

**The LIAJ's Comments on the FSB's
Public Consultation Document
Strengthening Oversight and Regulation of
Shadow Banking
Policy Framework for Addressing Shadow Banking
Risks in Securities Lending and Repos**

28 November 2013

The Life Insurance Association of Japan (LIAJ)

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1. General opinions on the public consultation document

1. We, the Life Insurance Association of Japan (LIAJ), would like to extend our gratitude to the Financial Stability Board (FSB) for providing us with the opportunity to submit our comments on the FSB's public consultation document, *Proposed regulatory framework for haircuts on non-centrally cleared securities financing transactions*, which was published in 29 August 2013.
2. The LIAJ is a trade association comprised of all 43 life insurance companies operating in Japan. Its aim is to promote the sound development of the life insurance industry and maintain its reliability within Japan. We would like to respectfully request that the FSB carefully consider comments submitted by the sole representative body of the life insurance industry in Japan, the second largest life insurance market in the world.
3. We have deep concerns about the proposed 'minimum standards for cash collateral reinvestment', 'minimum standards for methodologies used by market participants to calculate haircuts', and 'numerical haircut floors'. Therefore, we would like the FSB to take into account the differences in circumstances and business profile in each jurisdiction and avoid adopting uniform regulation.
4. Liquidity problems occurred in the financial crisis motivated to propose regulation in this public consultation document, we believe that life insurers in Japan should be excluded from the proposed 'minimum standards for cash collateral reinvestment', 'minimum standards for methodologies used by market participants to calculate haircuts', and 'numerical haircut floors', as insurers in Japan are sufficiently supervised and monitored by regulatory authorities with regards to the liquidity risk management.
5. Considering the nature of cash-collateral repo transactions by life insurers in Japan described below, we think the proposed 'minimum standards for cash collateral reinvestment' focus essentially on market participants who are engaged in security lending by using 'client assets' managed separately from their own assets (e.g. custodians), rather than life insurers who are engaged in security lending as their own account.
6. Life insurers in Japan manage and invest premiums received from their policyholders in exchange for insurance cover as their proprietary assets (own assets) in order to fulfil their obligation to pay future insurance and pension benefits, and as part of their management and investment, they are engaged in securities lending and repos by using some part of large-sized security portfolio they hold. Thus, we think that life insurers in Japan would not need to make strict matching, as they manage cash flows taking into account not only positions occurred by securities lending and repos, but also cash flows as a whole including those positions.
7. Furthermore, life insurers in Japan can not identify reinvestment portfolio, as they invest received cash collateral collectively with premiums received and cashes for future claims given their objective of improving efficient asset management.
8. Besides, in terms of types of contracts, we think that the standards for cash collateral reinvestment need not be applied for closed-end contracts as these contracts set out due date for return, and calls for the return are foreseeable unlike the open-end contracts that can be recalled at any time.
9. With regards to the proposed 'numerical haircut floors', although the sovereign bonds and

government guaranteed securities are outside the proposed scope of application, we believe that, in addition to those bonds, particularly transactions posting national agency securities and local government bonds as collateral in Japanese market should be excluded from the standards, considering the circumstance that the haircut is not applied in the current market practice, as well as the high liquidity of the bonds. Besides, with regards to the proposed 'minimum standards for methodologies used by market participants to calculate haircuts', we believe that the sovereign bonds, government guaranteed securities, national agency securities and local government bonds should be similarly excluded from the standards.

10. In essential, setting numerical floors of the haircut at relatively high level would lead to, for example in repos, delivering much more sovereign bonds as collateral and thus, institutional investors may have concerns about the lost investment opportunity from restrictions on flexible trading of sovereign bonds and the decline in the liquidity of the market. Furthermore, we think that the level of the haircut, particularly for domestic transaction in each jurisdiction, should be the level that align with market practice in that jurisdiction, as there may be a concern that securities firms with relatively poor collateral reserve will incur increased transaction cost when it is necessary for those firms to secure additional collateral.

2. Responses to the questions

Q7. In your view, is there a practical need for further clarification with regard to the definition of proposed scope of application for numerical haircut floors?

11. We believe that bonds with high liquidity next to the sovereign bonds, such as local government bonds and national agency securities should also be excluded from the proposed scope of application.
12. In addition, liquidity problems occurred in the financial crisis motivated to propose regulation in this public consultation document, we believe that life insurers in Japan as well as banks should be excluded from the standards, as insurers in Japan are sufficiently supervised and monitored by regulatory authorities with regards to the liquidity risk management.

Q8. Would the proposed scope of application for numerical haircut floors be effective in limiting the build-up of excessive leverage outside the banking system and reducing procyclicality of that leverage, while preserving liquid and well-functioning markets? Should the scope of application be expanded (for example, to include securities financing transactions backed by government securities), and if so why?

13. With regards to the proposed 'numerical haircut floors', although the sovereign bonds and government guaranteed securities are outside the proposed scope of application, we believe that, in addition to those bonds, particularly transactions posting national agency securities and local government bonds as collateral in Japanese market should be excluded from the standards,

considering the circumstance that the haircut is not applied in the current market practice, as well as the high liquidity of the bonds.

14. In essential, setting numerical floors of the haircut at relatively high level would lead to, for example in repos, delivering much more sovereign bonds as collateral and thus, institutional investors may have concerns about the lost investment opportunity from restrictions on flexible trading of sovereign bonds and the decline in the liquidity of the market. Furthermore, we think that the level of the haircut, particularly for domestic transaction in each jurisdiction, should be the level that align with market practice in that jurisdiction, as there may be a concern that securities firms with relatively poor collateral reserve will incur increased transaction cost when it is necessary for those firms to secure additional collateral.