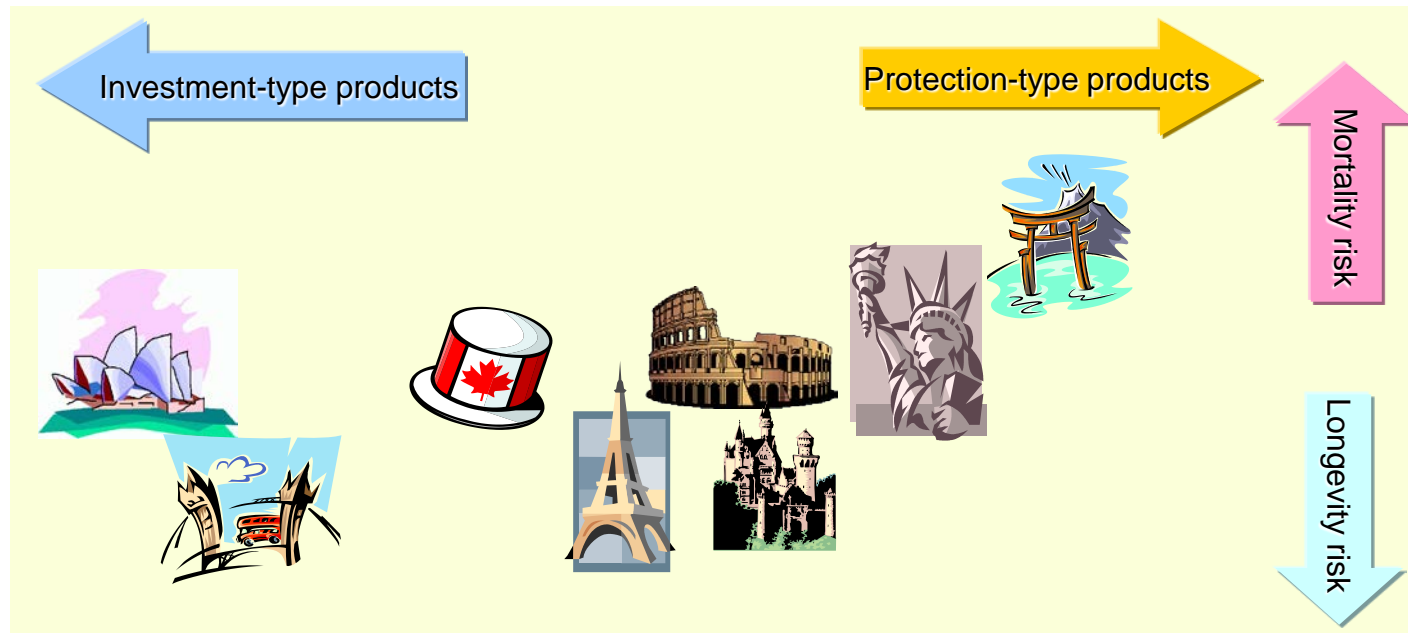
- **Economic-based regime should have a long-term vision**
- **If a short-term-minded economic regime were implemented**
  - **Significant volatility** for long term products
  - Driven to transfer risks over to customers
  - Refrain from investing in non-fixed income assets



(Photo – Santiago, Chile)

## 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



## ■ Volatility in the balance sheet

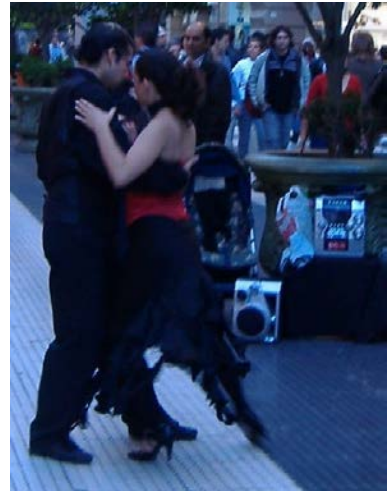
- Short-term fluctuation should be avoided
  - Assets-liabilities interaction should be reflected for a wide range of products sold in the region
  - Discount rate should reflect the business model

## ■ 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)

## 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***

# 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 interface. At the top, the site name 'MackGlobe.com' is on the left, and a search bar is on the right. Below the header is a large banner image of a sunset over a body of water with silhouettes of trees and structures. A navigation menu below the banner includes: Home, Insurance/Finance, Language/Essays, Travel/Photography, and Theater/Entertainment.

**Asia-Pacific**



A section on Asia-Pacific region, including Asia Pacific Financial Forum (APFF)

This is a sub-section under

- Insurance/Finance

**Recent Posts – Asia Pacific**

- APEC Finance Ministers officially endorsed the APFF interim report, Beijing, October 22, 2014
- Mack participated in the ASEAN Insurance Summit in Singapore, October 1, 2014

**APEC Finance Ministers officially endorsed the APFF interim report, Beijing, October 22, 2014**

APEC Financial Ministers officially endorsed the ABAC report, including the APFF interim report as annex, during the APEC Finance Ministers Meeting that took place on October 22 in Beijing. Please see the following statements: 1. Joint Ministerial Statement (See para...

[Read more →](#)

**Mack participated in the ASEAN Insurance Summit in Singapore, October 1, 2014**

The ASEAN Insurance Council (AIC), with the support of the ASEAN Secretariat, organized the inaugural ASEAN Insurance Summit, which was held at the Marina Bay Sands, Singapore on Wednesday, October 1, 2014. Centred around the theme of "ASEAN Economic Community...

[Read more →](#)

**Members Only**

- APFF Insurance and Retirement Income Workstream
- ABAC PWG

**Resources**

- National Center for APEC: The 2014 Asia Pacific Financial Forum
- ABAC (APEC Business Advisory Council)

**Links**

- 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)

# APPENDIX

## **An excerpt from “Structure and types of guarantees and risk management of annuity products”**

prepared by Makoto Okubo for the OECD  
Roundtable on annuities, December 6, 2012, Paris



# Variable annuity market in Japan

- Variable annuity market rapidly grew through bancassurance, matured with diversified products, and dropped after the Lehman shock.

**October 2002**  
Bancassurance permitted for individual annuities

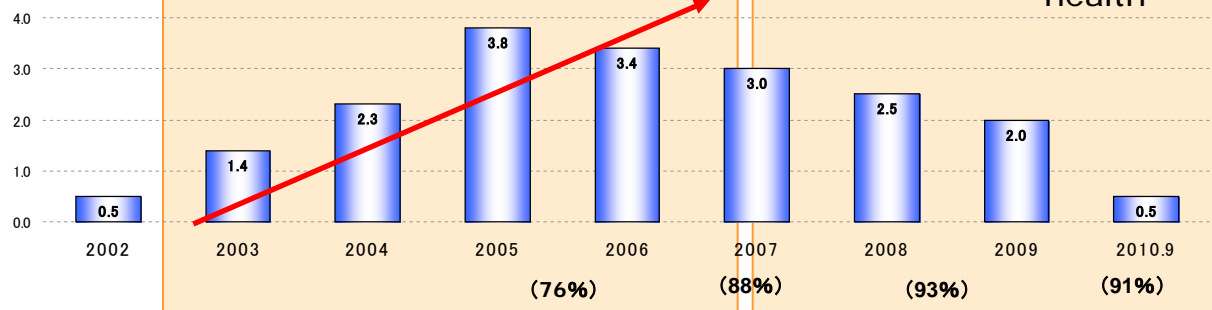
**October 2004**  
Introduction of technical reserving rules

**December 2005**  
Bancassurance permitted for whole life and endowment

**December 2007**  
Financial Instruments and Exchange Act  
**December 2007**  
Bancassurance permitted for health

**September 2008**  
Lehman shock

**New Business Issued trillion JPY**  
(principal guaranteed %)



(76%) (88%) (93%) (91%)

(98%) (99%) (97%)

Market rapidly growing through principal-guaranteed products

Matured market and product diversification

Lehman shock and focus on risk management



# Product trends and type of guarantees in Japan

- After 2005, products with various guarantee features emerged
- After Lehman shock, rebalancing asset allocation became popular

2002      2003      2004      2005      2006      2007      2008      2009      2010.9

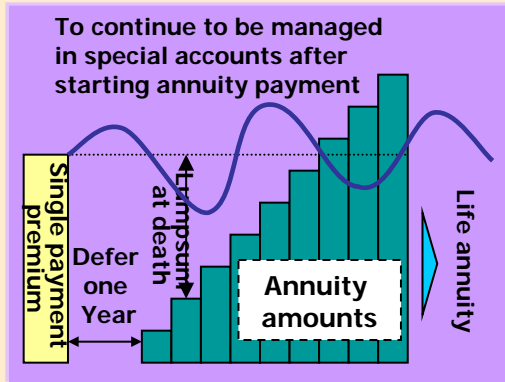
Market rapidly growing through principal-guaranteed products

Matured market and product diversification

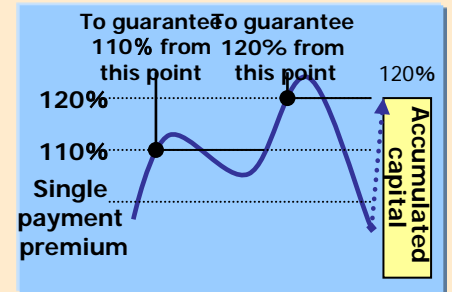
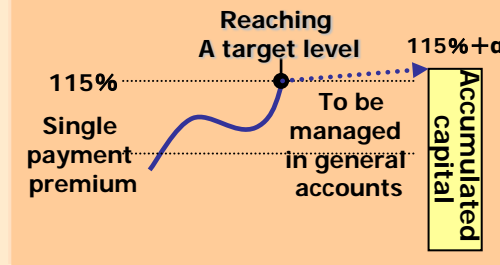
Lehman shock and focus on risk management

Guaranteed minimum accumulation benefit(GMAB) at age 90

GMAB (10 years ⇒ shorter) / Guarantee for total annuities amount



Target function



GMAB Step-up function (Ratchet)

Needs

Accumulate the funds

Receive annuities

Pass assets to heirs

Immediate life annuities (Fixed / Roll-up / Step-up)

Guaranteed minimum death benefit (Principal / Roll-up / Step-up)

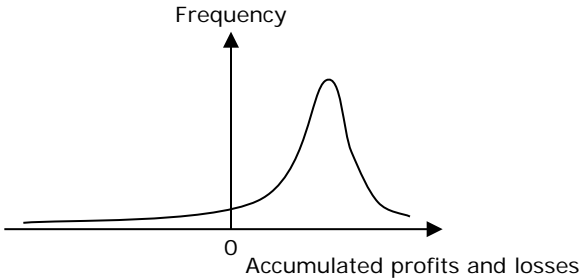
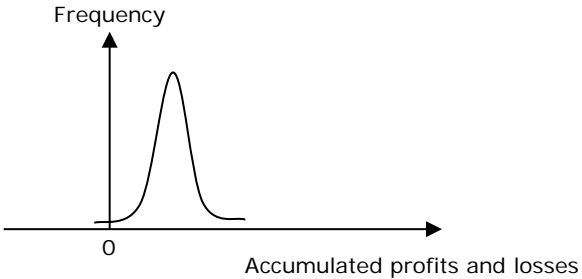
Investment funds

Customers can select freely among funds

Fixed allocation funds

Risk management type funds (Rebalancing asset allocation based on investment environment)

# Risk profiles of variable and fixed annuities

|                            | Variable annuities   | Fixed annuities   |
|----------------------------|--|---|
| Profit & loss distribution | <ul style="list-style-type: none"> <li>At the time of good performance, profits would be within the level of expenses</li> <li>At the time of bad performance, losses would occur with minimum guarantee</li> </ul>  | <ul style="list-style-type: none"> <li>Risk would be reduced with matching, but profitability might be limited as assumed interest rate and market rate are linked each other.</li> </ul>  |
| Insurance risk             | <p style="text-align: center;">☹️</p> <p>[ At the time of bad performance, some risk may arise with minimum death guarantee ]</p>  | ☺️  |
| Lapse risk                 | <p style="text-align: center;">☹️</p> <p>[ If lapse decreases at the time of bad investment performance, minimum guarantee risk may be increased ]</p>   | <p>Without MVA - ☹️</p> <p>With MVA - ☺️</p>  |
| Investment risk            | <p>With guarantee - ☹️</p> <p>Without guarantee - ☺️</p>   | <p style="text-align: center;">☹️</p> <p>[ Matching and change in assumed interest rate may limit investment risk ]</p>   |
| Matching                   | <p style="text-align: center;">☹️</p> <p>[ Hedging is possible but some risk may arise by policyholder behavior (switching) ]</p>  | ☺️  |

# Risk management approaches for variable annuities

| Approach   | Effect   | Content  | Issues   |
|--|--|--|--|
| Reinsurance  | Possible to increase sales                       | <ul style="list-style-type: none"> <li>• Cession to parent companies, etc.</li> </ul>  | <ul style="list-style-type: none"> <li>• Risk retained within the group</li> </ul>   |
|  |  | <ul style="list-style-type: none"> <li>• Cession to external reinsurance companies</li> </ul>  | <ul style="list-style-type: none"> <li>• Counterparty risk</li> <li>• Reinsurance cost</li> </ul>  |
| Hedging  | No reinsurance cost needed                       | <ul style="list-style-type: none"> <li>• Derivative transactions                             <ul style="list-style-type: none"> <li>➤ Exchange forward contracts, stock index futures, etc.</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>• Risk tolerance (not risk free)</li> <li>• Fluctuation in hedging cost</li> <li>• Administrative burdens</li> </ul>                  |
| Conversion to fixed annuities<br>(Knock-out provision)           | Prevent further risk expansion                   | <ul style="list-style-type: none"> <li>• Convert to general account management in case a unit price goes under pre-determined level</li> </ul>   |  |
| Restriction in switching   | Restrict risk expansion by policyholder behavior | <ul style="list-style-type: none"> <li>• Limit the number of switching in a year</li> </ul>  |  |
| Change in investment allocation                                  | Restrict risk fluctuation                        | <ul style="list-style-type: none"> <li>• Increase a weight for JPY denominated fixed income assets</li> </ul>  | <ul style="list-style-type: none"> <li>• Need to consider rebalancing in case interest rates increase</li> <li>• Need to limit sales volume due to residual risks</li> </ul> |
| Increasing insurance-related expenses<br>(raising premium rates) | Restrict risk expansion                          | <ul style="list-style-type: none"> <li>• Increase the cost of minimum guarantee included in insurance-related expenses</li> </ul>  | <ul style="list-style-type: none"> <li>• Decline in price competitiveness</li> <li>• Limited impact at the time of financial turmoil</li> </ul>                              |
| Limit sales volume   | Restrict risk retention level                    | <ul style="list-style-type: none"> <li>• Suspend sales in case the sales volume exceed expectations</li> </ul>   | <ul style="list-style-type: none"> <li>• Depending on other risk mitigation tools (reinsurance, hedging, etc.)</li> </ul>  |

# Annuities/pension system in Japan and longevity risk

- The public pension provides a whole life annuity and the corporate pension provides a supplement in the form of a lump sum retirement payment or fixed-term annuity
- Longevity risk is mainly borne by government, employers, and individuals.
- Life insurers are subject to longevity risk, in case where the option for whole life annuity is chosen by policyholders for self-private pension.
- Offsetting longevity risk and mortality risk, Japanese life insurers' exposure to longevity risk is limited, although gradually increasing

| Pension system                 | Typical form of payment                             | Other features  |
|--------------------------------|---|---|
| ① National Pension             | whole life annuity                                  | -   |
| ② Employees' Pension Insurance | whole life annuity                                  | survivor's pension  |
| ③ Corporate Pension            | lump-sum retirement allowance or fixed-term annuity | some companies provide <b>whole life annuities</b> with a guaranteed term             |
| ④ Self-Private Pension         | fixed-term annuity                                  | options for <b>whole life annuity</b> with guaranteed term and lump-sum are available |