National Association of Insurance Commissioners

Summary of Findings and Determination

Japan:
Financial Services Agency (FSA)

Evaluation of Reciprocal Jurisdiction

Approved By:

Qualified Jurisdiction (E) Working Group	November 5, 2019
Reinsurance (E) Task Force	December 8, 2019
Executive (EX) Committee and Plenary	December 10, 2019

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I. Evaluation of Japan as Reciprocal Jurisdiction

The Qualified Jurisdiction (E) Working Group of the National Association of Insurance Commissioners (NAIC) has completed this *Summary of Findings and Determination* with respect to the evaluation of the Financial Services Agency (FSA), the lead insurance regulatory supervisor for Japan, as a Reciprocal Jurisdiction. It is the recommendation of the Working Group that the NAIC approve the FSA as a Reciprocal Jurisdiction and place it on the *NAIC List of Reciprocal Jurisdictions*, to be effective as of January 1, 2020. Further, the Working Group recommends that California be the Lead State for purposes of regulatory cooperation and information sharing with the FSA. These recommendations are based on the following analysis:

II. Procedural History

On September 22, 2017, the United States and the European Union (EU) entered into the "*Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance*." A similar agreement with the United Kingdom (UK) was signed on December 18, 2018. Both agreements (collectively referred to as the "Covered Agreements") will require the states to eliminate reinsurance collateral requirements for reinsurers licensed and domiciled in these jurisdictions within 60 months (five years) after signing or face potential federal preemption by the Federal Insurance Office (FIO) under the Dodd-Frank Act.

The NAIC adopted revisions to the *Credit for Reinsurance Model Law* (#785) and *Credit for Reinsurance Model Regulation* (#786) (collectively, the "Credit for Reinsurance Models") on June 25, 2019, to recognize a new designation of "Reciprocal Jurisdiction" under which certain reinsurers licensed and domiciled in Reciprocal Jurisdictions are not required to post reinsurance collateral. A Qualified Jurisdiction which meets certain additional requirements described in the Credit for Reinsurance Models may be determined to be a Reciprocal Jurisdiction under the revised Credit for Reinsurance Models.

A list of Reciprocal Jurisdictions will be published through the NAIC committee process. Jurisdictions subject to an in-force Covered Agreement and states that meet the requirements of the NAIC Financial Standards and Accreditation Program are automatically included on the *List of Reciprocal Jurisdictions*. A state must consider this list in its determination of Reciprocal Jurisdiction status, and if the state approves a jurisdiction not on this list, the state must thoroughly document the justification for approving this jurisdiction in accordance with the standards for approving Reciprocal Jurisdictions contained in the Credit for Reinsurance Models

On October 22, 2019, the Reinsurance (E) Task Force updated and revised the *Process for Evaluating Qualified and Reciprocal Jurisdictions* to specify how Qualified Jurisdictions that recognize key NAIC solvency initiatives, including group supervision and group capital standards, and also meet the other requirements under the revised Credit for Reinsurance Models, will be recognized as Reciprocal Jurisdictions and receive similar treatment as that provided under the EU and UK Covered Agreements, including the elimination of reinsurance collateral and local presence requirements by the states.

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III. Japan's Status of a Qualified Jurisdiction

A Qualified Jurisdiction may not be reviewed for inclusion on the *NAIC List of Reciprocal Jurisdictions* unless it remains in good standing with the NAIC as a Qualified Jurisdiction. On December 16, 2014, the NAIC approved the FSA as a Qualified Jurisdiction and placed it on the *NAIC List of Qualified Jurisdictions*, to be effective as of January 1, 2015. This designation as a Qualified Jurisdiction was to be valid for five years (absent a material change in circumstances) ending on December 31, 2019, after which the FSA would be re-evaluated.

The Working Group met in regulator-to-regulator session on October 7, 2019 and re-approved the FSA as a Qualified Jurisdiction. The Reinsurance (E) Task Force is expected to approve the re-evaluation of the FSA as a Qualified Jurisdiction, which is expected to be confirmed by the NAIC Executive (EX) Committee and Plenary at its 2019 Fall National Meeting. This *Summary of Findings and Determination* with respect to the FSA as a Reciprocal Jurisdiction is expressly made contingent upon the NAIC's re-approval of the FSA as a Qualified Jurisdiction.

IV. Written Confirmation

In making its recommendation with respect to whether a Qualified Jurisdiction that is not automatically designated as a Reciprocal Jurisdiction should be added to the *NAIC List of Reciprocal Jurisdictions*, the Qualified Jurisdiction Working Group shall undertake the following analysis in making its evaluation:

1. The Qualified Jurisdiction must confirm that an insurer which has its head office or is domiciled in that jurisdiction shall receive credit for reinsurance ceded to a U.S.-domiciled assuming insurer in the same manner as credit for reinsurance assumed by insurers domiciled in that jurisdiction is received by United States ceding insurers;

2. The Qualified Jurisdiction must confirm that it does not require a U.S.-domiciled assuming insurer to establish or maintain a local presence as a condition for entering into a reinsurance agreement with any ceding insurer subject to regulation by that jurisdiction or as a condition to allow the ceding insurer to recognize credit for such reinsurance;

3. The Qualified Jurisdiction must recognize the U.S. state regulatory approach to group supervision and group capital, by providing written confirmation by its competent regulatory authority that insurance groups that are domiciled or maintain their worldwide headquarters in this state or another jurisdiction accredited by the NAIC shall be subject only to their U.S. home jurisdiction's worldwide prudential insurance group supervision, including worldwide group governance, solvency and capital, and reporting, as applicable, and will not be subject to group supervision at the level of the worldwide parent undertaking of the insurance or reinsurance group by the Qualified Jurisdiction;

4. The Qualified Jurisdiction must provide written confirmation by its competent regulatory authority that information regarding insurers and their parent, subsidiary, or affiliated entities, if

applicable, shall be provided to the states in accordance with a memorandum of understanding or similar document between a state and the Qualified Jurisdiction, including but not limited to the IAIS MMoU or other multilateral memoranda of understanding coordinated by the NAIC This requirement may be satisfied by an MOU with a Lead State, which shall provide for appropriate confidentiality safeguards with respect to the information shared between the jurisdictions, similar to the MOU requirement outlined in paragraph 11 of this section III; and

5. The Qualified Jurisdiction must confirm that it will provide to the states on an annual basis confirmation that each eligible assuming insurer that is domiciled in the Qualified Jurisdiction continues to comply with the requirements set forth in in Section 9C(2) and (3) of Model #786; i.e., must maintain minimum capital and surplus of no less than $250,000,000, and maintains on an ongoing basis the required minimum solvency or capital ratio, as applicable.

The FSA provided the NAIC and the chief insurance regulators of the 50 states, the District of Columbia and five U.S. territories with this written confirmation by letter dated October 31, 2019. The Qualified Jurisdiction Working Group performed a due diligence review of available public and confidential documents to confirm that to the best of its determination, the representations in the letter are true and accurate on November 5, 2019.

V. Minimum Solvency or Capital Ratio

The Qualified Jurisdiction Working Group, working in coordination with the Qualified Jurisdiction and the Reinsurance Financial Analysis (E) Working Group, must make a determination on a minimum solvency or capital ratio under which reinsurers licensed and domiciled in the Qualified Jurisdiction may assume insurance from U.S. ceding companies without posting reinsurance collateral. The applicable minimum solvency or capital ratio must be an effective measure of solvency, comparable to either an NAIC risk-based capital (RBC) ratio of three hundred percent (300%) of the authorized control level, or one hundred percent (100%) of the solvency capital requirement (SCR) as calculated under the Solvency II Directive issued by the European Union, giving due consideration to any applicable equivalency assessment conducted by the European Insurance and Occupational Pensions Authority (EIOPA) on the Qualified Jurisdiction with respect to Solvency II.

In the *2015 EIOPA Advice to the European Commission: Equivalence assessment of the Japanese supervisory system in relation to Article 172 of the Solvency II Directive (EIOPA-CP-14/043),* EIOPA made the following observations on the FSA's capital requirements:

> JFSA regulation defines a capital requirement that is named the 'total risk' in Ministry of Finance Notice No. 50 "Calculation methods...". This capital requirement broadly corresponds to the Solvency II Solvency Capital Requirement (SCR) (see below)…JFSA regulation defines a 'Solvency Margin Ratio' (hereunder SMR), which equates to double the own funds divided by the 'total risk'.
>
> JFSA regulation defines three levels of supervisory intervention:

- Even when the SMR is **above 200%,** the JFSA may require insurers to adopt 'improvement measures', notably on profitability, credit risk (including a reduction to their credit concentration risk), stability (reduction to their market and interest rate risks) and liquidity risk. The JFSA refers to this 'early' supervisory intervention as the "early warning system".

- When the SMR is **between 100% and 200%**, the JFSA may order insurers to submit and implement an improvement plan for ensuring managerial soundness

- When the SMR is **between 0% and 100%**, the JFSA may order a series of measures such as reduction of dividends to shareholders, reduction of dividends to policyholders, and contraction of business operations.

- When the SMR is below **0%**, JFSA may order the total or partial suspension of business.

> …From the above description, it follows that in terms of supervisory action the JFSA system has at least one supplementary level of intervention, compared to the Solvency II system. It also follows that supervisory actions taken at 200% of the SMR would, broadly speaking, correspond to those taken at the Solvency II SCR level of intervention —even though JFSA may intervene in a legally binding manner even if the SMR is more than 200%—, while supervisory actions taken at 0% of the SMR along with actions taken at the level of 100% of the SMR would, broadly speaking, correspond to possible actions under the Solvency II MCR.

In its consultation e-mail to the NAIC dated October 3, 2019, the FSA advised as follows: "an SMR of 200 percent triggers early remedial action such as submission of a management plan to restore the SMR, as an SCR of 100 percent triggers supervisory action such as submission of a realistic recovery plan. In this regard, we understand supervisory actions taken at 200% of the SMR would correspond to those taken at the Solvency II SCR level of intervention, even though the FSA may take supervisory actions in a proactive manner even if the SMR is more than 200%."

The Qualified Jurisdiction Working Group approved 200 percent of the SMR as the minimum solvency or capital ratio for reinsurers domiciled in Japan, and the Reinsurance Financial Analysis (E) Working Group approved 200 percent of the SMR as the minimum solvency or capital ratio on October 11, 2019.

VI. Summary of Findings and Recommendation

Therefore, it is the recommendation of the Qualified Jurisdiction Working Group that the NAIC recognize the FSA as a Reciprocal Jurisdiction and place it on the *NAIC List of Reciprocal Jurisdictions*, with such evaluation to be effective as of January 1, 2020. Further, the Working Group recommends that the minimum solvency or capital ratio for eligible reinsurers domiciled in Japan to be 200 percent of the SMR.