

The Life Insurance Association of Japan (LIAJ) comments on “Guidance on Identification of Critical Functions and Critical Shared Services”

Summary

We believe that critical functions should be identified based on whether the disruption of an insurer's activities would cause an adverse impact on the stability of the whole financial system and on the broader economic activity.

This is because we understand that the purpose of developing a resolution plan is to protect "systemically important functions" as described in the "Key Attributes of Effective Resolution Regimes for Financial Institutions", and to avoid the risk that failure or deteriorated business situation of a financial institution adversely affects the financial market and causes failure of the other financial institutions (systemic risk).

We also believe that, regarding the impact on the real economy, "systemically important functions" should be identified when the disruption of functions adversely impact the broader economic activity, rather than when it simply impact third parties or when these functions can hardly be substituted in a timely manner. In regard to functions that disruption of products or services adversely affects only individual economic activities, usually, contingency mechanisms have been put in place in each jurisdiction's legislation in the context of policyholder protection. It should be taken into careful consideration when identifying critical functions that the event would have already been covered by existing systems.

In our opinion, there is no such systemic risk in traditional insurance activities that undermines financial stability, as is also indicated by the IAIS. As far as traditional insurance is concerned, the broader economic activity is materially affected only if, for example, the insurer has a dominant share in insurance market in a specific country. However, this is thought to be an unusual case, considering the fact that fair competition is performed in the relevant market and that other sectors such as banking coexist in the jurisdiction.

We understand by applying the 3 steps to identify critical functions, as the FSB mentioned, the functions which are finally considered critical should be narrowed down. However, this paper does not clearly explain substantiality of insurer's scale or its market share which makes its functions identified as having an adverse impact on the financial system and on the real economy in the application of “firm-specific test”. Examples provided in the guidance are not followed by analysis on this point of view, ending up in listing a wide variety of cases. As a result, it raises a concern that this paper may lead to an excessive enhancement of regulations in the future which requires insurers to develop a resolution plan just because of their large volume of business or large market share.

Questions 1&2 (Definition of critical functions, the scope)

We believe that critical functions should be identified based on whether the disruption of an insurer's activities would cause an adverse impact on the stability of the whole financial system and on the broader economic activity. However, as we mentioned in response to Question 3, the definition and the scope of critical functions are very ambiguous due to the lack of clear criteria for identifying critical functions.

Question 3 (Methodology for identifying critical functions)

As we stated in response to Questions 1 and 2, we believe that critical functions should be identified based on whether the disruption of an insurer's activities would cause an adverse impact on the stability of the whole financial system and on the broader economic activity.

However, this paper does not clearly explain substantiality of insurer's scale or its market share which makes its functions identified as having an adverse impact on the financial system and on the real economy in the application of "firm-specific test", and there remains a concern about whether the identified critical functions will be appropriately limited.

Question 4 (Categories of critical functions)

We believe that critical functions should be identified based on whether the disruption of an insurer's activities would cause an adverse impact on the stability of the whole financial system and on the broader economic activity. This paper does not clearly explain substantiality of insurer's scale or its market share which makes its functions identified as having an adverse impact on the financial system and on the real economy in the application of "firm-specific test". Also, examples provided in the guidance are not followed by analysis on this point of view, ending up in listing a wide variety of cases.

Question 5 (Methodology for identifying critical shared services)

Although we do not have specific objection to the methodology itself for identifying critical functions, as we stated in response to Questions 1 and 2, functions other than those which adversely impact the stability of the financial system and the broader economic activity should not be included in critical functions.

Questions 6&7 (Whether the framework is flexible enough to cover the different types of business by G-SIIs, whether the non-prescriptive lists are helpful, and whether the framework is flexible enough to take account of the whole environment in which failure is occurring)

As we responded to Questions 1 and 2, we believe that critical functions should be identified based on whether the disruption of an insurer's activities would cause an adverse impact on the stability of the whole financial system and on the broader economic activity.

Question 8 (Issues in relation to critical functions and critical shared services that it would be

helpful to clarify in further guidance)

No comment.