# Past steps and current topics of life insurance industry in Japan

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**Abstract**

Japanese life insurance industry enjoyed a steady growth by the end of 1990's, thanks to the increase of payable income caused by high economic growth, sound profit caused by lifetime expectancy improvement, and sound financial market, though it had some difficulties on its way.

However, the environment which surrounds us changed dramatically, due to the collapse of bubble economy. Some companies became bankrupt, because of the rapid change of financial environment and negative spread. And life insurance market started to shrink, because of aging society with low birthrate. Moreover, there have been trends for customer protection and deregulation. So life insurance companies are forced to cope with the change of environment, and they started to develop new markets for further growth, such as medical products, variable annuities, overseas markets.

In this paper, we are going to review the past steps of life insurance industry in Japan, and then introduce the new practices which are being carried out by life insurance companies for growth, reflecting the current circumstances we are in.

**Key-words:** deregulation, globalization, mutual company, demutualization

**Contents**

# 1. Past steps of life insurance industry in Japan

## 1.1 Birth of life insurance companies in Japan

The first life insurance company in Japan was ‘Kyousai-gohyakumei-sha’(later Yasuda life) established in 1880. Around this time, life insurance companies modeled on Western insurance institution began to be established in Japan. Meiji life, the first modern life insurance company in Japan, was established in 1881. Many life insurance companies were established after that, but there were a lot of problems; for example, some companies did not have any statistical basis or others sold new contracts in excessive manners, because of increasing competitions between companies. In such an environment, The Life Insurance Association of Japan was established in 1899 to keep fair developments and orderly market of life insurance industry, and in 1899, The Institute of Actuaries of Japan was established and started technical co-operations about insurance. In 1899, Insurance Business Law became effective and life insurance industry became under government regulation. In 1901, Dai-ichi life was established as the first mutual life insurance company in Japan.

Around that time, Japan experienced some big wars: Japanese-Sino War and Japanese-Russo War., in which many people were killed. Life insurance companies paid insurance benefit for bereaved families. As a result, more people understood the utility of life insurance. After these wars, Japanese economy recovered. The need for economic preparation by life insurance was gradually understood, and sales of new contracts showed steady growth.

During the First World War, Japan was not damaged directly, so Japanese economy was active and life insurance industry showed a big growth. Spanish flu in 1918 and Great Kanto Earthquake in 1923 brought hundreds of thousands of deaths. Responding to them, life insurance companies carried out their missions by paying insurance benefits. The need and role of life insurance were known better, and sales of life insurance contracts increased more.

When the Second World War started, all Japanese industries including life insurance were placed on a war footing, and life insurance companies were forced to underwrite a lot of government bond and to invest their assets in armament industry.

## 1.2 Restart after the Second World War

August 15, 1945, the Second World War ended with the unconditional surrender of Japan. Japanese economy was troubled by shortage of goods and rapid inflation. Life insurance industry, too, was damaged seriously by huge loss of assets in Taiwan and Korea, and increasing operating costs and decreasing value of contracts by inflation.

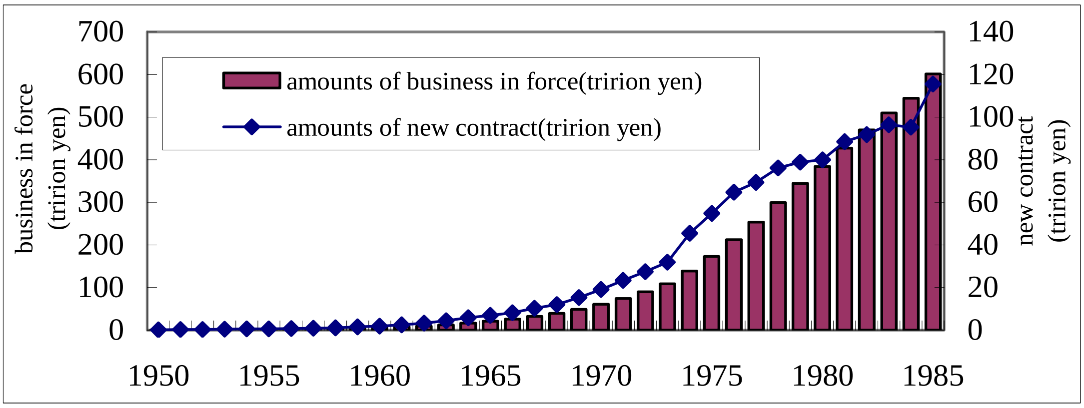
Companies dealt with this damage by separating bad account and restarting as mutual companies. Behind this background, Japanese economy was heavily damaged, and ‘zaibatsu’, family-run conglomerates, were dismantled by GHQ(General Headquarters of the Allied Forces). Because of these reasons, mutual company, where policyholders became the owner of the company, was a better structure for life insurance than stock company which required big financial sponsors.

After 1950s, Japanese economy was industrialized, and working people increased. In response, the welfare system by employers was developed, and group term insurance became widespread. Due to the concentration of population in large cities and growing the need for life security, many companies started to sell contracts for death security like endowment policy with term life rider. Because of these situations, death security contracts became main products in Japan.

As the growth of real GPD shows, from late of 1950s to 1960s, Japanese economy showed one of the greatest growths that the world had ever known, and from 1970s to early 1980s, despite the oil crisis, Japanese economy grew steadily. Hand in hand with that, life insurance industry developed and its operation expanded. Under increasing the need for whole life death security, main product changed from endowment with term life rider to whole life policy with term life rider. Competition between companies became heavier, and sometimes bad sales techniques, for example, sales agents explained their customers about non-guaranteed maturity bonus as it was guaranteed.

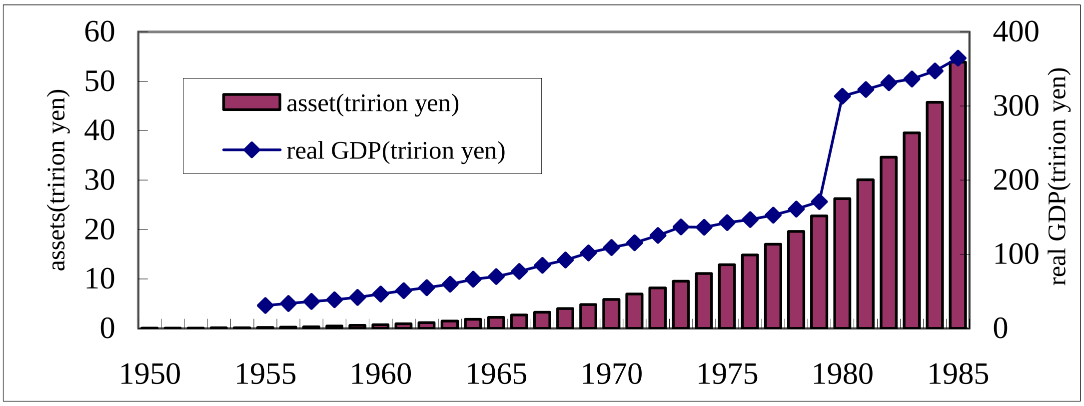
Next figures show the trends of amounts of business in force and new contracts of individual life insurance, assets, and real GDP.

Table 1 Amounts of business in force and new contract of individual life insurance(total of all life insurance companies in Japan)




(Source: Fact book of life insurance business (life insurance association))

Table 2　Asset and real GDP(total of all life insurance companies in Japan)




(Source: Fact book of life insurance business (life insurance association))

1.3 Bubble economy and its collapse

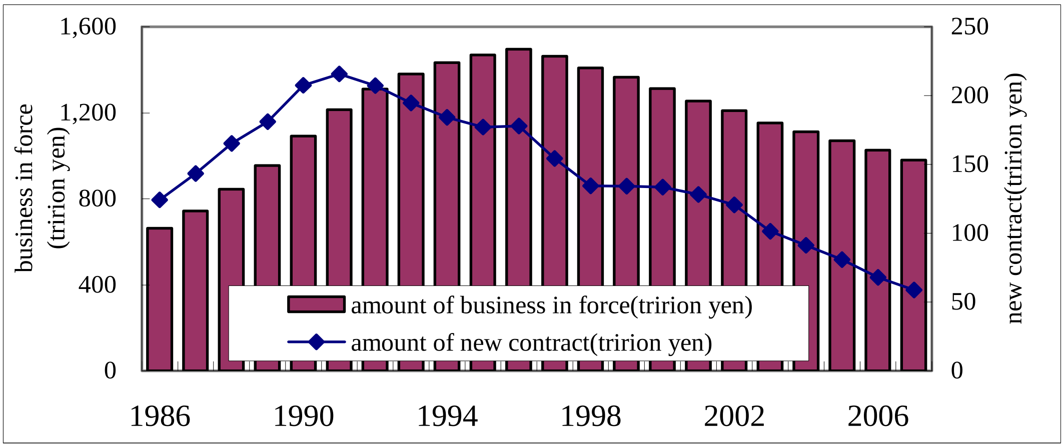
In the late 1980s, Japan experienced a long-term economic expansion with the raise of stock and land price. It was called ‘bubble economy’.

Taking advantage of this economic expansion, Japanese life insurance companies, expanded their business positively. They started to turn over not only whole life insurance but also single premium endowment and individual annuity, to raise guaranteed interest rates, and to sell variable insurance whose investment incomes belong to customers. And some companies invested more and more assets in risk assets such as stock and real estate. If companies ensured high guaranteed interest rates, companies could earn more return than guaranteed interest thanks to high level of revenue from stock dividend. In addition, companies could make more profit because of appreciation of assets.

But this booming economy did not run on so long, and Japanese economy started to slow down in 1991. Stock price and land price started to fall.

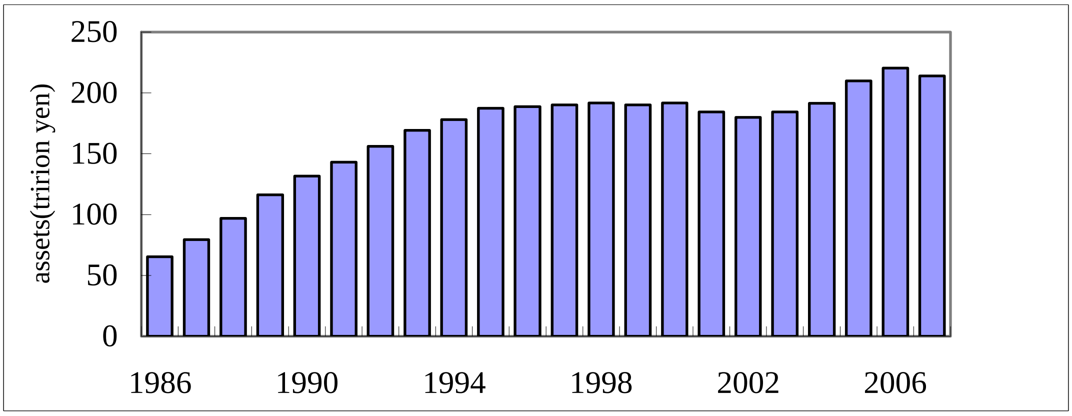
In tune with this, sales of new contracts stopped increasing, and then started to decrease. While asset management yield started to fall, guaranteed interest rates remained high, so ‘negative spread’ occurred. This is a situation that asset management yield is lower than guaranteed interest rate. And depreciation of assets negatively affected their balance sheets. Therefore, some life insurance companies fell apart. Asset management yields in 1990s and 2000s are lower than those before 1980s, and guaranteed interest rates are kept high for a long term, so ‘negative spread’ problem still weighs on many life insurance company’s operations.

Table 3 Amounts of business in force and new contract (All life insurance companies in Japan)



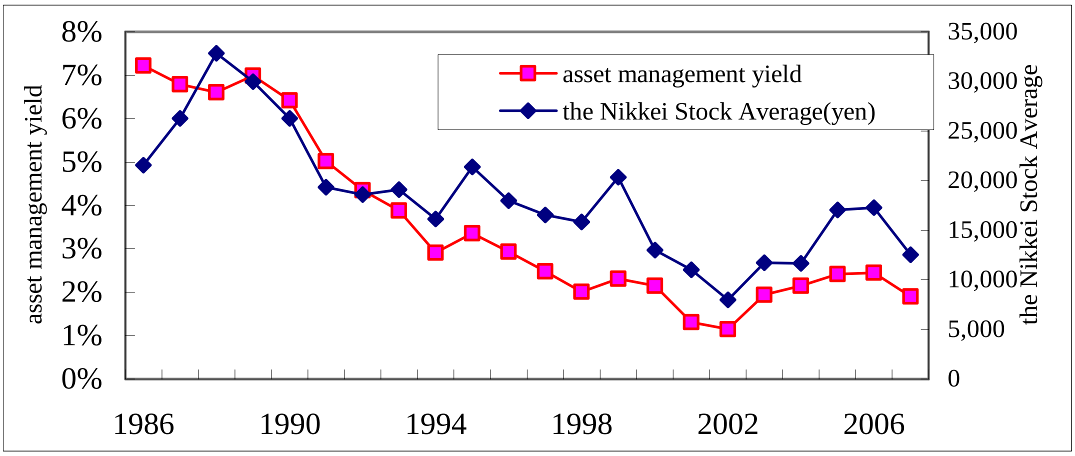

(Source: Fact book of life insurance business (life insurance association))

Table 4 Assets(all Japanese life insurance companies)




(Source: Fact book of life insurance business (life insurance association))

Table 5 Asset management yield(average of all Japanese life insurance companies) and the Nikkei Stock Average




(Source: Fact book of life insurance business (life insurance association))

## 1.4 Current situations

Circumstance surrounding Japanese life insurance industry is still changing.

### 1.4.1 Deregulation and globalization of finance

In Japan, financial deregulation started from the late 1990s. Life insurance industry is no exception. It became permitted for life insurance companies to have non-life insurance subsidiary and other finance-related subsidiary. Because of this change, life insurance companies became to do not only life insurance business but also various financial businesses, but at a time, life insurance companies started to be exposed to competitions with not only another life insurance companies but also various financial companies. In addition, some companies decided to demutualize for more aggressive business operation.

Sales channels of life insurance are becoming more multifaceted. In Japan, face-to-face selling by sales agents was the main channel, but recently some companies adopted another sales channels dealing with types of contracts; selling saving products such as annuities at a teller's window in a bank, or selling simple products on the internet.

Economic globalization also expanded in this period. As a result, life insurance companies are forced to operate their business looking around not only domestic but also overseas situations. Globalization of accounting standard is also moving ahead. It is a challenge to deal with international accounting standards. In term of business competition, many foreign companies have their operations in Japan, and some Japanese companies start to have their operations abroad.

### 1.4.2 Changes of customer's need

Japan faces rapid aging population with low birthrate. Many Japanese life insurance companies mainly sold high death benefit coverage to men from 20s to 50s, the baby boomers. But they are starting to retire under the age limit and they do not need high amount of death security coverage any more, and the number of people from 20s to 50s is decreasing. On the other hand, population after retirement is increasing, and therefore, it is important for life insurance companies to satisfy their needs such as saving and medical security. At the same time, more women play increasingly important roles outside the home, so it is also important to satisfy need of working women.

### 1.4.3 Efforts of regulatory authority to keep soundness of life insurance business

As above, companies are permitted to operate their business more liberally. On the other hand, regulatory framework is changing.

Insurance Business Law was revised in 1996. This law introduced some regulatory frameworks for companies to keep their soundness;

| | |
|---|---|
| Standard valuation system | The mortality rate, the interest rate, and the method of calculating reserves to keep minimum level of reserve are designated by law. |
| Solvency margin regulation | Static solvency check |
| Projection of profit and loss by appointed actuary | Dynamic solvency test |

In addition, the life insurance policyholder's protection corporation of Japan was established in 1998. When a company fails, they make reparation for policyholders of failed company

Recently, sales of variable annuities and third sector products were expanded. In 2005, standard valuation system for guaranteed minimum benefit was introduced. And in 2007, rules for reserve of third sector products, including stress test for these products, were introduced. And now, following changes of economic environment and so on, new solvency margin regulation is being updated.

In this situation, every company is working in each way to attract more customers.

2. Investment in growing market

In an environment where traditional death benefit market, which most insurers have regarded as main for a long time, is shrinking, they are starting to seek new markets such as saving, medical insurance and overseas as promising.

i Saving market

On the contrary to the shrink of traditional death benefit market, the need for saving products is growing due to the aging society and people's anxiety for future social security. The product which insurance company can offer to answer such anxieties is individual annuity. In Japan, variable annuity became remarked from around 2000. The reason why variable annuity, not fixed annuity, became main stream is that fixed annuity could not appeal to customers in a low interest environment. Sales of variable annuity achieved rapid growth after 2002 when bank-assurance became available.

At first, foreign insurance companies got into sales of variable annuity actively through bank-assurance, while domestic insurers are reluctant to do, due to the minimum guarantee risks inherent to the variable products.

Dai-ichi Life, to which we belong, started variable annuity business with such prudent attitude at first, too. But in 2006, it founded Dai-ichi Frontier life, which is a subsidiary specialized in annuity business through bank-assurance. It founded the subsidiary because the speed of product development is important in bank-assurance and it can speed up product development by founding the subsidiary specialized in the market.

In the financial turmoil after Lehman shock, some foreign companies withdrew from Japanese variable annuity market, and therefore, market share of some domestic insurers have jumped sharply in 2009. So they are starting to deal with such over-risk-taking by restricting the sales amount.

In this way, market environment which surrounds variable annuity market is now in confusion.

ii Medical insurance market

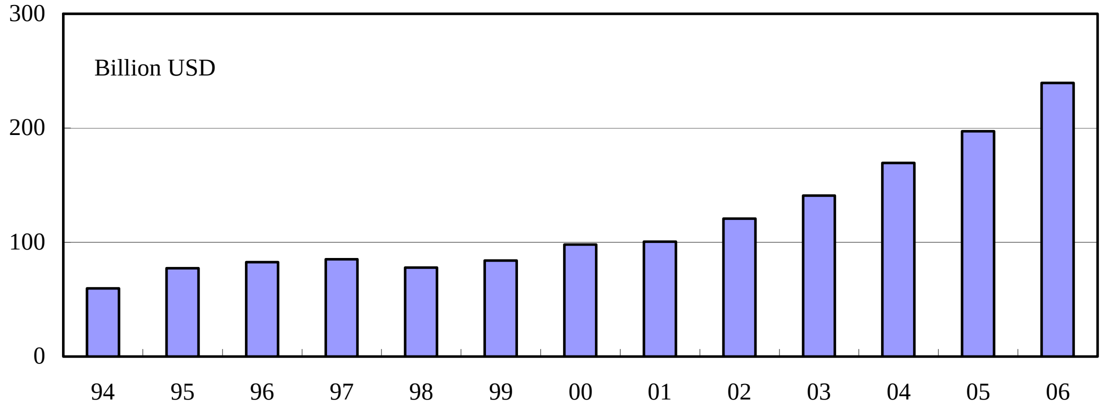
On the contrary to the shrink of traditional death benefit market, the need for living benefit products is growing. Babyboomers who are retiring in these several years do not need traditional life insurance any more, rather they need to prepare for the cost concerning their health. Also, younger generation needs supplemental medical insurance because co-payment percentage was raised in social health insurance.

There used to be a regulation which banned domestic insurers to sell stand-alone medical products. After the abolition of this restriction, they got into this market, and are making efforts to grip market share in this market.

iii Overseas market

To achieve company’s growth in the current environment, development of new promising market is required. And currently, Asian market is seen as promising. Table 6 shows the growth of Asian insurance market.

Table 6　Premium income in Asian market(excluding Japan)




(Source: author)

The demography of such countries is similar to former Japanese one. There are affluent working generation people, and high level of economic growth is expected. So some Japanese companies are starting to invest in such Asian market, though it still remains small.

## 3. Demutualization

Currently, most leading life insurers in Japan are mutual companies, but they are facing new difficulties in the environment as stated above. In this section, we are going to introduce demutualization in Japan, mainly targeting the environmental recognition.

### 3.1 Limitation of mutual company structure

#### 3.1.1 Hurdle for further growth

i Mobility

As already stated, life insurers have to seek new growing markets, as domestic market shrinks. In this environment, to enable mobile management, stock company is a better corporate form than mutual company.

Stock company has merits in reformation of business through foundation of holding company, business expansion through M&A, as well as accessibility to financial market. These are not impossible for mutual companies, but in terms of mobility, stock company comes first. In current environment, in which financial conditions change fast and dramatically, being a mutual company can be a hindrance in achieving mobile business management.

ii Interest conflict

Investment in new markets by mutual company induces problems of interest conflict.

Investment in new markets such as variable annuity through bank assurance or overseas market is usually done based on mid-to-long term point of view and does not contribute to company’s profit in a short span of time. Therefore, the investment which is desirable for the company for a long run, is sometimes undesirable for some part of policyholders. For example, policyholders who contracted lately expect long term growth of the company, while policyholders whose maturity date comes soon does not expect such investment and expect dividend distribution at the time.

In this way, corporate structure to which various policyholders join as members of the company induces interest conflicts between them, and coordination of such conflict is difficult.

iii Restriction in capital reinforcement

Since Japanese economy has achieved steady growth until bubble economy in 1980’s, insurance companies could manage their business steadily with certain level of capital, thanks to risk margin included in premium.

However, after the bubble collapsed, some portion of capital was lost, and the environment surrounding insurance industry became drastic due to the deregulation, so insurance companies are required to keep higher level of capital. It is not impossible for mutual companies to reinforce their capital, but compared to stock companies, their options and mobility is limited.

3.1.2 Disappearance of philosophy of mutual company

i Dividend distribution

The original philosophy of mutual company is “to offer insurance coverage with substantially cheapest premium by receiving safely determined premium and paying back the profit afterward”.

At the time of establishment, when there were few contributor of risk money in financial market, mutual company structure matched the social background. And thanks to the absence of shareholders, mutual companies achieved high level of dividend distribution. Based on such environment, mutual company became widespread.

And afterward, thanks to high economic growth and stable condition, mutual companies could continue to pay high level of policyholder’s dividends. As far as this is met, being a mutual company is not a problem.

However, after the collapse of bubble economy and recent deregulation, retaining of earning is required to even mutual companies because of the instability of business environment, and thus, the level of dividend distribution became lower. In this environment, mutual companies cannot advocate the merits of mutual company structure.

Moreover, the level of premium and dividend is becoming lower due to the competition, and the increase of contributor of risk money. So it is difficult to design high-premium-high-dividend products any more.

In this environment, it is difficult to appeal the merit of mutual company structure by stating the dividend distribution, and therefore, it is agreeable for policyholders to demutualize and distribute company’s value by allotting the share of the company, and then plan future business strategy.

ii Autonomy by policyholders

Mutual companies are based on the philosophy that each policyholder joins the autonomy of the companies. But as the scale of the companies became larger, current mutual companies are run by representative policyholders meeting, not policyholders meeting, which is an indirect management structure.

Such kind of management is difficult to be accepted currently. Therefore, to show the sophisticated corporate governance which is required nowadays, mutual company structure has its limit.

And mutual company structure, which gives equal right to every policyholder, are right limiting, in corporate value belonging and its distribution method. Therefore, mutual companies will soon face a situation where it has difficulty in explaining the corporate value belonging and distribution.

3.2 Demutualization in Japan

Although some problems concerning mutual company structure became clear after the collapse of bubble economy, there was no provision in insurance law concerning demutualization, and therefore, demutualization was substantially impossible. But in 1996, insurance law was revised, and concrete provisions are added, and then, some mutual companies demutualized.

Table 7.1 Demutualization in Japan

| | Company | |
|---|---|---|
| 2002.4 | Daido life | established holding company with Taiyo life in 2004.4 |
| 2002.4 | Yamato life | |
| 2003.4 | Taiyo life | established holding company with Daido life in 2004.4 |
| 2004.4 | Mitsui life | |
| 2010.4 | Dai-ichi life | |

(Source: author)

Other than above, there are some examples of demutualization caused by bankruptcies. After their bankruptcies, they demutualized, found sponsors, and restarted.

Table 7.2 Demutualization in Japan (caused by bankruptcies)

| | Company | |
|---|---|---|
| 1997.4 | Nissan life | Aoba life |
| 1996.6 | Toho life | AIG Edison life |
| 2000.5 | Dai-hyaku life | Manulife |
| 2000.10 | Chiyoda life | AIG Star life |
| 2001.3 | Tokyo life | Yamato life |

(Source: author)

*(Note) Japanese financial industries lived under the protection of Ministry of Finance, called 'convoy system', so no life insurance company bankrupted for about 50 years after the Second World War, and Nissan life was the first failed company in Japan.*

After above operation, the number of mutual companies decreased to 5 compared to 16 as of

1997.3.

Table 8 Market share by corporate structure (in terms of total asset)

| | 1997.3 | | 2009.3 | |
|---|---|---|---|---|
| | number | share | number | share |
| Mutual | 16 | 91.7% | 5 | 50.4% |
| Stock | 28 | 8.3% | 40 | 49.6% |
| Total | 44 | 100.0% | 45 | 100.0% |

(Source: author)

*(Note1) Dai-ichi life is mutual company as of 2009.3, but is categorized in stock company here.*
*(Note2) Kampo is excluded from the figure as of 2009.3.*

Ref. Demutualization in the world

As to demutualization of life insurer, Japan is backup party, and there were more example of demutualization in the world.

In the U.S., there started demutualization in the 1980's, and metropolitan demutualized in 2000, and Prudential in 2001. The companies which still remain mutual is limited to small number, Northwestern, NY life, Mass mutual, etc.

Table 9 Examples of demutualization in the U.S

| | Company | |
|---|---|---|
| 1992 | Equitable | AXA |
| 2000 | Metropolitan | Met life |
| 2001 | Prudential | |
| 2001 | Principal | |

(Source: author)

In the U.K., there are many example of demutualization and currently, no major insurers remain mutual.

Table 10 Examples of demutualization in the U.K.

| | Company | |
|---|---|---|
| 1997 | Norwich union | AVIVA |
| 2000 | Scottish widows | |
| 2001 | Equitable | |
| 2001 | Friends provident | |
| 2006 | Standard life | |

(Source: author)

In Canada and Australia, most major companies demutualized and very few remain mutual.

Table11 Examples of demutualization in Canada

| | Company | |
|---|---|---|
| 1999 | Clarica life | |
| 1999 | Manulife | |
| 1999 | Canada life | |
| 2000 | Sun life | |

(Source: author)

In these examples, the recognitions for business environment are thought to be similar to that of ours, except for the case caused by bankruptcies.

## 4. Summary

As stated above, the environment which surrounds Japanese life insurance industry is changing dramatically in this decade. In this paper, we introduced each company's effort to deal with such environment. But other than that, there are many problems which deeply affect insurance company's management such as IFRS and solvency requirement based on economic value. Life insurance industry has to deal with many problems including these, and for this purpose, we actuaries should play larger roles.

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