Ongoing Change in Japan’s Life Insurance Industry

Japan’s life insurance industry, following a relatively static decade, is experiencing deregulation and market entry by foreign firms. A fight for survival is taking place among Japanese and foreign life insurers in the “third sector” of cancer, medical and long-term care insurance. Given the extremely high levels of financial assets held by Japanese households, there is still plenty of room for innovative ideas in the market.

Industry Restructuring

According to a nationwide survey by the Japanese Institute of Life Insurance (JILI) in 2003, 89.6% of all households have life insurance policies. Of these households, the average number of policies (including individual annuities) came to 4.3 and total annual insurance premiums amounted to ¥531,000, making Japan one of the world’s largest insurance markets.

Between roughly 1996 and the start of this year, a time of extremely low interest rates and stagnating stock prices due to the collapse of Japan’s asset-inflated “bubble” economy, domestic life insurance companies saw their financial situations deteriorate rapidly as their asset investments fell short of the guaranteed yields promised to policyholders. At the same time, poor economic conditions encouraged individuals not only to stop buying new policies, but also to cancel or not renew existing policies. In response, life insurers began restructuring through moves such as laying off sales personnel. Nevertheless, Nissan Mutual Life, a mid-sized company, went bankrupt in 1997, and was followed by six other life insurers, including second-tier companies. Of the 31 names listed as members in the Life Insurance Association of Japan in 1996, only 15 of these companies remained in 2005 (although total membership had risen to 39). The other 16 companies either changed their names due to a merger or acquisition, or went bankrupt.

Individual insurance in force declined from a peak of ¥1,495 trillion in the fiscal year ending March 1997 to ¥383 trillion in March 2005.

Deregulation Spurs New Market Entry

Most observers, however, feel that the Japanese life insurance industry has put the worst behind it. Although earnings growth was hurt by continuing declines in new policies and insurance in force in the fiscal year ending March 2005, cancelled and lapsed policy rates declined and premiums calculated on an annualized basis improved.

Although the negative spread between investment return and policy income has not been entirely eliminated, the amount of the spread has decreased. Moreover, there was a rise in the solvency margin, or insurance companies’ capacity to pay against greater-than-expected risk. In addition, individual insurance benefits were raised for the first time in eight years, further evidence of better conditions.

Improved financial results enabled the larger insurers to increase their reserves, which exceeded ¥100.0 billion for the four major life insurers. Unrealized gains on marketable securities also increased. Given such developments, Moody’s Investors Service raised the credit ratings of eight Japanese life insurance companies.

According to the Life Insurance Association of Japan (LIAJ), premium income has increased for two consecutive years and that the financial positions of its member companies have improved dramatically thanks to stronger stock prices.

But the makeup of the industry has changed significantly over the past 10 years. Besides Nissan Mutual Life and others withdrawing from the market, the merger between Meiji Life and Yasuda Life to form Meiji Yasuda Life is just one example of how companies are being restructured. Although it had been a difficult 10 years, LIAJ members managed to rise to 39 companies by July 2005 for two key reasons. First, the regulation prohibiting companies from offering both life and non-life insurance was relaxed, which enabled major companies from various fields to enter the life insurance market (through subsidiaries). The second reason is the growing presence of foreign
companies in the market. Current LIAJ membership includes 10 companies affiliated with non-life insurance companies and 16 foreign-affiliated companies, which together account for two-thirds of new members.

Foreign Players

Foreign life insurers have clearly raised their presence in the industry. In the interim period to September 2004, the U.S. firm American Family Life (AFLAC) surpassed Nippon Life to take the lead in number of individual policies, something of a shock considering that Nippon Life had been the top firm for so many years. AFLAC, which only offers individual—not group—insurance policies, had 16.92 million policies in force at the time.

Since becoming the first company in Japan to sell cancer insurance in 1974, AFLAC’s strategy has been to consistently specialize in “third sector” insurance. The first sector, life insurance, pays insurance benefits related to living and dying, and the second sector, non-life insurance, pays compensation for damage caused by accidents. The third sector, which occupies a position somewhere between the first and second sectors, includes medical insurance, long-term care insurance and personal injury insurance.

According to Jun Shigematsu of AFLAC’s public relations department, “Specialization in the third sector allows us to keep operating costs low. We commercialized cancer insurance to complement Japan’s public health insurance system. We had sold cancer insurance in the U.S., but cancer awareness differs in Japan, so we had to match the product to the local health insurance system. As a result, we developed a unique product for the Japanese market, initially just to cover hospitalization and death. But over the years we have adapted our policies to meet new needs, such as sizable death benefits and coverage for the cost of surgery.”

New Sales Strategies

Insurance is generally sold through agents, which totaled 16,961 nationwide as of March 31, 2005. According to the Insurance Business Law, life insurance must be sold by agents who are affiliated with a life insurance company or insurance agency. AFLAC, for example, has about 73,000 agents. Japanese life insurance companies tend to use their own sales personnel, who serve as insurance agents but are formal members of the company. A benefit of selling through agents is that it keeps costs down.

A financial crisis occurred in 1997, when a succession of large finance/insurance companies including Nissan Mutual Life declared bankruptcy. AFLAC saw a drop-off in its number of new policies and decided to shift the focus of its sales from company employees (low sales overhead) to general individuals. The company’s financial performance recovered sharply in 1998, so AFLAC began aggressively establishing walk-in retail outlets and now has more than 200 nationwide.

Strategies for Medical Insurance
The third sector, spurred by its complete liberalization in 2001, is expected to be a primary battleground in the life insurance industry. Many foreign companies are generating strong earnings in the sector, at the same time that domestic companies have watched their once-mainstay whole life insurance products with term insurance options (riders to insurance with large death benefits) decline in sales.

Major Japanese insurers have approached the third sector in various ways. Sumitomo Life sells a unique whole life policy for senior citizens that provides hospitalization, surgery benefits and death benefits. The company is aggressively expanding its share. Dai-ichi Mutual Life established an alliance with AFLAC in 2000. Nippon Life markets essential medical products and medical insurance for in- and out-patient treatment, serious illness and even death. Unlike medical insurance focused on hospitalization and surgery benefits, the company is targeting the growing number of middle-aged and elderly people who simply want basic medical insurance. The company emphasizes the need to cover risks regarding possibly substantial changes in benefit payouts due to medical advances and other factors.

Activity at Major Life Insurers

Nippon Life set up an in-house medical research unit in fiscal 2005 to develop medical insurance products. The unit, which has a staff of 19, including seven physicians, is analyzing medical data to look for opportunities to begin offering new forms of medical insurance as soon as possible. The company’s commitment to this market reflects the rising level of competition in the third sector, although AFLAC, the leader in medical insurance, appears ready to do battle.

According to Shigematsu, “We have been specializing in the third sector for 30 years, so our cumulative knowledge and experience will be an advantage going forward. When the market was deregulated in 2001, it did not have much of an effect on our financial performance. And our alliance with Dai-ichi Mutual Life is proceeding extremely well. While competition in the third sector is bound to heat up, I believe we will be able to maintain our superiority.”

The government is drafting a policy to lift the ban on insurance sales by banks, starting with single-premium endowments and other products this year. Sales of individual annuities and certain other policies are permitted already. If the prohibition on all insurance were lifted, it would likely work to the advantage of foreign life insurers, especially those with strong networks of agents or phone-based sales channels.

The promise of deregulation may tempt more foreign companies to enter the market. Just 39 life insurance companies are vying for a market made up of ¥1,400 trillion in household financial assets. The markets in the U.S. and Europe are quite crowded by comparison, with 354 companies in the U.S. (American Council of Life Insurance), 455 in Germany (German Insurance Association) and around 400 in the U.K. (Association of British Insurers). While it is impossible to make simple comparisons, the exceptionally small number of life insurance companies in Japan suggests there is room for more foreign firms. Further—even profound—transformation of the industry is a real possibility.
Reference

The Life Insurance Association of Japan (www.seiho.or.jp)
Japan Institute of Life Insurance (www.jili.or.jp)