Solvency Supervision in Japan
－Experience of Japanese Non-life Insurance Industry－

Hisaya Ishii

Director, Asia Department I

Japan Center for International Finance

Japanese Non-life Insurance Market

- Direct Premium Written   \ 8,748.1 billion
  Automobile Insurance (including Compulsory
  Insurance) accounts for 54.3%. Workers'
  Compensation and Health are Social Insurance.

- Total Assets   \ 32,094.2 billion
- Combined Ratio   88.5%
- Number of Non-life Insurers

  29 Domestic Non-life Insurers + 22 Branches of
  Foreign Non-life Insurers

Characteristics of Japanese Non-life Insurance Market

- Frequent Occurrence of Natural Disasters such as Typhoons and Earthquakes
- Maturity-Refund-Type Insurance
- Few Serious Liability Claims

Background of the Introduction of Solvency Margin Standards by New Insurance Business Law in 1996

- Increase of Asset Management Risks

- Possible Increase of Insurance Underwriting Risks by Expected Deregulation of Insurance Products and Premium Rates

- Banking Sector already had Tier I&II Capital Rules.

Basic Concept for the Calculation of Solvency Margin Ratio

- Risks in excess of Normal Expectations
- Probability Calculation
- Aggregation of Risks:Diminishing Effects

Solvency Margin Ratio (Non-life Insurance)

$$\text{Solvency Margin Ratio} = \frac{\text{Total of Solvency Margin}}{1/2 \times [\sqrt{(\text{Ordinary Insurance Risks})^2 + (\text{Assumed Interest Risks} + \text{Asset Management Risks})^2} + \text{Business Management Risks} + \text{Major Catastrophe Risks}]} \times 100$$

	Ordinary Insurance Risks	Assumed Interest Risks	Asset Management Risks		Major Catastrophe Risks	Business Management Risks	Total of Solvency Margin
			Price Fluctuation, etc. Risks	Credit Risks			
criteria of current Regulations	- Risks of the payment of insurance claims in excess of normal expectations. - The risks shall be deemed to arise from differences between the maximum probable losses and the average loss ratios obtainable with a certain probability according to the statistics of past loss ratios by types of business.	- Risks of invested assets failing to secure required yields corresponding to assumed rates of interest. - The risks shall be calculated by applying the amount of underwriting reserves in each category of interest to the probability of assumed rates of interest causing a back spread considering the past development of indexes.	- Risks of retained securities and other assets fluctuating in prices in excess of normal expectations. - Risks arise from yields in each type of investment being lower than normal expectations (with a 90% probability) on the basis of indexes in the past 10 years and more. **Subsidiaries, etc. Risks** - The risks shall be deemed to arise from investments, etc. in subsidiaries, etc. - The measurement of risks of investments in or loans to subsidiaries shall be made according to the types of subsidiaries, etc.	- Risks arising from the default, etc. of other parties to the transactions of retained stocks loans and other assets. - Risks are classified according to the creditworthiness of other parties. **Derivative Transaction Risks** - Risks arising from derivative transactions. - Risks shall be deemed to arise from price fluctuations in the balance of transactions at the end of a fiscal year, creditworthiness, etc. **OtherRisks (Reinsurance Risks and Reinsurance Recoverable** - The amount of unestablished underwriting reserves, etc. and a certain percentage of reinsurance recoverable shall be deemed to compose these risks.	- Risks of the occurrence of major catastrophes as a result of natural disasters like earthquakes, windstorms, floods, etc. - The amount of damage caused by an earthquake similar to the Great Kanto Earthquake in scale or a typhoon similar to Typhoon NO. 19 in 1991 in gravity shall be deemed to be the risk.	- Risks arising in excess of normal expectations in connection with the management of business and not falling under any of the above categories. - The risks shall be calculated at a certain percentage of the total of all other risks.	- Net Worth - Shareholders' Equity (Appraisal Gains or Losses excluding Latent Gains) - Special Catastrophe Reserves - Price Fluctation Reserves - General Bad Debt Reserves - 90% of Latent Gains in Securities (100% of Losses) - 85% of Latent Gains in Land (100% of Losses) - Amount Equivalent to the Tax Effects of Retained Earnings - Unallocated Amount of Reserves for Dividends to Members - Subordinated Debts, etc. (with ceiling on inclusion) - Deductions (*) * Intentionally held stocks of subsidiary insurance companies, banks, and securities companies shall be deducted.

Early Warning System

- 200% or more ― No measure
- 100% or more and less than 200% ― Submission and Implementation of Improvement Plan
- 0% or more and less than 100% ― List of Measures to Serve for Improving the Capacity to Pay Insurance Claims
- Less than 0% ― Suspension of Whole or Part of Business for a Fixed Period

Concluding Remarks

- The solvency supervision has turned out much more important than originally expected.
- The liberalization of policy conditions and premium rates requires more rigid solvency supervision.
- Successful Liberalization calls for an adequate regulatory restructuring.
- Good regulation makes a good market.
- There should be considerable grounds for further co-operation and dialogue between supervisors and industry around the world.