

Life Insurers and the Third Sector Insurance Industry

1. Introduction

This report is the 2005 issue of the annual analysis of the life insurance industry – what has become the life insurance white paper -- that the Japan Center for Economic Research has been releasing since the year 2000.

Since 2000, we have seen a crisis in the life insurance industry in Japan with consecutive bankruptcies in this sector. The failure of a life insurer has grave effects on not only the individual policyholders, but also on the financial system as a whole. However, in fiscal 2004, the profitability of life insurers appears to have recovered thanks in large part to the stability in stock prices. Here, we pose the question, has the financial health and profitability of Japan’s life insurers really improved? In this Chapter, we analyze and verify the financial health, the profitability and the health indicators making use of public financial statements.

2. Financial Health of Life Insurers

2.1 Overview of Life Insurance Companies

As of September 2005, there were 39 private life insurance companies (including branches of foreign owned insurers). Due largely to regulation, this is a smaller number than in the US. The total assets of these 39 insurers amounted to 200 trillion yen, and the insured amount (individual insurance plus individual annuities) was about 1200 trillion yen. Of these, 6 are mutual companies, while the majority, 34, is stock companies. However, most of the insured amount is held by the six mutual companies (which includes Nippon Life, Dai-ichi Mutual Life etc). We will refer to the nine large domestic life insurers (includes the six mutual companies) in the following discussion as the nine major insurers.

Aside from these private insurers, there is also the Postal Life Insurance System (Kampo), a government run life insurance system. The total assets of Kampo are 120 trillion yen and their total insured amount is 181 trillion yen, and Kampo is expected to be fully privatized in ten years from now as part of the postal privatization bill in Japan. The privatization of a huge government run life insurer is sure to have great effects on the life insurance world as well as the economy (Table 3.1).

Table 3.1 Total Insured Amount and Total Assets of All Life Insurers in Japan

Total Insured Amount as Fiscal Year-end 2004
 (Individual Insurance and Individual Annuities)

	trillion yen %		
		Year-on-Year Change	Share of Total
Nine Major Life Insurers Total	990.1	-4.4	62.6
Foreign Insurers Total	124.2	3.3	7.9
Kampo	181.0	-3.6	11.4
JA-Kyosai	214.6	-3.9	13.6
Other Domestic Life Insurers Total	71.9	9.2	4.5
Grand Total	1,581.9	-3.2	100.0

Total Assets as Fiscal Year-end 2004

	trillion yen %		
		Year-on-Year Change	Share of Total
Nine Major Life Insurers Total	154.2	0.9	43.4
Foreign Insurers Total	28.1	18.7	7.9
Kampo	121.3	-0.5	34.1
JA-Kyosai	42.7	1.3	12.0
Other Domestic Life Insurers Total	9.2	17.2	2.6
Grand Total	355.5	2.0	100.0

2.2 Assets

The breakdown of assets of the nine major life insurers in their general accounts at fiscal year-end 2004 is shown in Table 3.2. On average, 60.5% of the investment assets are in such fixed yield assets as cash and deposits, and public and corporate bonds and loans. Since most of the liabilities of life insurers are policy reserves – reserves that are accumulated over the long-term to be paid out in future insurance claims -- their assets need to be invested so that they secure stable income over the long-term. Thus the share of their assets in fixed income vehicles tend to be quite large. On average for the nine insurers, the share of public and corporate bonds in their general account assets grew by 2.2% over the previous year on average for the nine insurers.

The share of stock holdings in their assets rose 0.4 percentage points to 13.3% on a nine company average. The value of the shares increased as the insurers aggressively managed their holding of names and the market as a whole was up. Continuing on a trend from the previous year, their investment into foreign public and corporate bonds increased and their share is now 13.1%. As domestic interest rates continued to be very low, foreign investments, which yield higher interest rates, became more attractive.

Table 3.2 Breakdown of Assets on their General Account (As at Fiscal Year-end 2004)

	Deposits etc.	Public and Corporate Bonds	Stocks	Foreign Public and Corporate Bonds	Foreign Stocks	Other Securiti es	Loans	Real Estate	Other	Fixed Income Assets Total
9 Major Life Insurers Average	2.0 (-0.3)	34.4 (2.2)	13.3 (0.4)	13.1 (0.1)	2.9 (0.1)	1.3 (0.1)	24.1 (-2.3)	4.7 (-0.2)	4.0 (-0.1)	60.5 (-0.5)
Kampo	2.2 (-0.5)	69.2 (1.8)	3.7 (-0.7)	3.4 (0.0)	1.2 (0.1)	0.0 (0.0)	19.9 (-0.6)	0.0 (0.0)	0.4 (-0.1)	91.3 (0.7)

Note: Figures in parentheses denote year-on-year percentage point changes

The main reason behind the difference in the asset composition of Kampo vis-à-vis the private life insurers are that Kampo, as a government-run entity, is subject to some government imposed restrictions. The composition of the assets of Kampo depends on the investment plans of Kampo funds. As a result, the fixed yield component of their assets -- such as the public and corporate bonds -- accounted for 90.5% of their assets in fiscal 2004 and the share of stocks in their assets was only 3.7%. However, the actual amount held in stocks totals 4.4 trillion yen and is large enough that the impact of a change in the stock market would be great.

In order to find the real assets and real profits of the individual companies, the unrealized gains and losses on their assets must be properly reflected in the analysis. The unrealized gains and losses of the nine life insurers as at fiscal year-end 2004 are shown in Table 3.3. Unrealized gains and losses on securities and land held improved by 50 billion yen over the previous year for the nine major insurers, but they are still in a position of net unrealized loss. Gains in securities increased by 1,614 billion yen as at fiscal year-end 2004 over the previous year. This was due to the robust

stock market and the decline in interest rates towards the end of the fiscal year (From 1.44% to 1.32% for the ten year government bond).

Table 3.3 Unrealized Gains and Losses for the Nine Major insurers (Fiscal Year-end 2004)

	Land	Securities			Total unrealized gains/losses	billion yen	
		Stocks	Public and Corporate Bonds	Foreign Securities		Nikkei 225 at which their unrealized gains on stock falls to zero(yen)	
Nippon	-183	3,836	2,967	471	397	3,653	7,100 (7,300)
Dai-ichi	-112	1,711	1,274	263	174	1,599	8,200 (8,400)
Meiji Yasuda	-33	1,501	1,110	231	160	1,468	7,300 (8,000)
Sumitomo	-85	445	280	127	37	360	9,500 (9,800)
Mitsui	-163	96	57	28	11	-67	10,400 (11,000)
Asahi	-85	3	14	17	-27	-82	11,500 (11,500)
Taiyo	-12	182	122	37	23	170	8,970 (8,990)
Daido	-11	226	128	85	13	215	7,300 (6,800)
Fukoku	70	194	141	46	8	264	8,500 (7,900)
9 Major Life Insurers Total	-613	8,194	6,094	1,305	796	7,581	7,886 (8,165)

Note: Figure in parentheses is for fiscal 2003

2.3 Liabilities

Most of the liabilities of a life insurer is its obligations to pay out insurance claims to the policyholders. Annual insurance premiums are calculated to be fixed and flat rates at a level that if mortality rates and assumed interest rates follow their expected paths, the net income over the insured period should be zero. When the mortality rates are still low soon after the policy is entered into, the total insurance premium income will be much greater than the insurance claims paid out, resulting in a surplus. As time progresses, and the mortality rate of the insured persons rises with the older age of the individual, the total income will be less than the amount paid out in claims, and at this time the company makes use of the accumulated surplus from the earlier period.

The Insurance Business Law stipulates that the excess that results from the insurance premium income from the first half of the covered period, being greater than the claims paid out in that period must be kept in a “policy reserve” to meet the obligations of the insurance policy in the future. This “policy reserve” accounts for over 90% of the liabilities of the life insurance company.

2.4 Capital

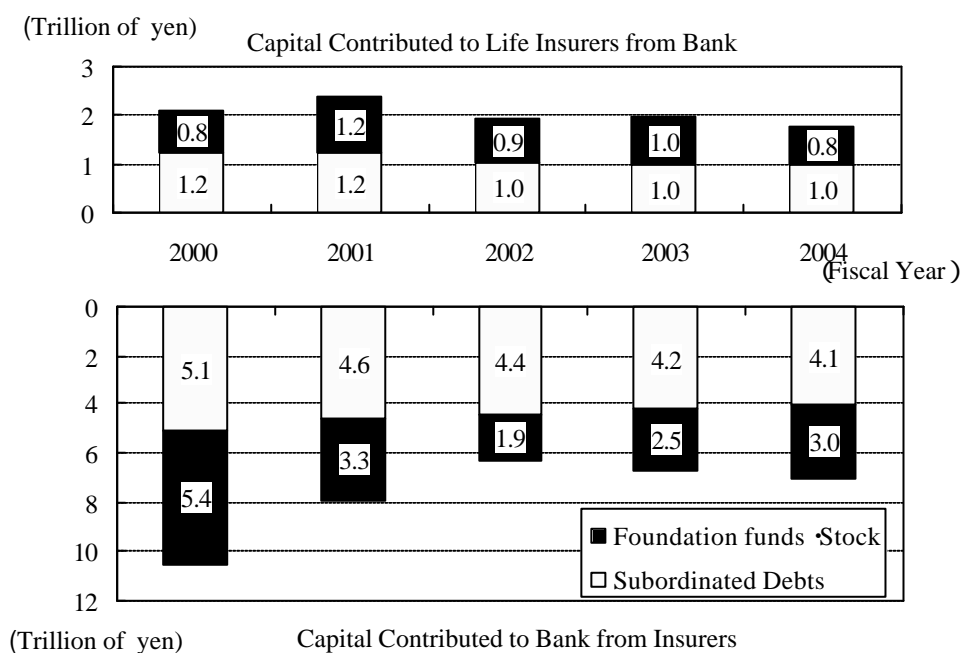
The capital of life insurers -- such as foundation funds (*kikin*), subordinated loans, and subordinated bonds for example – has been sourced mainly from financial institutions, largely banks. According to published sources, at fiscal year-end 2004 the nine life insurers held bank stocks at a market value of 3.0 trillion yen, and contributed 4.21 trillion yen to banks in the form of subordinated loans and bonds. At the same time, banks contributed a total of 1.8 yen to the nine major life insurers in foundation fund (capital) and subordinated loans.

This cross-holding of capital in the for the five years from fiscal 2000 is shown in figure 3.1, where we see that the banks’ contribution to life insurers’ capital peaked in fiscal 2001 and has

gradually declined since then. At the same time, the market value of the amount of capital contributed to banks by life insurers had been declining until fiscal 2002, but it has turned up again in fiscal 2003. In fiscal 2003 this was due to the increase in share prices held, while in 2004 stock holdings increased due to recapitalization underwriting. However, the amount of subordinated lending (bonds with subordination clauses, subordinated loans, subordinated debentures, preferred investment securities) contributed by banks to the insurers was only marginally smaller.

In the proceedings after the failure of Chiyoda Mutual Life, all subordinated loans were written off as uncollectible. Thus if another life insurer were to fail, then the impact on banks would be huge. The danger with this cross holdings of capital with banks (known as “double gearing”) is that if there is a crisis in either of the industries, the other would suffer a serious blow, and this could lead to catastrophic results in the financial system as a whole. It is imperative that life insurers mitigate the risk associated with their credit being concentrated in the banking industry.

Figure 3.1 Double Gearing of the Life Insurers and Banks



3. Profitability of Life Insurers

3.1 Market Value Investment Returns

The return on investments of the insurers— that includes the market value changes of the held assets – are as shown in Table 3.5. Stock prices were falling from fiscal 2000 to 2002, and the market value yields were negative, but these turned to positive after fiscal 2003 for the nine insurers and Kampo. As Kampo’s stock holdings in their total assets are low compared to the private

insurers, the returns on their investments are lower than the private insurers from fiscal 2004. However, over the five years, their market value returns have been stable.

Table 3.4 Market Value Returns for the Nine Major Insurers and Kampo

	FY2000	FY2001	FY2002	FY2003	FY2004	Average (5 years)
Nippon	-1.00	-1.27	-0.89	5.04	3.36	1.02
Dai-ichi	-0.65	-1.43	-0.50	4.61	3.16	1.01
Meiji Yasuda	0.00	-0.74	-0.52	4.04	3.58	1.25
Sumitomo	-0.60	-1.07	0.18	2.70	2.06	0.64
Mitsui	-1.74	-1.19	-0.72	1.78	3.33	0.27
Asahi	-1.76	-1.92	-0.68	3.56	2.27	0.27
Taiyo	0.45	-0.55	1.11	4.03	2.09	1.41
Daido	0.58	0.08	1.57	3.32	1.86	1.48
Fukoku	1.06	-0.61	-0.47	4.16	2.37	1.29
9 Major Life Insurers Average	-0.41	-0.92	-0.15	3.70	2.67	0.96
Kampo	2.63	1.11	1.20	1.55	2.38	1.77

3.3 Negative Spreads

The negative spread issue continues to put downward pressure on the life insurers. The negative spread amount refers to the difference between the payout rate guaranteed to policyholders and the return on investment (from an income perspective) multiplied by the policy reserve balance on the general account. In Table 3.5, we show the negative spread amounts of the nine insurers and Kampo and the shares of these negative spreads in their general account policy reserves.

Table 3.5 Negative Spread Amounts of the Nine Major Life Insurers and Kampo

	FY2002		FY2003		FY2004	
	Negative spread Amounts	Share of General Account Policy Reserves	Negative spread Amounts	Share of General Account Policy Reserves	Negative spread Amounts	Share of General Account Policy Reserves
Nippon	320	0.93%	290	0.83%	270	0.78%
Dai-ichi	250	1.06%	217	0.91%	181	0.77%
Meiji Yasuda	104	0.49%	99	0.47%	99	0.48%
Sumitomo	224	1.25%	201	1.16%	190	1.13%
Mitsui	80	1.22%	68	1.09%	51	0.84%
Asahi	88	1.41%	98	1.73%	93	1.70%
Taiyo	43	0.72%	30	0.51%	39	0.68%
Daido	20	0.40%	13	0.25%	19	0.39%
Fukoku	38	0.91%	42	0.98%	37	0.85%
9 Major Life Insurers Total	1,167	0.93%	1,058	0.85%	979	0.80%
Kampo	1,410	1.23%	2,010	1.77%	1,740	1.55%

The prolonged low interest rates and the still high average guaranteed payout rates of the policy reserves are the factors behind the large negative spreads. Thus, this is expected to continue unless the investment environment improves and returns on investment are greatly improved, or the average payout rates of the policy reserves decline greatly. In Table 3.6, these rates, however, are expected to be at these high levels for the time being.

Table 3.6 Average Guarantee Return of the Nine Major Life Insurers and Kampo

	FY2002	Fy2003(A)	FY2004(B)	
				B - A
Nippon	3.49	3.36	3.31	-0.05
Dai-ichi	3.38	3.29	3.27	-0.02
Meiji Yasuda	3.06	2.94	2.92	-0.02
Sumitomo	3.40	3.40	3.37	-0.03
Mitsui	3.63	3.49	3.43	-0.06
Asahi	4.17	4.13	4.07	-0.06
Taiyo	3.17	2.96	2.85	-0.11
Daido	2.86	2.66	2.61	-0.05
Fukoku	2.92	2.72	2.64	-0.08
9 Major Life Insurers Total	3.34	3.22	3.16	-0.05
Kampo	3.31	3.10	2.91	-0.19

Note : Numbers are rounded.

Next, we estimated the “economic profits” from each insurer’s Income Statements in Table 3.7. Economic profits can be defined as the change in the net assets of the company on a market value basis, provided there were no dividends paid, increases in capital or some repayment of capital in that period. This is an indicator of each company’s real profitability in one operating year. If economic profits are negative, this means that real capital has declined.

We also define “insurance-related income” as the income that would be earned from insurance policies under an environment of zero operating expenses and a market value yield that is equal to the assumed rates of interest. This is equivalent to the total of the life insurers’ mortality profits and additional premiums. “Investment related profits and losses” is defined as investment profit on an income basis, with market value assessed investment profits taken into account. This reflects not only the amount of the negative spread amounts as publicized by the life insurers, but all investment-related gains and losses such as capital gains and losses, and changes in the unrealized gains and losses on assets. When this is a negative figure, this means that the company is in a negative spread situation on a market value basis.

Table 3.7 Economic Profits of the Nine Major Life Insurers

	billion yen,% in parentheses		
	Total for 9 major life insurers		
	FY 2002	FY 2003	FY 2004
Insurance Income	5,663 (3.73)	5,478 (3.59)	5,287 (3.43)
Operating Expenses, Other Gains/Losses (-)	2,669 (1.76)	2,462 (1.61)	2,316 (1.50)
Investment-Related Gains/Losses	-4,573 (-3.01)	2,104 (1.38)	483 (0.31)
Economic Profit	-1,613 (-1.06)	4,901 (3.21)	3,264 (2.12)

Notes:

- 1) Figures in parentheses are shares of total assets
- 2) Insurance Income = Mortality Profits+ Equivalent Amount to Additional Premiums
 = Basic Profit + Negative Spread Amount + Operating Expenses
- 3) Investment Gains/Losses = Negative Spread Amount + Changes in Unrealized
 Gains/Losses on Assets + Capital Gains/Losses + Other Investment Gains/Losses
- 4) Economic Profit = Insurance-Related Income + Investment-Related Profit/Loss – Operating Expenses +
 Other Gains/Losses – Corporate Taxes etc. – External Outflow Amount

Source: Disclosure Materials of Life Insurers, 2004

In fiscal 2004, due to the improvement in investment-related gains and losses, all nine life insurers marked positive economic profit figures, totaling 3.3 trillion yen. Most of the improvement can be explained as being due to capital gains and the impact of any improvement in the negative spread is very small. The negative spread declined by about 80 billion yen for the nine major insurers. Most of the companies were able to cover their negative spread amounts with their investment gains, including capital gains.

The marked improvement in capital gains and losses over the previous period is due to the increase in unrealized gains on stocks thanks to the recovery in the stock market, and the decrease in the losses from revaluation of securities. However as each company is struggling to sell new policies, their insurance-related profits have been flat, or are on a decline. The effects of any reductions in operating expenses have been limited. We could thus say that their financial situation is one that is vulnerable to stock price changes.

4. Analysis of Financial Health

4.1 Solvency Margin Standards

The solvency margin is the standard by which the regulatory agency monitors life insurers in Japan and is calculated as follows:

$$\text{Solvency Margin Ratio(\%)} = \frac{\text{Amount equivalent to shareholders equity}}{\text{Total risk} \times 0.5} \times 100$$

In Japan, if this ratio falls below 200%, then an Early Correction directive is issued by the Financial Services Agency (FSA).

The indicator is important not only as a measure of financial health for the policyholders, but it is also important for the regulatory authorities as it provides an indication of when they need to take action. However, these solvency margin standards have not necessarily functioned effectively in the past. Of the life insurers that failed in the past, most had solvency margin ratios of over 200% -- the threshold rate where they are considered healthy. The fact that officially “healthy” life insurers failed is the factor behind the low confidence behind Japan’s solvency margin ratios.

Some deficiencies with the Solvency Margin Standards are 1) The recent volatility in stock and land prices is not adequately reflected in the market (price) risk etc., – a factor in “Investment Risk” and 2) the standard assumes that the insurance company is a going concern.

With these issues in mind, we make some adjustments to the disclosed solvency margin ratios and calculate their “corrected” solvency margin ratios. In order to give the corrections some objectivity, we adopt the RBC (Risk Based Capital) Standard methodology.

(1) Objective to Finding the Adjusted Solvency Margin Ratios.

We attempt to bring the Japanese solvency margin ratios as close as possible to the RBC standards. First we assess all assets – such as securities held and land -- by their market values as much as possible to adjust the numerator, the solvency margin, for unrealized gains and losses. Then we adjust the figure for JCER’s own set of standards, such as assuming that the companies will all make loss loan provisions at the same rate, depending on classification of the bad loan.

As for the denominator, we raise the risk coefficient for the risk of losses caused by price fluctuations up to RBC standards so that changes in asset prices are captured. Finally, we focus on the solvency of the company in the *event of failure*, and thereby correct the solvency margin ratio to liquidation standards, or in other words, eliminate all items that do not have any liquidation value.

(2) Results of Adjusted Solvency Margin Ratio Analysis

Because we are using US RBC standards for our corrected solvency margin ratios, we also classify our estimation results by the same RBC rates that are used as guidelines for government intervention.

There are two major points where the RBC standards differ from the ones where Japan’s Early Corrective Measures will be implemented. One is that in Japan, if the solvency margin ratio is 200% or higher, then the life insurer is viewed as being healthy and no corrective measure is taken. However with the RBC standards in the US, the ratio may be 200% or higher but if it is below 250%, then a trend test must be conducted. If the results of the test show that the capital of the insurer is rapidly declining, then the same measures will be taken for the company as if the ratio were under 200%.

The other main difference is that in Japan, the solvency margin ratio must be below 0% before the

regulator can issue a reconstruction or even issue a liquidation order to the company. In the US, this measure can be taken when the ratio is below a much higher ratio of 70%.

In Table 3.8, we show the solvency margin ratios as disclosed by the insurers and our adjusted ratios. As at the end of March 2005, there is one insurer that would be required to undergo a trend test (ratio from 200-250%), while there are no insurers whose ratios are low enough that would require action from the regulators (150-200%). According to RBC standards, if a company’s solvency ratio falls to a level that requires action on the part of the insurer itself, then an RBC planning document must be submitted the insurance regulatory body. If action is required at the administrative level then the insurance regulatory body would conduct an examination, and a business improvement order would be issued. At the end of March 2005, there were eight insurers whose ratios were over 250%, and we can say that the life insurers overall are recovering their health.

Table 3.8 Disclosed and Adjusted Solvency Margin Ratios (End of March 2004-2005)

	Under 0%	0 ~ 70%	70 ~ 100%	100 ~ 150%	150 ~ 200%	200 ~ 250%	Over250%
Number of insurers (total 9) 31 Mar 2004	0	0	0	1	1	0	7
Number of insurers (total 9) 31 Mar 2005	0	0	0	0	0	1	8

5 . Third Sector Insurance

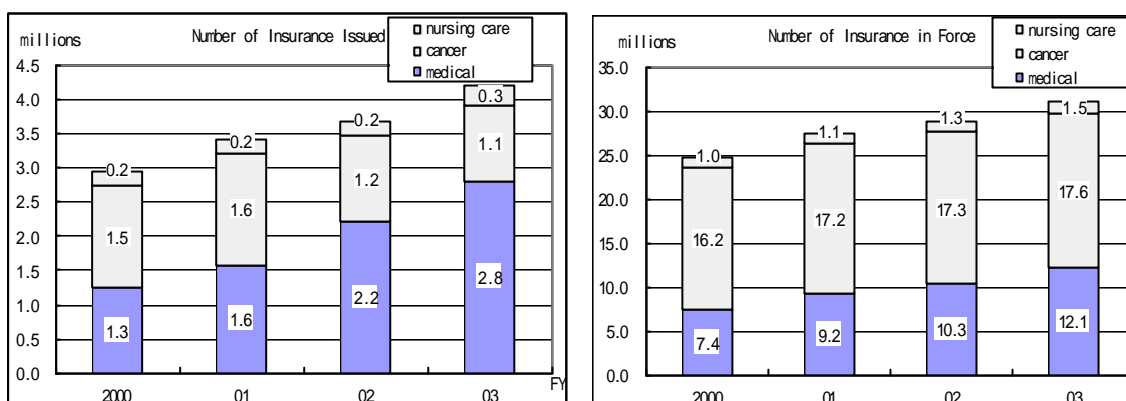
5.1 The Third Sector Insurance Market in Japan

”Third Sector” insurance occupies a position somewhere in between life insurance (first sector) and damage insurance (second sector). The insurance is designed to help people continue living, and will take the form of medical benefits paid out at times of hospitalization due to illness or injury, or if the policyholder falls ill with cancer. Entry into this business was until recently closed to the major domestic life insurers, though some foreign insurers were allowed entry. This third sector, however, was fully liberalized from January 2001 in response to the Japan-US Insurance Talks at the end of 1996 on deregulation in the insurance industry.

As the number of new policies for the main life insurance product was not growing, many insurers have positioned the third sector insurance product as one of their new main sources of revenue, and competition to win new policies is intensifying. The reasons that third sector insurance is gaining in popularity can be summarized as follows: 1) As families have fewer children, and the baby boomer generation reaches retirement age, the demand for life insurance products are declining. 2) There is anxiety towards the future of the health insurance system in Japan. 3) Many products have low monthly premiums because they do not offer cash surrenders. 4) The policies are easily entered into as there is no medical examination.

In Figure 3.2, we show the number of new policies and in policies in force of some of the more typical third sector insurance products – medical insurance, cancer insurance and nursing care insurance.

Figure 3.2 Number of New Policies and Policies in Force of Third Sector Insurance Products (of Life Insurers)



Regarding new policies, medical insurance policies have been growing steadily since fiscal 2001. In fiscal 2003, the number of new policies became 2.2 times that of fiscal 2000. With the full liberalization in January 2001, once domestic life insurers entered the third sector insurance market, they have focused their efforts on mainly the medical insurance product. In contrast to this, the number of new cancer insurance policies entered into has been declining since fiscal 2002. Cancer insurance has been the mainstay product for some foreign life insurers and they have already captured a portion of the market, and so this is probably due to the market being almost saturated. Long-term insurance policies are also increasing at a steady pace though still at a low level compared to medical insurance policies.

As for current policies in force, since cancer insurance was the main product of third sector insurance, this product continues to have the highest number of policies. However, lately the growth has been smaller as there have been fewer new policies. In the meantime, with the growth in new policies, the policies in force for medical insurance are also growing steadily.

5.2 Players in the Third Sector Insurance Market

The foreign life insurers such as American Family Life and AIG Group are very active in the third sector insurance market (Table 3.9). These two insurers receive the equivalent of half of the premiums paid to the top nine insurers in this market.

Furthermore life insurers associated with damage insurers and life insurers originally from other industries such as Sony are entering the market with force and are earning good revenues.

Table 3.9 Annualized Insurance Premiums of Third Sector Insurance (Fiscal 2004)

	billion yen, %					
	Annualized of Premiums of New Contracts			Annualized of Outstanding Contracts		
		Year-on-Year Change	Share of Total		Year-on-Year Change	Share of Total
Nippon	50	-22.9%	19.4%	549	0.0%	16.5%
Dai-ichi	63	11.4%	36.2%	453	4.8%	21.1%
Meiji Yasuda	39	-	31.4%	343	1.3%	17.1%
Sumitomo	60	27.4%	37.3%	414	6.3%	21.2%
Mitsui	11	-6.2%	22.5%	110	0.6%	15.7%
Asahi	22	21.6%	59.2%	131	9.8%	19.9%
Taiyo	14	9.3%	30.4%	106	3.1%	14.5%
Daido	4	-6.3%	4.6%	62	-2.3%	9.2%
Fukoku	11	-10.8%	24.0%	87	5.8%	19.8%
9 Major Life Insurers Total	274	-	28.0%	2,255	3.1%	17.8%
American Family	80	-3.6%	78.0%	882	5.0%	92.3%
AIG Group (Three entities)	77	-	23.9%	364	-	-
AXA Group (Two entities)	16	20.6%	23.4%	142	-	31.3%
Tokio Marine Nichido anshin	8	7.8%	15.2%	42	14.2%	16.0%
Sompo Japan Himawari	18	91.6%	43.1%	74	17.1%	38.4%
Sony Life	16	-	25.2%	103	-	22.8%

5.3 Characteristics of Third Sector Insurance Products

Whole life insurance policies are gaining popularity in Japan as the Japanese are more and more anxious about the future of the health insurance system. In overseas countries, term policies make up the lion’s share of the policies, and the fact that whole insurance policies account for most of the third sector policies in Japan distinguishes this market from other countries. From the insurers’ perspective, however, they are assuming greater risk in having most of their sales in whole, over term policies products and managing this risk is essential.

The main product in Japan in this sector is the Fixed Benefit Type product that supplements the public health insurance by paying out a fixed amount per day. There are fewer products in Japan along the lines of US private insurance policies that reimburse the policyholder’s claims for actual expenses incurred.

There are also the insurance products that promise to insure anyone. Though it is easy to buy this kind of insurance, it is important to note that when the policyholder makes a claim, they may be confronted with various regulations (exclusion clauses).

5.4 Risks Involved in Third Sector Products

The risks in the third product insurance industry can be classified into risks that can be anticipated – risks that we can forecast from past trends – and risks that can not. The third sector insurance industry, that offers many products and accompanying different types of benefits, seem to be vulnerable to the external risk factors – those that cannot be anticipated. Some typical kinds of risks include 1) the risks involved with advancement in medical technology and changes in the healthcare system, 2) the risk that the payout of benefits will be greater than anticipated with an aging of the population that exceeds expectations, 3) the risk of insuring against a specific disease

and 4) risk concentration, moral hazard risks.

For third sector insurance, there is little data, and since insurance incidents may occur at vastly different rates depending on external factors, it is difficult to establish standard occurrence rates. Thus, the rate of policy reserves to be accumulated has been left to the discretion of the individual insurer. However, as third sector insurance policies are long-term policies, it is imperative that a standard be established for this sector immediately. To tackle this problem, the FSA established a team in February 2005 to discuss policy reserve rules and post-incident verification measures. This group is made up of actuaries, public accountants, experts, and other persons involved in life and non-life insurance, and they have been discussing risk management measures for the third sector insurance industry.

In this environment, the FSA has been enforcing further transparency in disclosure. Life insurers need to have adequate disclosure regarding their risk management and ensure that their policyholders are protected and market discipline is being enforced. For example, if the company has chosen reinsurance as a means of mitigating their risk, then they need to disclose the contents thereof and show that the risk has been transferred. Furthermore, they should also disclose the profits of their insurance products, revisions to their actuarial assumptions, and results of their liability adequacy tests.

In the third sector insurance industry, risk management must be stringently enforced under several items such as; appropriately calculated expected occurrence rates, post-incident verification, adequacy of policy reserves, and information disclosure. As the product offerings in third sector insurance are very diverse, there is great uncertainty in the risks involved. Therefore, a comprehensive risk management program would be more effective than managing risk on a risk by-type basis.

6 . In Conclusion

Fiscal 2004 was a year where we saw a recovery in the health of life insurers in increased in real assets, and improvements in solvency margin ratios against the backdrop of robust stock prices. Policy cancellations had been a concern in the past, but the surrender and lapse ratios are also improving since peaking in fiscal 2002. Many life insurers saw a lengthening in the years to maturity of their assets held. From an asset-liability management perspective, they are mitigating their interest rate risk by matching the terms of their assets with their liabilities – policy reserves that are long-term liabilities. However, this is not to say that all issues have been resolved, as we also saw a decline in policies in force, and in insurance premiums, and so some structural issues do remain.

We also conducted JCER’s corrected solvency margin analysis, using these more stringent ratios than are publicly disclosed. Though the anxiety in the life insurance industry has receded and we a recovery in the health of the life insurers has been confirmed, the Japanese regulators must still review the indicators disclosed to the public by the insurers, ensure that they are stringent enough and make the insurers more transparent.

Japanese life insurers are at a transition stage as privatization in the postal system is imminent, and

they are making a full-fledged foray into the third sector insurance market. We hope that the recovery of fiscal 2004 becomes a stepping stone for each company to embark upon some new challenges, and we look forward to their results.