



# Japan's Insurance Market 2011

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# The Great East Japan Earthquake and the Status of The Toa Reinsurance Company, Limited

# 1

● **Hiroshi Fukushima** President and Chief Executive, The Toa Reinsurance Company, Limited

## *Introduction*

I would like to extend my heartfelt gratitude to customers and overseas reinsurers for their support and words of encouragement following the Great East Japan Earthquake of March 2011. The insurance industry as well as many nations, regions, international institutions and non-governmental organizations have been involved in relief activities for Japan while providing material support. The magnificence of such international cooperation that has transcended region and race has reaffirmed my faith in human nobility.

This paper covers the status of damage, the impact on Japan's insurance industry, and the status of The Toa Reinsurance Company, Limited (Toa Re) with regard to the Great East Japan Earthquake of March 2011.

## *Damage from the Great East Japan Earthquake*

The Great East Japan Earthquake struck the Tohoku region of Japan at 14:46 (Local time) March 11, 2011, with its epicenter off Japan's Sanriku coast in the Pacific Ocean. This powerful earthquake stands out because it caused an enormous tsunami. With a magnitude of 9.0, it was the fourth-strongest earthquake worldwide since 1900. This powerful temblor and subsequent tsunami caused widespread destruction and have had severe economic repercussions from collateral issues such as disrupted logistics and supply chains and electricity shortages due to the shutdown of nuclear power plants.

### (1) Economic Costs

#### **A. Direct Costs**

I would like to cover the direct costs of the Great East Japan Earthquake. This temblor had a magnitude of 9.0, the highest in Japan's recorded history. It created tsunami of over 10 meters tall, with the highest at 38.9 meters in height. Damage extended broadly along Japan's Pacific coast from the Tohoku to the Kanto Region. A Cabinet Office announcement July 2011 indicated that more than 20,000 people were dead or missing as a result of the disaster and that more than 200,000 structures were either completely or partially destroyed.

The scale of destruction from the Great East Japan Earthquake surpassed the extensive damage from the Great Hanshin-Awaji Earthquake (Kobe Earthquake) of 1995. Approximately 6,400 people were dead or missing after the Great Hanshin-Awaji Earthquake, compared with approximately 20,000 dead or missing after the Great East Japan Earthquake as of July 2011. Damage from the Great Hanshin-Awaji Earthquake totaled 9.9 trillion yen, while damage from the Great East Japan Earthquake is estimated at 16 trillion yen to 25 trillion yen.

In addition, the Great Hanshin-Awaji Earthquake had a magnitude of 7.3, while the Great East Japan Earthquake had a magnitude of 9.0. Expert analysis indicates that the latter released energy on an order of several hundred times greater than the former.

## **B. Indirect Costs**

The Great East Japan Earthquake is the cause of many indirect costs that will arise for long time through secondary channels. The earthquake cut into corporate economic activity by disrupting the road and rail distribution network, thus cutting supply chains and causing numerous companies to suspend production activities. Moreover, the widespread effects of suspended production in the automobile and electronics industries were apparent not only in Japan but also worldwide. Consequently, some companies in manufacturing industries shifted production to western Japan after the earthquake.

In addition, the earthquake and tsunami damaged Tokyo Electric Power Co., Ltd.'s Fukushima Dai-Ichi Nuclear Power Station, which has also impacted the lives of individuals. People living in the area around the power plant have necessarily been evacuated to shelters for an extended period, fishermen and farmers in the area are suffering damage from radioactive contamination as well as reputational damage.

Further, Fukushima Dai-Ichi formerly supplied electricity to Tokyo and surrounding areas, giving rise to the problem of electricity shortages. Appeals to further conserve electricity to counter the power shortages caused by the Great East Japan Earthquake extend to the household level.

## **(2) Insurance Losses**

### **A. Scale of Losses**

I would now like to consider insurance market losses. As discussed above, the impact of the Great East Japan Earthquake is huge and wide-spread. Consequently, it will take time to estimate the damage clearly. I would like to look at figures announced after the earthquake by modeling companies and recently announced insurance payouts for each insurance company.

First, the calculations of the modeling companies, based on estimates after the earthquake from EQECAT, Inc. on March 16, AIR Worldwide on March 25, and Risk Management Solutions, Inc. on April 12.

Estimates were broadly in the 1.5 trillion yen to 2.8 trillion yen range. EQE estimated the global insured loss, including co-operatives but before reinsurance, at 980.0 billion yen to 2,050.0 billion yen. AIR put the figure at 1.5 trillion yen to 2.5 trillion yen, while RMS estimated it at 1.75 trillion yen to 2.84 trillion yen.

According to the Financial Services Agency (FSA), after the announcement of financial results of insurance companies in 2011, insured losses related to the Great East Japan Earthquake among non-life and life insurance companies and co-operatives will total 2.7 trillion yen. Earthquake coverage for personal dwellings, a major component of this sum, is estimated at more than 1.0 trillion yen based on the General Insurance Association of Japan (GIAJ) calculations. Non-life insurance coverage excluding earthquake coverage for personal dwellings was estimated at 600.0 billion yen by the five major insurance companies. Looking at this situation, clarifying the details will take time, but the scale is generally in line with the modeling company's estimates. (FSA press release, July 2011)

According to the GIAJ, as of July 2011 losses to earthquake coverage for personal dwellings due to damage from the Great East Japan Earthquake are estimated to total 1.0 trillion yen. This is more than 10 times the losses to personal earthquake coverage of 78.3 billion yen as a result of the Great Hanshin-Awaji Earthquake.

While statistics are not available for extended earthquake coverage for corporations from the Great Hanshin-Awaji Earthquake, the record amount to date was 567.0 billion yen in 1991 as a result of Typhoon No. 19. Insured losses from the Great East Japan Earthquake will surpass this figure.

#### **B. Response by Primary Companies**

Primary companies realize that the insurance industry's top priority is paying out insurance benefits because it is critical to the lives of the affected people. The GIAJ and the Life Insurance Association of Japan are working to accelerate payment of claims and strengthen response to inquiries from policyholders.

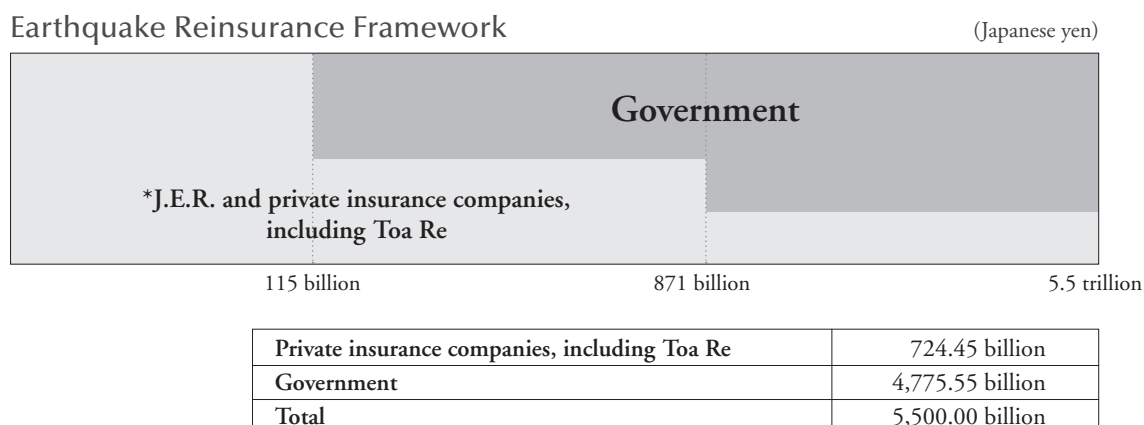
For example, for the first time the industry is partially introducing the use of aerial and satellite photographs to efficiently handle approval of insured losses for entire areas and quickly pay out insurance claims. Further, insurance companies are putting all their capabilities behind priority initiatives to provide economic support to policyholders in areas such as procedures for concluding follow-on contracts and offering premium payment extensions.

Insurance companies do not only pay out policyholder claims proactively. While actively moving to speed payment of claims, the entire industry is making every effort to help affected people and areas through means such as donating money to relief efforts and consulting with policyholders.

**C. Impact on Insurance Companies**

The insurance for earthquake risk discussed above can be broadly divided into coverage for personal dwellings and extended earthquake coverage purchased by corporations. What effect will these types of coverage have on insurance companies? The short answer is that the impact of insured earthquake losses on Japanese insurance companies will be limited.

Earthquake coverage for personal dwellings has been included as a rider to home fire insurance policies under an earthquake insurance system Japan established in 1966, which has served as the framework enabling consumer access to earthquake coverage for dwellings. Private insurance companies cooperate with the government in a reinsurance system for earthquake coverage for personal dwellings that provides coverage for damages of up to 5.5 trillion yen per earthquake. As shown in the diagram below, under this system insurance companies establish reserves for earthquake coverage for personal dwellings with no accounting impact on income.



\*J.E.R. : Japan Earthquake Reinsurance Company, Ltd.

The majority of corporate earthquake coverage is included in fire insurance as a rider covering losses from earthquakes and tsunami. Insurance companies cover various types of damage with extended earthquake coverage purchased by corporations, and expert analysis indicates that insurance companies will be able to respond within established provisions for catastrophe reserves.

The minimum solvency margin ratio which insurance companies must maintain in Japan is 200%, but in actuality as of March 31, 2011 the solvency margin ratio of Japanese insurance companies was much higher, generally in the 600% to 800% range. Overall, the insurance industry must be considered sound.



I would like to conclude my comments on the impact of the recent earthquake on insurance companies by discussing the nuclear power issue. The Japan Atomic Energy Insurance Pool (JAEIP) was established in 1960 because losses associated with nuclear power represent an enormous and specialized risk. Japanese direct underwriters, including Toa Re, and foreign companies that had acquired a license to operate in Japan structured this nuclear power insurance pool. It underwrites insurance for nuclear power liabilities to a maximum of 120.0 billion yen per incident with reinsurance through nearly 20 pools worldwide.

The accident at Fukushima Dai-Ichi is a nuclear power incident caused by an earthquake, and earthquake risk is excluded from nuclear power facility liability insurance indemnity. Private insurance (JAEIP) is therefore not expected to pay out claims in connection with the accident.

### *Unprecedented Disaster*

Having discussed the impact of the Great East Japan Earthquake and associated losses, I would like to point out that the recent disaster was, in a word, unprecedented.

This term “unprecedented” refers to an occurrence that is truly rare, but recently its use has become increasingly common in describing disasters and incidents around the world. Looking back on just the past 10 years, the insurance industry has experienced a succession of “unprecedented” disasters, and I would like to examine several of them.

#### September 2001: Terrorism at the World Trade Center

On September 11, 2001, simultaneous acts of terrorism using hijacked airplanes took place in the United States. More than 3,000 people died and more than 6,000 people were injured. Insurance losses on property and business interruption insurance alone exceeded 20.0 billion dollars. It was the worst man-made disaster in history, making it unprecedented.

#### December 2004: Sumatra Earthquake

On December 26, 2004, the world's largest earthquake in 50 years with a magnitude of 9.1 struck the island of Sumatra. It caused a tsunami that wrought enormous and widespread damage along the coast of the Indian Ocean. More than 220 thousand people died, and more than 130 thousand were injured. Insurance losses on property and business interruption insurance alone exceeded 2.0 billion dollars.

### August 2005: Hurricane Katrina

In late August 2005, a hurricane of the Category 5 level at its peak called Katrina caused immense damage to the southern coast of the United States. It killed 1,836 people and economic losses were more than 900.0 billion dollars. Insurance losses on property and business interruption insurance alone exceeded 70.0 billion dollars, the largest amount in history.

### 2008: The Financial Crisis

The impact of the drop in housing prices in the United States in 2007 caused sub-prime borrowers to default on their obligations, and the U.S. housing bubble collapsed. Subsequently, the credit risks of a wide array of financial products materialized, causing widespread alarm.

In 2008, Bear Stearns faced business crises, touching off a full-scale global financial crisis. The collapse of Lehman Brothers and other incidents deepened the crisis, and the global economy entered an extended recession. This was an unprecedented crisis in the financial industry.

### 2010: Earthquakes in Chile and New Zealand

Many natural disasters occurred in 2010. A January 2010 earthquake in Haiti killed more than 220,000 people. In February 2010, a storm named Cynthia struck Western Europe, causing 2.8 billion dollars in insurance losses. In the same month, a magnitude 8.8 earthquake occurred in Chile that caused tsunami on the other side of the world in Japan.

In April 2010, the British Petroleum plc oil-drilling platform Deepwater Horizon exploded. Though not a natural disaster, it released a large amount of crude oil from the seabed into the Gulf of Mexico, creating a massive oil slick.

In September 2010, a magnitude 7.0 earthquake occurred near Christchurch, New Zealand. From December 2010, record-breaking rain fell in the state of Queensland, Australia, resulting in extensive flood damage. Then in January 2011, a massive cyclone named Yasi struck that area, causing further significant damage.

Then in February 2011, another earthquake struck Christchurch, New Zealand, causing greater economic and social losses than the September 2010 temblor. Given the occurrence of so many natural disasters in just over a year along with consecutive natural disasters in the same regions, we can call it “a year of disasters far exceeding assumptions” without exaggerating.





The first Chancellor of Germany, Otto von Bismarck, said, “Fools learn from experience, wise men learn from history.” He meant that fools must first make a mistake to understand its cause and avoid the same mistake in the future, while wise men learn about the mistakes of the past to avoid the same mistake in the future. Given the occurrence of multiple unprecedented disasters, we must once again confirm the importance of diligently learning from history.

*Learning from History  
(Jogan Earthquake,  
A.D. 869)*

Newspaper articles have suggested that the Great East Japan Earthquake was a once-per-thousand-years temblor, and actually it closely resembles the Jogan Earthquake of A.D. 869.

*Nihon Sandai Jitsuroku*, a classical Japanese history text, suggests the Jogan Earthquake was a powerful temblor with an estimated magnitude of 8.3 and its epicenter off the Sanriku coast. It destroyed numerous castles and other structures, and created a tsunami that affected a wide area and drowned approximately 1,000 people.

The Great East Japan Earthquake has been described as unexpected, but actually the latest research from Japanese research institutes warned about the risk of a massive earthquake and tsunami in that region.

On the other hand, all households survived in some areas of the coastal towns that suffered extensive damage from the tsunami caused by the recent massive earthquake. Life has gone on in these areas for decades, in houses built in heed of the warning on stone markers (photo) set at 60 meters above sea level.

The massive tsunami resulting from the Great East Japan Earthquake swept over the area, carrying with it fishing boats and wreckage. However, the tsunami went no further than these stone markers, and the dwellings in areas beyond the markers were not damaged. The inhabitants had heeded the important message that the stones had been communicating to them since their childhood.



The inscription reads, “The area below this marker is subject to disastrous tsunami. For the sake of future generations, do not build houses below this point.”

## *Future Tasks and Considerations*

What tasks has the recent earthquake set for the insurance industry, and what does the industry need to consider? I would suggest that the following are three major issues.

### (1) Greater Sophistication in Managing Exposure

Greater sophistication in managing exposure is the first major issue. Natural disaster risk such as earthquake risk can cause massive losses if it materializes. Appropriate quantitative evaluation is therefore critical to managing insurance.

The following are three problems in evaluating earthquake risk using historical data:

- 1) historical data are not sufficient for statistical modeling;
- 2) historical data require revision and correction for application to the present; and
- 3) the possibility of extensive damage due to an event of unprecedented scale or unforeseen cause must also be considered.

Progress in research into the occurrence of earthquakes and the damage they cause from perspectives such as earth science and architectural engineering has created methodologies for engineering modeling of earthquake risk. The insurance industry needs to further raise the sophistication of earthquake modeling through the use of this kind of engineering modeling as a core component supplemented by historical data.

### (2) Enhanced Stress Testing

Enhanced stress testing is the second major issue. Even with the Great East Japan Earthquake, Japan's insurance companies maintained sufficient solvency margin ratios during the fiscal year ended March 31, 2011. A key reason was that companies ensured sufficient capital as a result of stress testing using assumptions such as a recurrence of the Great Kanto Earthquake of 1923.

Insurance companies will require an even greater variety of stress tests in the future. Looking at natural disasters in the Oceania region since 2010, two major earthquakes in the space of a year, large-scale floods and major cyclones have wrought major damage. With natural disasters occurring more frequently, insurance companies must implement stress tests that assume multiple natural disasters per year. They must also enhance stress testing by examining the validity of their assumptions about the scale of natural disasters in light of data such as the occurrence of consecutive earthquakes in the same region and historical events.



### (3) Enterprise Risk Management (ERM)

The third major issue is ERM. Even if a company improves modeling sophistication and conducts various stress tests, the manner in which it uses the results is crucial. Modeling and stress tests are necessarily limited and do not by themselves provide completely accurate solutions.

Recognizing that theory has its limits, companies need to implement ERM throughout operations using the results of modeling in combination with the unspoken, tacit knowledge of underwriting and risk management professionals.

Many books and scholarly papers explore ERM. Using ERM in the course of daily work and enhancing its sophistication are the important issues. In an unpredictable environment, ERM provides insight into various phenomena that transforms vague data points into identifiable risks.

#### *Status of Toa Re*

#### (Toa Re's Initiatives and 70-Year History)

October 15, 2010 was the 70th anniversary of Toa Re's establishment in 1940. During those 70 years, Toa Re has maintained stable and continuous growth.

Since its establishment in 1940, Toa Re has positioned the domestic non-life business as its core business. Since the 1980s, Toa Re has expanded the regions it serves in ways such as establishing The Toa Reinsurance Company of America and three branches in Asia. In 1997, Toa Re received approval to provide life reinsurance, while in 2000 it received approval to provide reinsurance to co-operatives, thus expanding underwriting risk. Duly assessing the market environment, Toa Re has prudently diversified its sources of earnings based on its risk appetite, which has contributed to the Company's steadily growing scale.

(Crescendo 2011 – Toa Re’s Medium-Term Management Plan)

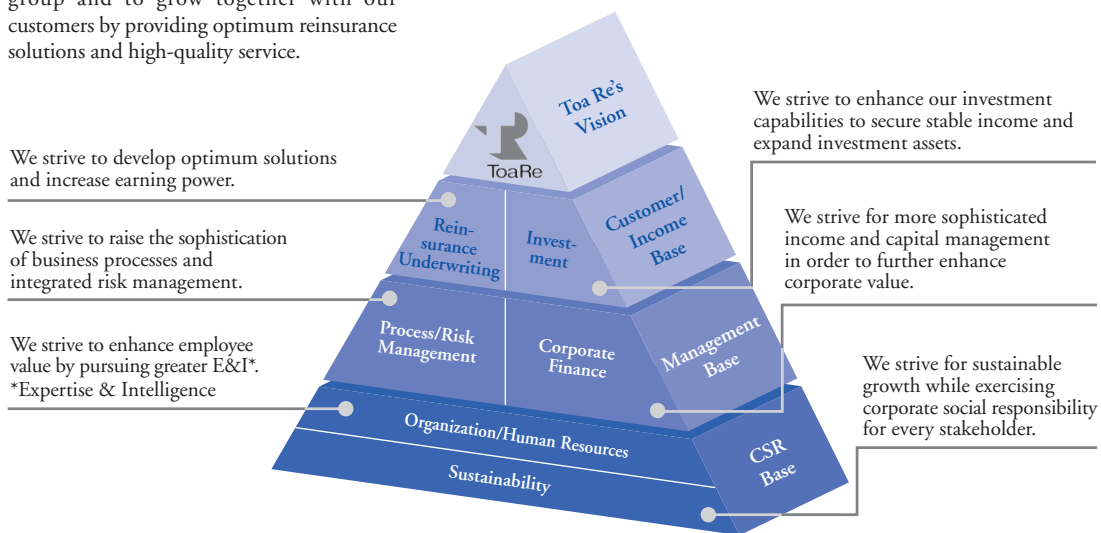
The Toa Re Group is now working together to implement Crescendo 2011, the medium-term management plan initiated in April 2009. Under this plan, Toa Re is establishing a powerful management structure that can respond to changes in the operating environment. With our corporate philosophy of contributing to society’s peace of mind as our starting point, we are providing stable, long-term reinsurance and various other services from a strong financial base.

As the pyramid diagram shows, our goal is to generate sustained growth as a reinsurance company by providing customers with optimum reinsurance solutions and high-quality services. A strategy with the three bases of customers, income management and governance, and corporate social responsibility, Crescendo 2011 is positioned as the road map to our goals.

The year ending March 31, 2012 is the final year of Crescendo 2011. All employees are working together to implement measures to provide optimum solutions and service, improve profitability, and achieve the targets of the medium-term management plan.

Crescendo 2011 – Our Vision Pyramid–

We are striving to become a trusted corporate group and to grow together with our customers by providing optimum reinsurance solutions and high-quality service.



We strive to develop optimum solutions and increase earning power.

We strive to raise the sophistication of business processes and integrated risk management.

We strive to enhance employee value by pursuing greater E&I\*.  
\*Expertise & Intelligence

We strive to enhance our investment capabilities to secure stable income and expand investment assets.

We strive for more sophisticated income and capital management in order to further enhance corporate value.

We strive for sustainable growth while exercising corporate social responsibility for every stakeholder.



## (Impact of the Great East Japan Earthquake and Toa Re's Risk Management System)

I would like to discuss the impact of the Great East Japan Earthquake on Toa Re. While we are still calculating accurate figures for claims paid, certainly they will be greater than we have experienced over the past several years.

However, Toa Re underwrites earthquake risk reinsurance based on prescribed reserves, and calculates risk retention based on its solvency margin. Toa Re also rigorously manages risk through means including the use of retrocession techniques for risk in excess of its calculated risk retention.

Although the Great East Japan Earthquake exceeded assumptions, Toa Re's solvency margin is sufficient to cover the payment of claims that would result from a recurrence of the Great Kanto Earthquake. Moreover, our catastrophe reserve is adequately funded. Toa Re has sufficient equity capital and is well able to meet its solvency related to the Great East Japan Earthquake.

The success of initiatives based on Toa Re's mission statement of providing long-term, stable reinsurance has enabled Toa Re to remain in the reinsurance business and increase its corporate value over many decades. Consequently, the impact of the Great East Japan Earthquake on our businesses is relatively light and indeed, because of our ability to manage risk and maintain our solvency it further validates Toa Re's mission statement.

### *Conclusion*

Toa Re is Japan's sole comprehensive reinsurance company, operating for 70 years since its establishment in 1940 with the support of customers inside and outside Japan and overseas reinsurance companies. I would like to express our gratitude to all of our stakeholders.

The Great East Japan Earthquake reaffirmed the importance of learning from history. Reinsurance companies have a responsibility to think carefully about this earthquake along with other unprecedented disasters.

While reinsurance carries a number of responsibilities, the Great East Japan Earthquake underscored the importance of providing long-term, stable reinsurance capacity. Reinsurance companies exist to provide continuous reinsurance capacity so that insurance company customers swiftly receive payment of claims when an emergency occurs.

The responsibilities of reinsurance companies are not limited to providing long-term, stable reinsurance capacity. They also have the important responsibility of participating in the development of the insurance market in a variety of forms. Toa Re contributes to the development of insurance markets worldwide by holding seminars for customers in Japan and overseas, sending lecturers and panelists to international conferences, and participating in the Global Reinsurance Forum.

Committed to our mission of providing long-term, stable reinsurance capacity and contributing to the development of insurance markets, Toa Re will continue to contribute to its customers and society as a whole.



## The Introduction of an Economic Value-Based Regime in Japan and Its Impact on Non-Life Insurance Companies

# 2.

**Yuji Morimoto** President, Capitas Consulting Corporation

### *Introduction*

Japan's non-life insurance industry is subject to an array of issues and changes in the environment. Numerous challenges have confronted the management of non-life insurers, ranging from the unprecedented damage of the Great East Japan Earthquake in 2011, the dramatic changes brought on by the financial crisis of 2008, the maturation of Japan's non-life insurance market and its contraction due to population decline, and the gradual but very real impact of global warming. At the same time, international changes have included projects to align insurance contracts with international accounting standards, the creation of a regulatory framework for financial soundness by the International Association of Insurance Supervisors (IAIS), and the introduction of Solvency II in the European Union.

Under these conditions, Japan's non-life insurers have been strongly urged to strengthen risk management in order to compete on an international level. This paper summarizes trends in supervisory and regulatory conditions in Japan and how non-life insurance companies are dealing with them, followed by this author's opinions on what will be expected of the non-life industry in the future.

### *Current Status of Japan's Non-Life Insurance Industry*

I will begin with a basic overview of the status of Japan's non-life insurance industry.

As of January 2011, Japan's non-life insurance industry consists of 28 domestic non-life insurance companies (26 insurance companies and 2 reinsurance companies), in addition to 22 foreign non-life insurance companies. Net premium income for domestic non-life insurance companies totaled 7.025 trillion yen for the year ended March 2010, ranking third<sup>1</sup> worldwide after the United States and Germany despite an ongoing downward trend.

The major insurance products sold include motor, fire, compulsory automobile liability, personal accident and liability insurance. Savings-type non-life insurance that is unique to Japan is also available. This product incorporates both security and saving because it returns money to the policyholder at maturity if no accidents occur during a specified period. Interest rate risk management has also emerged as a crucial theme for non-life insurance companies because non-life insurance policy terms now extend beyond the standard one year.

The domestic market is not likely to grow strongly because the population of Japan is declining while the market is maturing. With the aging of Japanese society, the number of vehicles insured and other factors that drive motor insurance, a mainstay product, are projected to decrease. In this milieu, entering overseas markets is a key to growth, primarily among large companies. In addition, a series of alliances and mergers have taken place in the industry since 2000. Further restructuring occurred in 2010, resulting in the creation of three mega non-life insurance groups.

Table 1 summarizes the balance sheet of the members of the General Insurance Association of Japan as of September 30, 2010. One unique feature is that so-called cross-shareholdings account for a substantial share of equity portfolios.



Table 1: The Balance Sheet of Japan's Non-Life Insurance Companies  
(As of September 30, 2010; Billion yen)

Cash and deposits	2,756	Underwriting funds	21,783
Money in trust	109	Outstanding loss reserves	3,080
Securities	20,768	Underwriting reserves	18,703
National government bonds	9,242	Other liabilities	3,307
Stocks	6,330	Total liabilities	25,090
Foreign securities	4,792	Capital	3,157
Other securities	405	Unrealized gains on securities, net of income taxes	1,829
Loans	2,310	Deferred gains and losses on hedge transactions	42
Real estate	1,088	Other	-15
Other assets	3,072	Total equities	5,013
Total assets	30,103	Total liabilities and equities	30,103

Additional details on the current status of Japan's non-life insurance industry are available at the General Insurance Association of Japan's website (<http://www.sonpo.or.jp/en/>), particularly in the English version of the Association's fact book.

### *Proposed Revision of the Solvency Margin Standard*

In Japan, the current (as of May 2011) basis of the standard for computing the solvency margin ratio was introduced in 1996. This ratio is calculated with the solvency margin as the numerator and risk as the denominator. It indicates whether or not a company is properly able to pay insurance benefits and meet other commitments, with the standard set at 200%. Risk uses a factor-based approach, and the margin reserve incorporates financial accounting items included in net assets such as the reserve for price fluctuation and the contingency reserve.<sup>2</sup>

Although subsequent fine-tuning was implemented, the basic framework remained in use unchanged. However, in 2004 the Financial Services Agency (FSA) announced a financial reform program and in 2005 unveiled a basic schedule of items to consider in its review of the solvency margin ratio. More specifically, from the viewpoint of strengthening the financial condition of insurance companies and enhancing their risk management, the FSA initiated a study of the standard for calculating the solvency margin ratio that fit the actual conditions of financial markets in March 2005 and implemented a review of the standard for calculating the solvency margin ratio based on the results of this study with due regard for the status of inspection in connection with the principles shared with the IAIS.

Upon completing this review, the FSA formed a team to review issues related to the standard for calculating the solvency margin ratio in November 2006. Takau Yoneyama, professor of the Graduate School of Commerce and Management of Hitotsubashi University, led the review team, which consisted of 16 members including scholars, analysts, financial planners, certified public accountants, and practitioners from the life and non-life insurance industries. The Insurance Business Division of the FSA's Supervisory Bureau acted as the team's executive office. I was

one of the team members. The team held 11 review meetings, and released the results of its work in the paper “Regarding Solvency Margin Ratio Calculation Standards” in April 2007.

This paper proposes a two-stage revision of the standard for calculating the solvency margin ratio. The first stage is considered a short-term revision involving changes to the risk coefficient and other components within the existing regulatory framework. It is positioned as a stop-gap measure, a swift and specific revision of the solvency margin ratio that would suffice until the introduction of an economic value-based solvency regime. Until that time, a one-year period and a confidence level of 90% would be used for determining the risk coefficient. The first major objective is raising the confidence level to 95%.

The second stage involves so-called medium-term revisions: the economic value-based evaluation of assets and liabilities, and proposals for the introduction of a framework for comparing risk and capital consistent with IAIS proposals. This step is one of the aims set when the review team was formed, and was presupposed to be included before the report was announced. However, the report was surprising because of its strong call to introduce an economic value-based regime and particularly its clear emphasis on making consistent progress with the medium-term revisions in 2010.

Actually, as a participant on the review team, I myself was surprised. The assumption at the outset was that the team would primarily discuss the short-term initiatives. However, an impressive amount of the actual discussion was devoted to the medium-term revisions, or in other words, to economic value-based solvency margin regime. I personally wanted to strongly recommend the introduction of an economic value-based regime. While I welcomed this direction, I had not expected the discussion to embrace the importance of economic value to the extent that it did. I was under the impression that Japan’s non-life insurance industry at that time generally felt that an economic value-based regime was an issue for the distant future. On the other hand, the FSA and the review team had an appropriate sense of urgency given the background to this issue, which included the IAIS’s announcement in the same year of “the Common Structure for the Assessment of Insurer Solvency”, which indicated the importance of the economic value basis, as well as the discussions under the International Accounting Standards Board’s insurance policy project and the trend toward the introduction of an economic value-based regime as exemplified by the EU’s promotion of Solvency II. Moreover, the review team’s meetings regularly included discussion of the necessity of an economic value-based regime in raising the sophistication of risk management at insurance companies. This thinking was apparent in the review team’s report. For example, one passage read, “It is essential that the board members of insurance companies recognize the importance of solvency evaluation based on economic value in aiming for more sophisticated risk management at their companies. To that end, Japan needs to move with alacrity in promoting review and testing to introduce an economic value-based solvency regime.”





*Corresponding  
Subsequent  
Regulations and  
Supervision*

Once the review team issued its report, the FSA undertook the next phase of initiatives. First, in November 2007 the FSA issued its “Annual Supervisory Policies for Insurance Companies for Program Year 2007” that clarified key issues for supervisors. It strengthened linkage with the IAIS initiative, and clarified the increasing emphasis of using economic value as the basis for evaluating solvency risk. Specifically, the FSA wrote that it would “promote initiatives to realize a solvency regime that 1) recognizes the volatility of the net asset, or the difference between the value of assets and the value of liabilities (net assets), on an economic value basis as the risk quantity; and 2) manages the volatility appropriately.”

Subsequently, in 2008 the FSA partially amended its “Comprehensive Guidelines for Supervision of Insurance Companies”. The Guidelines for Supervision detail the fundamental approach to insurance supervision and items to evaluate. The revisions included additional sections such as “Creating a Framework for Appropriate Techniques for Comprehensive Asset and Liability Management” and “Economic Value-Based Asset and Liability Management for Comprehensively Understanding Risk.”

At the same time, the short-term revision of the standard for calculating the solvency margin ratio got under way. Short-term revision proposals were announced in 2008. Thereafter, with developments such as the financial crisis and the collapse of Yamato Life Insurance Co., Ltd., a proposal for an amendment to increase rigor in areas such as the inputs related to calculation of the solvency margin was announced in 2009, and its content was finalized in April 2010. The most pronounced direction was consistent with the short-term revision in the report issued in 2007. Application of the new calculation standard will begin in March 2012.

Further, an issue of great interest to the insurance industry is the complete overhaul of the Inspection manual for insurance companies conducted in 2011. As part of this overhaul, the category covering preparations for integrated risk management in “the Financial Inspection Manual” applicable to financial institutions such as banks was added to “the Inspection Manual for Insurance Companies”. A look at these items reveals that the content of the Financial Inspection Manual was added verbatim to the Insurance Inspection Manual along with a number of applicable new items. For example, the manual mentions that the object of integrated risk management is “risks confronting insurance companies.” It also mentions “comparison to equity capital,” but a footnote pertaining to equity capital states “here ‘equity capital’ is not limited to the accounting concept of net assets or the concept of capital based on current solvency regulations. Rather, the assumption underlying the definition is that it includes capital recognized through the evaluation of economic value (consistent evaluation of market value and evaluation based on the present value of future cash flows determined under a methodology that employs principles, techniques and parameters consistent with the market) which insurance companies compare with their risks from the perspective of risk management.” In addition, the item “comprehensive asset and liability management,” or ALM, reads “economic value, that is, evaluation consistent with market prices and evaluation based on the

present value of future cash flows determined under a methodology that employs principles, techniques and parameters consistent with the market, is desirable for comprehensive management of assets and liabilities.” Neither of these passages is in the Financial Inspection Manual, and both clearly underscore awareness that economic value will become more important in insurance supervision and inspection.

In June 2010, a field test was announced for the introduction of an economic value-based solvency regime in connection with the medium-term revision of the standard for calculating the solvency margin ratio, or in other words, an economic value-based solvency margin standard. In this test, insurance companies conducted economic value-based evaluation of insurance liabilities and measured interest rate risk embedded in assets and liabilities and reported the results. In addition, insurance companies that were already managing risk with internal models for economic value-based evaluation of insurance liabilities participated in a questionnaire survey of the status of their internal models. The former represented a standardized technique, the latter an internal model methodology. The specific calculations for the standardized technique have not been publicly announced, but risk equivalent was based on 95% VaR over a one-year period. In other words, the short-term revision level is in use.

The FSA announced the results of field tests in May 2011. Information such as problems in the practical application of the calculation procedures complemented the content discussed above. The FSA also announced an overview of the results of interviews regarding ERM conducted in February and March 2011 in tandem with the field tests.

However, the future development of and the roadmap for promoting the calculation standard for an economic value-based solvency margin ratio are unclear at this point. As the comments below suggest, a roadmap is desirable at the earliest possible stage because consistent economic value-based measurement and evaluation within the domestic regulatory regime are desirable, particularly as the non-life insurance industry is strengthening risk management, promoting the introduction of an economic value-based approach, and developing business overseas. The FSA included a guide titled “Proactively Clarifying the Roadmap for Smooth System Introduction” in announced results of the field tests mentioned above, which confirmed the importance of having a roadmap.

### *Non-Life Insurance Company Responses*

Insurance companies are responding to these circumstances in various ways. The responses of the so-called mega non-life insurance groups as obtained from sources such as investor relations materials are presented below.

For example, Tokio Marine Holdings is strengthening enterprise risk management (ERM) under the medium-term corporate strategy<sup>3</sup> it initiated at the start of fiscal 2009. The group calls this initiative “risk-based *keiei* (management).” In Japanese, “risk *kanri*” is the term for risk management, but it tends to evoke an administrative image of a checklist-based approach. Presumably, therefore, the Tokio



Marine Holdings intentionally used the term risk-based management instead to express ERM structured for deep involvement in management decision-making.<sup>4</sup> This approach presupposes the move to global standards involving international accounting standards and an economic value-based solvency regime in the future, and is also consistent with capital model reform and the new introduction of a stock-based capital strategy. Formerly, Tokio Marine Holdings used a 99% conditional value at risk (CVaR) capital model in which it maintained the amount of capital required to continue business even if risks with a probability of once per 100 years materialized, but has moved to maintaining the amount of capital for VaR of 99.95%. This model is premised on maintaining an AA credit rating, and Tokio Marine Holdings explains that it changed to this model to meet global standards.

The NKSJ Group<sup>5</sup> touched on comprehensive risk management at an IR meeting on June 2, 2010 to explain its management strategy.<sup>6</sup> Like the Tokio Marine Group, the NKSJ Group links capital to the amount of risks, evaluating risk at 99.95% VaR to maintain its target AA credit rating. In addition, the NKSJ Group has introduced methodologies in line with the thrust of the medium-term revision of the solvency regime, using techniques such as economic value-based evaluation for insurance liabilities.

The MS&AD Insurance Group<sup>7</sup> explained at a June 1, 2010 IR meeting<sup>8</sup> that it compares risk to the market value of net assets, which is consistent with industry trends. Moreover, in its medium-term management plan the MS&AD Insurance Group explained that maintaining its AA credit rating over the medium and long term is its basis for managing risk and capital within a unified Group framework.

These three groups are all taking the same concrete action of reducing cross-shareholdings. The Tokio Marine Group disclosed in the medium-term corporate strategy discussed above that it will accelerate (compared to the pace in its previous medium-term corporate strategy) further liquidation of cross-shareholdings to reduce their share of its equity portfolio. The NKSJ Group indicates that reduce strategic-holding stocks by a specific amount (300 billion yen) from 2010 through 2012, saying it will “review our plan with deliberate consideration of the future business environment.” The MS&AD Insurance Group says it will “Manage the strategic stockholdings under an integrated controlling method, where the efficiency of stockholdings and risks/returns are integrally measured on the total Group basis, thereby restraining the balance in the view of the market conditions.”

However, these disclosure materials alone do not indicate sufficient practical experience with ERM. Non-life insurance companies including the three groups above would do well to implement various measures to enhance their sophistication in using ERM and energetically present information regarding the status of such implementation.

### *Future Prospects and Their Impact on the Non-Life Insurance Market*

I would like to conclude by presenting my own opinions about future prospects and their impact.

Although the timeline is not clear, in the near future the insurance industry will introduce economic value-based standards for calculating the solvency margin ratio. Japan's non-life insurance companies are controlling the interest-rate risk embedded in liabilities better than life insurance companies, so the future impact of this risk will not be pronounced. However, non-life insurers could make better internal use of their approach to interest-rate risk in dealing with the risk margin. A specific and favorable objective for sales performance would be correctly structuring sales incentives by internally considering the relationship of price to risk, otherwise known as the risk margin, and selling at prices that are above the point where price matches risk. This approach requires the non-life insurance industry to develop a risk culture; conventionally the industry has emphasized ease of sale in pursuing sales volume, although it is certainly not alone in this regard as this approach has characterized Japan's financial industry as a whole.

Quantifying risk at the same 99.5% level as the provisional EU Solvency II is itself a major change. Yet an even larger change envisioned in Europe's Solvency II will be assigning risk probabilities to the tails of the probability distribution curve and aggregating risk via tail correlations. The impact will be great once these become the norm, with the latter especially important in determining how to evaluate the interdependence of cross-shareholding risk and Japan's natural disaster risk. Conducting risk management with the mindset of being more conservative than necessary is a problem, and emphasizing a framework for appropriate evaluation requires a correct understanding of the new approaches to risk and decisions as to how to respond.

This means Japanese companies must use internal models, just as their counterparts in Europe do. Essentially, one major aspect of the goal of introducing an economic value-based solvency regime is driving greater sophistication in risk management. Companies must therefore aim to become more sophisticated, whether calculating the solvency margin ratio or joining the growing ranks of firms using internal models. At the same time, the industry anticipates that supervisory authorities will provide specific schedules and other details regarding the implementation of the approval process for internal models.

Further, qualitative expectations are as important as quantitative. Among the draft revisions to Insurance Core Principles (ICP) that the IAIS announced in 2010, ICP 16 (Enterprise Risk Management) indicated that Own Risk and Solvency Assessment (ORSA) should receive emphasis in insurance supervision. In Japan, the essence of quantitative evaluation tools such as the solvency margin ratio could exacerbate the tendency for companies to adopt the simplistic mindset that clearing numerical hurdles means all is well. Risk management is not a process of performing a specific action to achieve a simple goal. Qualitative audits by supervisors encourage an even clearer understanding among companies of the need for diligence in enhancing sophistication.

The recent unprecedented disaster underscores the need for Japan as a whole to raise the sophistication of risk management, not only in terms of technology but also in terms of enhancing qualitative sophistication by sharing a risk culture and a fundamental mindset for confronting risk. The non-life insurance industry and experts in it must become the opinion leaders who encourage the proper confrontation, apprehension, evaluation and management of risk. Japan and its non-life insurance companies must think about economic value while considering evaluation and appropriate risk margins, and must also recognize the limits of worry, models and techniques. They must accumulate experience in combining stress testing with management leadership to compete with top-level global companies, while introducing the supervisory and regulatory regimes required to do so.

#### Notes

1. Swiss Re Sigma (2010), "World Insurance in 2009"
2. For additional details on the current methodology, refer to the General Insurance Association of Japan's website "Early Warning System and Policyholders Protection Scheme" at <http://www.sonpo.or.jp/en/regulations/002.html>
3. Source: investor relations materials dated December 5, 2008, available for download at [http://ir.tokiomarinehd.com/en/IRPresentation/IRPresentation9216476546961588032/IndexContent/02/IndexContent/IndexLink/pdf1/1205presentation\(en\).pdf](http://ir.tokiomarinehd.com/en/IRPresentation/IRPresentation9216476546961588032/IndexContent/02/IndexContent/IndexLink/pdf1/1205presentation(en).pdf)
4. Unfortunately, the English translation of these materials uses the term "enterprise risk management" for the Japanese term literally translated as "risk-based management." Consequently, this group's rationale and intention in using English for both the Japanese words *kanri* and *keiei* is unclear.
5. The group headed by the holding company established through the business integration of Sompo Japan Insurance Inc. and NIPPONKOA Insurance Company, Limited.
6. Materials available for download at [http://www.nksj-hd.com/doc/pdf/e\\_ir/e\\_20100602.pdf](http://www.nksj-hd.com/doc/pdf/e_ir/e_20100602.pdf)
7. The group headed by the holding company established through the business integration of Mitsui Sumitomo Insurance Company, Limited, Aioi Insurance Co., Ltd. and Nissay Dowa General Insurance Co., Ltd.
8. Materials available for download at [http://www.ms-ad-hd.com/en/ir/library/meeting/msad/pdf/20100601\\_info\\_e.pdf](http://www.ms-ad-hd.com/en/ir/library/meeting/msad/pdf/20100601_info_e.pdf)



# 3.

## The Financial Services Agency's Completely Revised Insurance Inspection Manual and Tasks Ahead for Insurance Companies

Taku Umezawa Attorney at Law, Nagashima Ohno & Tsunematsu

### *Introduction*

On April 1, 2011, the Financial Services Agency (FSA) issued a new and completely revised Inspection Manual for Insurance Companies (the "Insurance Inspection Manual"). It is the first large-scale revision of the Insurance Inspection Manual since June 2006. A checklist for the governance system and a checklist for the integrated risk management system are new additions to the latest Insurance Inspection Manual. Moreover, the new manual clarifies the responsibilities of divisions and managers at each layer as the basis for the comprehensive application of the PDCA cycle for each inspection category, while making the inspection checkpoints of insurance inspectors more sophisticated. This author was a member of the FSA Inspection Bureau team that was involved in the revisions in June 2006, and the wholly revised Financial Inspection Manual announced in February 2007 that introduced the new framework essentially the same as newly revised Inspection Manual. The Insurance Inspection Manual elaborates the checkpoints that the Inspection Bureau will use for inspecting the internal control system for various risk categories that licensed insurance companies should have in Japan, making it an indispensable resource for insurance companies upgrading their internal control systems in order to conduct their operations in a proper manner. This paper summarizes the legal positioning and background of the latest revisions of the Insurance Inspection Manual as the basis for discussing future tasks.

### *Legal Positioning of the Insurance Inspection Manual*

First, the Insurance Inspection Manual is positioned as the handbook for insurance inspectors that the Director-General of the Inspection Bureau directs to inspect an insurance company licensed in Japan. Therefore, it is not legally binding, and insurance companies and their executives and employees are not subject to criminal punishment or administrative sanctions if found to be in violation of the language set forth in the Insurance Inspection Manual. However, the manual delineates the FSA's conception of how insurance companies should operate, and FSA inspectors will conduct inspections of insurance companies according to it. Furthermore, while the Insurance Inspection Manual is made for the internal use of the FSA in its nature, the FSA has made it public with the expectation that, under the principle of self-responsibility, individual insurance companies will use their ingenuity and creativity to develop the internal control systems to accommodate it considering their size and particular characteristics, thus giving insurance companies a reason to emphasize the Insurance Inspection Manual in their operations.

### *Background of the Revision and Changes to the Framework*

#### (1) The Need for the Revision

As the ex-Insurance Inspection Manual did not distinguish inspection items for discrete problematic issues from inspection items for internal control systems, there was the difficulty for the inspectors in verifying which functions of which division or person in authority had problems. Also, it did not have a specific category checklist for corporate governance of the whole company or inspection items for integrated risk



management systems for the whole company, which made it unsuitable for insurance inspections in these areas. The latest revision therefore took these needs into account with the various updates detailed below.

## (2) Checklist Additions and Updates

Prior to the revisions, the ex-Insurance Inspection Manual<sup>1</sup> consisted of nine respective checklists for the internal control systems that insurance companies should implement. The new manual has been systematically revised with eight checklists for a re-ordered list of systems (see Figure 1). The name of the former “Internal Control System” checklist has been changed to “the Corporate Governance System”, and a checklist for inspection and confirmation of the Integrated Risk Management System was added. Also, the manual no longer has checklists for “the Financial Soundness and Actuarial Matters Management System” and “the Product Development Management System” because the checkpoints included therein were incorporated into other checklists. These revisions allow more appropriate verification of insurance companies’ corporate governance system and total risk management systems, which the Inspection Bureau considered to be important.

Figure 1: Comparison of Checklists Before and After Revision

Before Revision	After Revision
1. <u>Internal Control System</u>	1. Corporate Governance System
2. Legal Compliance System	2. Legal Compliance System
3. Insurance Sales Management System	3. Insurance Sales Management System
4. Customer Protection Management System	4. Customer Protection Management System
5. <u>Financial Soundness and Actuarial Matters Management System</u>	5. Integrated Risk Management System
6. <u>Product Development Management System</u>	6. Insurance Underwriting Risk Management System
7. Insurance Underwriting Risk Management System	7. Asset Risk Management System
8. Asset Risk Management System	8. Management System for Operational Risks
9. Management System for Operational Risks	

\*Underlined checklists have been changed.

## (3) Introduction of the PDCA Cycle Perspective

The new Insurance Inspection Manual uses a common format for system check items that are generally the same as risk management check items. This format is the basis for the addition of revisions according to the nature of specific risks. Consequently, the checkpoints on each checklist for the risk management system are consistent with other checklists and the ex-manual prior to revision. The rationale for this approach to revision was that sharing verification items among the risk management, legal compliance and other systems would make the viewpoint of

### 3. The Financial Services Agency's Completely Revised Insurance Inspection Manual and Tasks Ahead for Insurance Companies

inspectors in his or her evaluation clearer and more transparent and help insurance companies share the inspector's awareness of problematic issues.

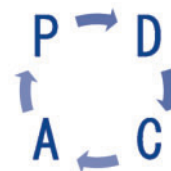
The structure of the shared format uses the PDCA Cycle of Plan (formulate policies), Do (implement internal regulations and organizational structures), Check (evaluate) and Act (improvement activities) (see Figure 2).

1. For the sake of convenience, the post-revision Financial Inspection Manual is called the revised Financial Inspection Manual, and the pre-revision Financial Inspection Manual is called the former Financial Inspection Manual.

Figure 2: The PDCA Cycle

Essentially, the PDCA Cycle is a concept for improving business processes within the context of areas including production management and quality control. It is also called the Deming Cycle or the Shewhart Cycle.

Plan: Formulate plans  
Do: Execute plans  
Check: Evaluate effectiveness of functions  
Act: Improvement activities



In general, the PDCA Cycle concept is mainly used for improving production management and quality control management. Based on the fundamental principles<sup>2</sup> for process checking in the Financial Inspection Basic Guidelines, and codifying the inspection techniques used for inspection in accordance with current realities, the FSA determined to introduce the PDCA Cycle concept to the new Insurance Inspection Manual. Historically, the verification framework based on the PDCA Cycle was added to the Financial Inspection Manual (Inspection Manual for Deposit-Taking Institutions) in February 2007, thus the latest revision of the Insurance Inspection Manual clearly applies the same techniques used in the Financial Inspection Manual to insurance inspection.

Furthermore, the introduction of verification items using the PDCA Cycle facilitates voluntary improvements by insurance companies and enables verification of whether management decision-making processes are functioning appropriately. This was a shift in systemic implementation that was indicative of the FSA's recent concern with consistently precluding the occurrence of problems at insurance companies in a proactive manner rather than verifying whether or not a problem exists at some fixed point in time from a retrospective viewpoint, and if a problem does occur, whether insurance companies have the mechanisms in place that enable voluntary improvement.



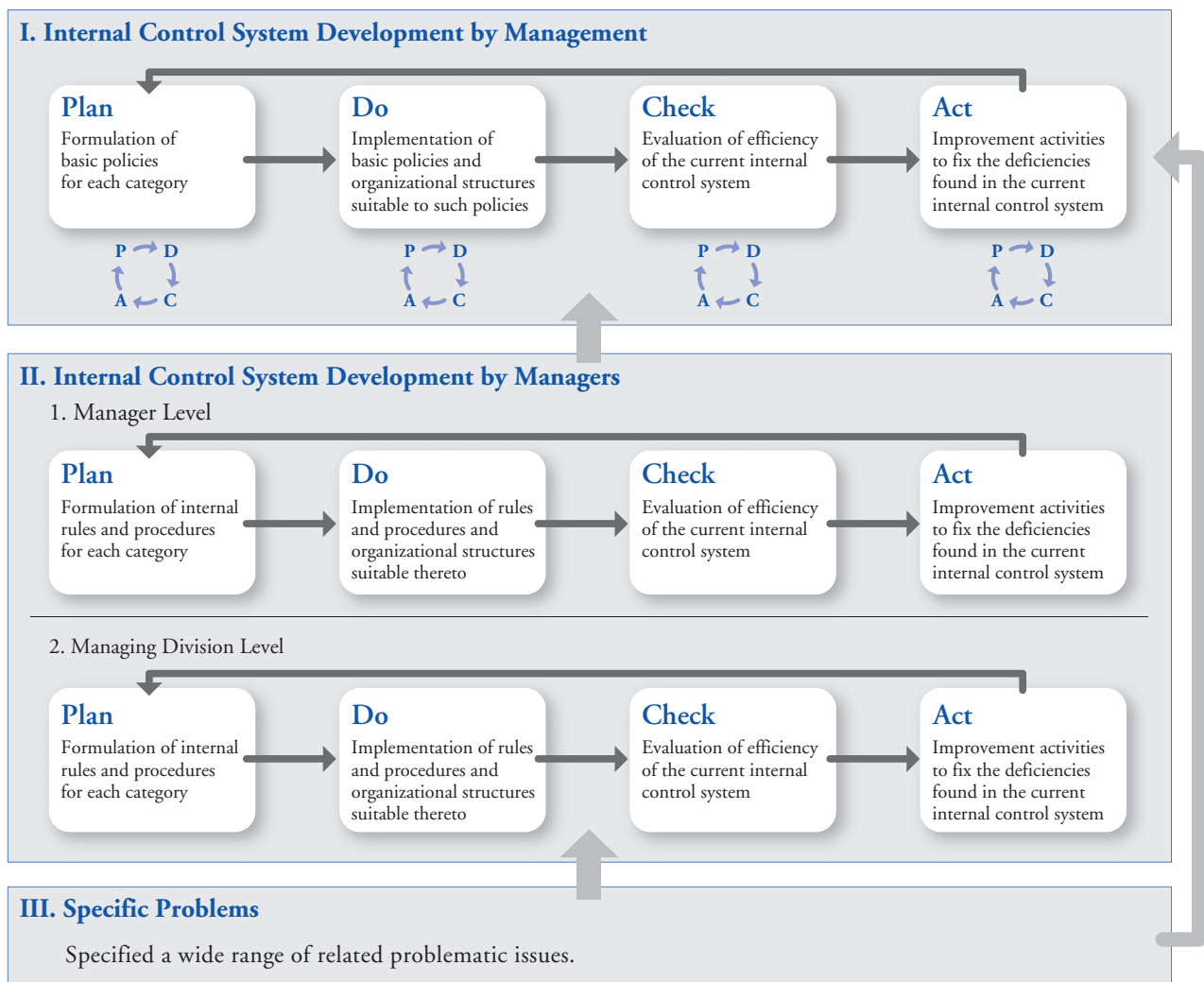


(4) A Three-Layer Framework

The new Insurance Inspection Manual addresses the perception that, formerly, responsibilities and duties were not clearly identified. As shown in Figure 3, for each category the new manual has the three layers: “I. Internal Control System Development by Management”, “II. Internal Control System Development by Managers”, and “III. Specific Problematic Issues”. This establishes a methodology for inspecting the organizational framework of insurance companies and enables more effective inspections therefore.

2. Please refer to “Financial Inspection Basic Guidelines”, 1. Basic Approach to Conducting Inspections, etc., 3 (5).

Figure 3: Three-Layer Framework and PDCA Cycle Concept



This three-layer framework is essentially the same as that of the completely revised Financial Inspection Manual of February 2007.

The recent revision of the Insurance Inspection Manual made its checklists more elaborate, giving rise to concern that the rigid application of the Insurance Inspection Manual would inhibit voluntary initiatives among financial institutions. The revised manual addresses this concern<sup>3</sup> because the “verification points” of each checklist are carefully written so that inspections emphasize function over form, in addition to clearly delineating points of concern so that consideration is given to the scale, nature and risk profile of the insurance company.

Moreover, in actual inspections, the inspector may be expected to use the concept of “Comply or Explain” based on the “mutual dialogue principle” that the FSA emphasizes in the Basic Inspection Policy. More specifically, the inspector can ask questions about systemic variance in cases that do not literally adhere to the text of the checkpoint, allowing the person responsible to explain why the alternative methodology and mechanisms the company is using function sufficiently to preclude negative outcomes. Adding dialogue to the inspection process allows lively exchange of views between the inspectors and insurance companies, and is expected to encourage insurance companies to further intensify efforts to implement systems on their own.

Under this framework, the process basically moves “from downstream to upstream”. If the inspection of check items after item II of the checklist uncovers a problem, for example, a complete inspection confirmed through discussion will determine if the omission or insufficiency of any element in item I was the cause, but this will not mean the exclusion of the other inspection process; in a case in which the items in the checklist in item I were inspected first and management recognized an improper item, the inspection would still be able to continue moving downstream.

3. The manual states, “Inspectors should take care not to apply these criteria in a mechanical and undistinguishing manner. Even a case where an insurance company does not literally meet the requirement of a check item should not be regarded as inappropriate if the arrangements and procedures put in place by the insurance company are reasonable from the viewpoint of securing of the soundness and appropriateness of its business and are thus deemed as effectively meeting the requirement or as sufficient in light of the insurance company’s scale and nature.”

#### (5) Other Revisions

Other revisions include newly established verification items for systems to manage insurance salespeople in accordance with their detailed attributes, and verification items that take the nature of liabilities into account in examining the suitability of portfolio assets for meeting future obligations that the insurance company owes (i.e. integrated risk, underwriting risk, asset management risk).



*Explanation of the  
Main Revisions for  
Each Checklist*

An explanation of several major points that particularly generated debate during the revision of each checklist follows.

### (1) Governance System

Considering the importance of governance in the current revision of the Insurance Inspection Manual, with the change in checklist name from “Internal Control System” to “Corporate Governance System – Checklist for Confirming and Inspecting Fundamental Elements”, items for inspecting whether corporate governance of an insurance company is functioning effectively from the enterprise wide perspective were revised and improved. The Product Development Management System checklist was incorporated into the Corporate Governance system.

Basically, items pertaining to business judgment are the responsibility of the board of directors and teams of directors of each insurance company; the regulators and inspectors of the relevant regulatory agency, the FSA, do not regulate or inspect whether business judgment in a respective matter is right or wrong. However, governance by management is indispensable to ensure sound insurance company operations, suggesting a strong need to inspect the function of basic elements of corporate governance that cannot be faulty (for example, audits by corporate auditors and internal audits). In addition, the collection of information from the entire insurance company and inspections to verify issues such as whether management is driving the internal checks and balances of an organization are also necessary. The latest revisions of the Insurance Inspection Manual do not question particular management judgments. Rather, they are checklists for the corporate governance function that include items to verify whether or not the process culminating in business judgments is appropriate. Please note that items to check the corporate governance implemented by shareholders of the company or insurance policyholders are not prescribed in this checklist.

### (2) Integrated Risk Management System

Integrated risk management involves self-control-type risk management in which insurance companies control risk for their overall business by comprehensively determining their direct exposure to risk, including major potential risks, and comparing it with their equity capital and cash flow issues including insurance underwriting and premium rate setting. This integrated risk management is predicated on properly checking the management of financial soundness and actuarial matters, including whether 1) premium reserves, loss reserves and dividend reserves are properly provided for; 2) the solvency margin ratio is properly calculated; and 3) management analysis and separate accounting are in compliance with the regulatory regime, as well as by evaluating equity capital adequacy and the management of equity capital.

The latest revision of the Insurance Inspection Manual added a checklist for confirming the integrated risk management system, which is similar to the framework as the integrated risk management checklist already added to the Financial Inspection Manual as a response to Basel II as of February 2007. This does not mean that the Basel II framework has been applied to insurance companies in Japan. Rather, this checklist is a means for simply verifying that insurance companies have an appropriate integrated risk management system, not a compartmentalized risk management system. The inspection manual instructs inspectors to “Verify whether the insurance company understands the essence and objectives of integrated risk management designed to achieve its objectives according to the company’s scale, nature and risk profile and is comprehensively assessing and controlling risks on a companywide basis.”

Additionally, asset portfolio, duration gap and other checkpoints have been added to determine if assets are appropriate for meeting future obligations based on the characteristics of the liabilities that the insurance company owes or will owe.

#### (3) Insurance Underwriting Risk Management System

For the insurance underwriting risk management system, checkpoints for insurance underwriting risk associated with new products have been moved, while checkpoints related to reinsurance risk management, including reinsurance ceded and received have been retained essentially unchanged from the former Insurance Inspection Manual.

#### (4) Insurance Sales Management System

The former Insurance Inspection Manual had many detailed checkpoints for the management of insurance sales. The revision covers a broad range of insurance agents, including insurance company salespeople, exclusive agencies, independent agencies, and companies in other industries that handle insurance as a side business, and so a uniform management system was seen as untenable. The number of checkpoints was therefore increased to match the types of agents.

In particular, inspection now includes verification of specific measures to ensure the effectiveness of systems to manage independent insurance agency sales because certain firms such as large-scale independent agencies have bargaining power with insurance companies. Given misconduct at agencies found in recent years, this checkpoint was added because sound insurance company control of agencies is important regardless of relative bargaining power.

## *Projected Changes in Inspection*

The following changes in inspections may be expected as a result of the revision of the Insurance Inspection Manual.

### (1) Impact on Management

Many check items on each checklist confirming, not only for directors and CEOs as a indispensable parts of the corporate governance system but whether the Board of Directors is executing its responsibilities, are added. This fact suggests the investigation of the duties and responsibilities that management should be executing is likely to intensify.

### (2) Impact on Managers

Each checklist clarifies the responsibilities of managers as a result of introduction of three-layer structure to the common checklists framework. This fact indicates that issues to be discussed with the inspectors in the process of inspection, such as the managers' responsibility, or self-awareness of its own role and delegation is especially likely to intensify.

### (3) Impact on Managers Responsible for Sales

The latest revisions of the Insurance Inspection Manual increased and emphasized description of the internal control system. As a result, investigation will not only focus on specific problems, but also will more intensely focus on whether governance is "precluding problems" and "preventing their recurrence". Under the concept of Comply or Explain, the dialogue process of inspectors and managers responsible for sales will be very important because of the absence of uniform and "automatic" judgment standards for the form that internal control systems should take.

As per the above, directors and members in insurance companies will need to be constantly aware of the desired form of their companies, proactively manage and robust overall business operations by redoubling their efforts to understand internal control system mechanisms while independently and continuously improving them.

## *Conclusion*

Overall, the latest revision of the Insurance Inspection Manual faithfully adhered to the framework of the Financial Inspection Manual that was completely revised as of February 2007. This was the basis for porting detailed checkpoints for insurance companies from the former Insurance Inspection Manual to the new manual. The revision not only allows the supervisory agency to conduct sophisticated and appropriate inspections of licensed insurance companies in Japan. It also permits reasonable assessment of independent efforts to improve through dialogue.

### 3. The Financial Services Agency's Completely Revised Insurance Inspection Manual and Tasks Ahead for Insurance Companies

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As mentioned earlier, the Insurance Inspection Manual is essentially a document for the internal use of the FSA that the agency has made public with the expectation that, under the principle of self-responsibility, individual insurance companies will use their ingenuity and creativity to develop the systems to accommodate it according to their size and particular characteristics. Each of the checkpoints of the revised Insurance Inspection Manual duly reflects the FSA's latest concerns and awareness of problems. Sharing them with insurance companies is expected to enhance the future for the insurance industry and contribute to greater transparency in financial administration.

Insurance companies need to accurately understand the concept of the internal control systems indicated by the checklists with awareness of the problems illuminating them. Going forward, insurance companies must formulate (P), execute (D), autonomously identify problems and improvements (C), and make further improvements (A) in constructing the needed systems. The latest revision also enhances the mutual dialogue between insurance companies and inspectors during inspections, and enhances the efficiency and effectiveness of inspections. As a result, the governance systems of insurance companies are expected to become more robust and appropriate.

This Article was written by Taku Umezawa, Partner, Nagashima Ohno & Tsunematsu. He started his career with Nagashima & Ohno in 1999, and was seconded to the Inspection Division of Financial Services Agency of Japan (2005-2007).

# Can Japan's Non-Life Market Grow Again? A Foreign Perspective...

## 4.

**Iain Ferguson** President & Chief Operating Officer, Lloyd's Japan Inc.  
(Chairman, Foreign Non-Life Insurance Association of Japan)

### Summary

This article sets out the author's opinion that Japan has the ability to increase domestic demand to end the current period of stagnancy. In order to do so, however, certain challenges must be overcome. The article suggests some potential in terms of further deregulation but the primary recommendations relate to market practices, and in particular, how greater broker penetration could benefit the sector. The article also contains some initial observations in relation to the Great East Japan Earthquake.

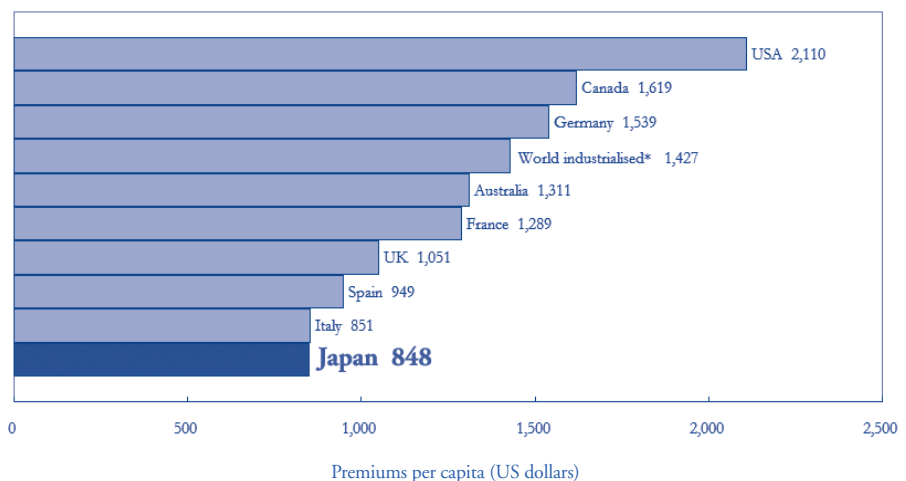
### Introduction

Despite being one of the largest developed insurance markets in the World, Japan's non-life insurance market can still be confusing and difficult to penetrate for foreigners.

In recent times, the market has often been referred to as 'stagnant' — in truth there has been a 14% decline in direct premiums since fiscal 2000. The market still produces profit, although as we have witnessed recently, this is heavily dependent upon catastrophe risk. It is also dependent upon the performance of motor business, which comprises 60% of market premium. With a very high level of market consolidation already achieved, the major domestic players have in recent years been placing more emphasis on seeking growth from beyond the domestic market, in both developed and emerging international markets.

So is "attractive but stagnant" all we can expect for the foreseeable future of Japan's non-life market? Hopefully not — the graph below shows that Japan still lags other developed non-life markets in terms of insurance spend per capita and provides some hope that there may yet be scope for increased domestic business.

### Non-Life Insurance Density 2009



Source: Swiss Re, Sigma No 2/2010, update December 2010

\* World industrialised = North America, Western Europe, Japan, Hong Kong, Singapore, South Korea, Taiwan, Oceania, Israel

*General Business Environment*

So what is holding new domestic growth back? From a foreign insurance professional's viewpoint, what areas of business practice define the character of the market and should Japan wish to pursue domestic growth what key issues need to be addressed to provide the catalyst for change?

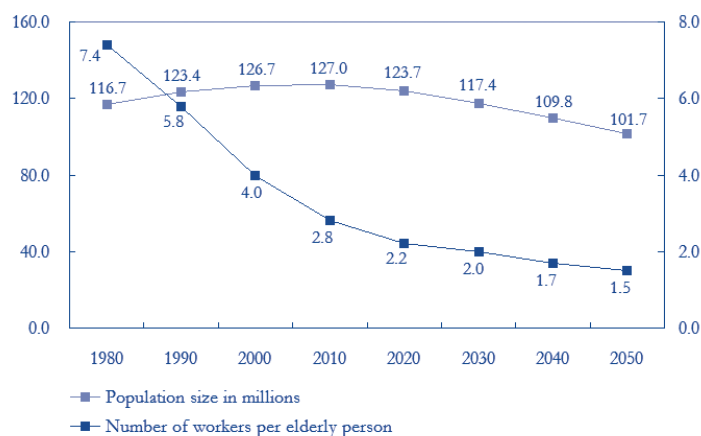
At the outset it is important to recognise that the non-life insurance industry operates within an environment where Japan faces significant political, economic, demographic and competitive challenges to maintaining its position as one of the world's economic superpowers. There is a limited amount that the non-life industry can do to counter these challenges.

The economy has shown marginal GDP growth over the last 15 years and the continued strength of the Yen remains a problem for exporters. Of course the current weak economic climate is not a challenge unique to Japan but in Japan's case there has been an extended period of stagnation.

Almost two years after the landmark election of the Democratic Party of Japan (DPJ) in October 2009, the DPJ still face the challenge of enthusing the general public and the business community with a coherent vision of how they will drive Japan forward.

Japan's demographic challenge has been well documented. The population is forecast to reduce by 20% by 2050 but due to continuing urbanisation, rural Japan will see even higher rates of population decline. Furthermore, over the last 30 years, there has been a significant drop in the number of workers per elderly person and this trend is forecast to continue. Without tax reform, Government income will decline and an ever greater strain will be placed upon the state benefits and pension scheme.

Japanese Demographics 1980-2050



Source: Market Intelligence based on Global Insight: Japan: Key Issues to Watch, (March 2010); IMF, "World Economic Outlook Database", (2009)





According to the IMF, China has overtaken Japan as Asia's largest economy. In addition, Hong Kong, Singapore and Shanghai are all challenging Tokyo for the position of Asia's leading financial centre. Given this competition among regional markets, strengthening the competitiveness of Japan's financial and capital markets has become a pressing policy issue. In the current climate it is, however, proving difficult to attract new domestic and international investment.

### Market Concentration

Whilst at October 1, 2010 there were 51 licensed non-life companies, approximately 84% of all non-life premium income in fiscal 2009-10 was controlled by three insurance groups - the MS&AD Group, the NKSJ Group and the Tokio Marine Group. For a developed non-life insurance market, it can be considered very unusual to see such strong domination by so few players.

The Japan non-life market has always had a relatively high level of concentration, which historically was created and supported by intra-group and inter-group relationships between major corporations, often based upon cross shareholdings or common ownership. In recent years, however, merger activity, born out of the need to reduce management expense through efficiency of scale and operation, has been the primary driver of market concentration. Although in some cases historical relationships may have weakened or dissolved through merger attrition or simply due to the passage of time, most remain relevant and active today. This can act as a barrier for new or existing companies (domestic or foreign), to gain market access to large commercial customers.

### Distribution

The following table clearly demonstrates that:

- i. non-life insurance distribution in Japan is overwhelmingly dominated by agents;
- ii. the number of agencies has steadily decreased over the last ten years;
- iii. the number of agency sales staff has increased over the same period;
- iv. the broker channel seems to be significantly under-represented; and
- v. there has been no significant change in channel market share during this time.

Fiscal year	2000	2005	2006	2007	2008	2009
Number of agencies	509,619	266,753	253,810	235,846	217,864	207,903
Number of agency sales staff	1,145,252	1,873,485	1,986,035	2,147,461	2,154,962	2,160,029
Agency share of market direct premium	91.7%	92.8%	93.0%	93.0%	92.9%	92.3%
Broker share of market direct premium	0.1%	0.2%	0.3%	0.3%	0.4%	0.3%
Direct* share of market direct premium	8.2%	7.0%	6.7%	6.7%	6.7%	7.4%

Source: The General Insurance Association of Japan

Note 1: Most brokers also write business via their own agency structures

Note 2: "Direct" includes sales through insurance company employed sales staff

The agency numbers quoted are primarily made up from two sources — the agency distribution networks of domestic insurers and the in-house agencies of mid to large corporations.

The reducing agency numbers are a result of market consolidation and the abolition in 2001 of the old agency classification system, which linked agent remuneration to classification. These factors provided insurers with the impetus and ability to rationalise and consolidate their agency networks, bringing cost efficiency, an easier to manage network and an increase in the general competency and productivity levels of the remaining agents.

The increase in agency sales staff is mostly driven by a change in regulation allowing life assurance sales staff and bank employees to become non-life insurance agents. The new agents focus on selling personal lines products to the retail customers of life companies or banks and their activities have had a minimal effect on channel share.

Considering that Japan has a mature insurance market with many sophisticated corporate insurance purchasers, many readers will be surprised to see such a low percentage share for the broker channel. In truth, the percentage share for brokers is higher than the 0.3% in the table. All major brokers also have agency operations through which they transact the majority of their direct business, however even allowing for this, the total broker share of market direct premium is still estimated at less than 10%.

From a regulatory & compliance point of view, before they can trade, brokers are subject to a good deal more scrutiny than agents. Only the first of the following requirements also applies to agents:

- brokers must register with the Japan Financial Services Agency;
- brokers must demonstrate to the JFSA that a sufficient level of technical professional qualification exists within their workforce;
- as representative of the customer, brokers must submit a cash deposit or guarantee to cover their errors & omissions risk - the amount required starts at a minimum of 40 million yen but can be as much as 800 million yen;
- brokers cannot operate on a wholesale basis, i.e. they may not represent other agents; and
- brokers are not allowed to manage client funds.

But these are not the biggest challenges that brokers face in getting to grips with Japan direct market business. Two additional market and cultural issues apply:

- The in-house agencies of mid to large corporations vary in terms of their technical ability, from basic to very sophisticated. They all have one thing in common, however, which is that they retain within the corporate group, agency commission or brokerage, which would otherwise have been paid externally. At rates commonly in the range of 15%-20%, this can represent a significant saving. Furthermore, the in-house agency management is often comprised of former corporation senior employees, thereby cementing the parent link and further inhibiting the ability of external providers to access the relationship; and
- There is insufficient customer understanding about whom agents and brokers represent. Very high levels of service exist in Japan in the provision of all manner of goods and services. Insurance company agents take a great deal of care about servicing customers. Agents that represent multiple companies will explain to customers the differences in price, coverage and service between each company's policies. Of course, no matter how well these agents manage the customer



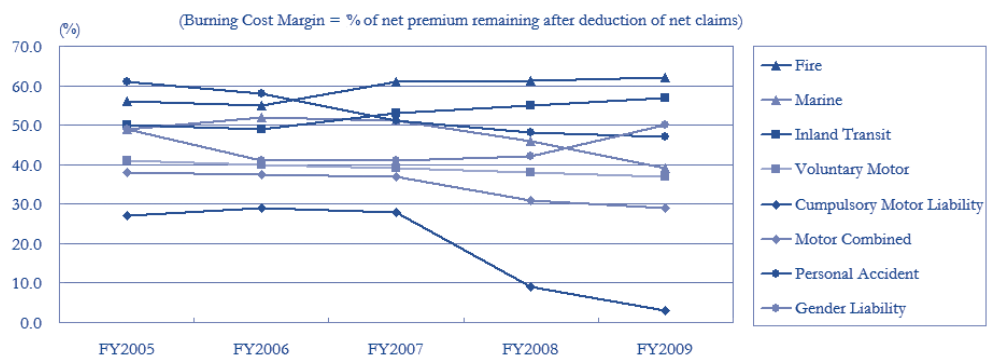
relationship, they are still contractually representing the interests of their principal(s), the insurance company — not the interests of the customer. Japan does not yet match the transparency levels of other mature markets, in explaining the difference between agents and brokers to the policyholder. Some market participants may believe that the high levels of customer service and the existence of a multi-agency system remove the need for a true broker system. As many domestic customers, their in-house agents and their insurers are happy with or tied to existing relationships, there seems little impetus for this situation to change.

Some relatively new (for Japan) sales channels have been adopted by various companies with a view to reducing expense e.g. direct marketing, internet sales, mobile phones. Along with the progressively deregulated bancassurance channel these all offer good potential for growth but at present still represent only limited volume.

*Market Performance*

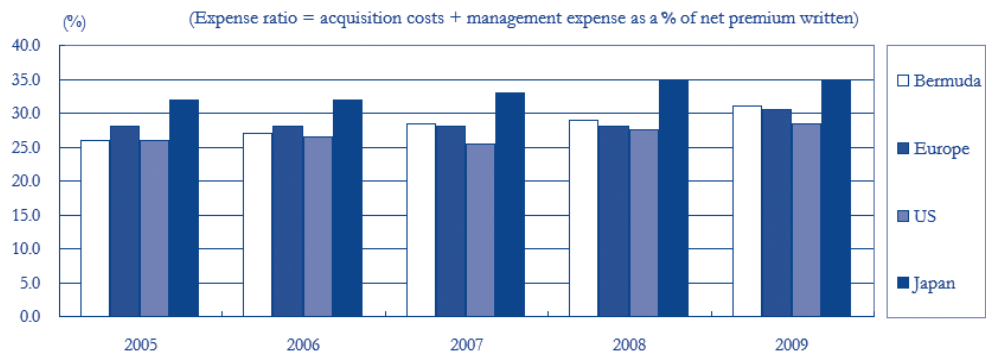
At a high level, it can be seen from the following two graphs that the performance of the Japan non-life market has been held back by the marginal performance of motor business. As the voluntary motor and compulsory motor liability lines combined represented approximately 60% of total direct net premium from fiscal 2005 to fiscal 2009, poor performance in these classes has a significant effect on overall market profitability. Combined motor business has shown a drop in burning cost margin from 37% in fiscal 2005 to 30%, primarily due to a strong deterioration in the compulsory motor class over fiscal 2008-09. This means that in fiscal 2009, after the payment of claims, only about 30% of the original premium was left to cover additional reserving requirements, acquisition costs, management expenses and profit. With management expenses (second graph) running at 35%, it is clear that motor business lost money. Compulsory motor liability performance is currently being addressed by the market through remedial pricing. All other major classes (up to the March 2011 EQ) have been consistently running at burning cost margins in the 40% - 60% range being comfortably sufficient to cover the expense ratio.

**Burning Cost Margin (%)**



Source: The General Insurance Association of Japan

### Non-Life Insurance Expense Ratios in Major Markets



Source: Japan data – General Insurance Association of Japan International data – Company Report & Accounts

It is also evident from the above graph that the expense ratios at Japanese non-life insurers remain noticeably higher than expense ratios achieved by their peers in other major developed markets. By foreign company standards, one may consider staff expenses at domestic companies to be relatively high and the cost of maintaining extensive nationwide agency networks to be a greater financial burden than developing business through the broker or direct channels. Whatever the cause, there does seem to be a significant opportunity for Japanese insurers to boost performance by reducing their expense base.

This has not gone unnoticed in the market and expense reduction is more frequently being quoted as a key management objective. It was one of the main drivers noted in the creation in April 2010 of the MS&AD and NKSJ groups and the management of these groups have stated that they intend to achieve further savings from these mergers through integration of certain operating company processes.

Savings are likely to be targeted through the integration of systems, processes and perhaps office facilities but it is as yet unclear whether or not management will take on potentially the most significant but also the most controversial area, staff and agency networks. Onerous requirements in the local Labour Law make it difficult and expensive to implement redundancy programmes and such moves may also meet opposition from unionised interests. At a time when domestic companies have worked extremely hard over the last few years to regain consumer trust, large scale rationalisation in these areas could have a detrimental effect on customer service, leading to the risk that adverse publicity may negatively impact public perception of the company.

#### *A Note on Foreign Participation*

A combination of the market concentration and distribution factors discussed above have historically made it difficult for foreign insurers (and smaller domestic insurers) to access major Japanese customers and build significant market share. In fiscal 2009-10, the non-life market share held by foreign companies was approximately 11% (including Chartis ownership of Fuji Fire & Marine Insurance Co., Ltd and JI Accident & Fire Insurance Co., Ltd — about 6.5% without). Whilst this figure



continues to show marginal growth year on year, it is still small in comparison with the estimated foreign company share of other developed markets.

### *The Great East Japan Earthquake*

The earthquake and tsunami that struck the Tohoku and Kanto regions of Japan on March 11, 2011 was a truly tragic event which shocked the entire world. Many people suffered the loss of family or friends and a great number also lost their homes and their livelihood. Our thoughts are with them as they continue to recover their daily lives.

A few months on, it is not my intention to provide a detailed analysis of the event. Many other papers have already been published containing detailed technical analysis of the event, the scale of losses and the action taken by the Japan insurance industry. Instead, I intend only to highlight the following few key points and consider the effect that this event may have on local market terms:

1. First and foremost, the Japan insurance industry is to be commended for the positive and consolidated action taken in the aftermath of this event to support policyholders and the relief effort in general. Working in collaboration under the administrative leadership of the General Insurance Association of Japan, all companies domestic and foreign contributed to the swift assessment and disbursement of claims. Within three months of the earthquake, on household dwelling risks alone, over 500,000 claims had been settled and more than 900 billion yen paid out to policyholders. I know of no other event of this scale, where so much progress was made so effectively. There will certainly be key crisis management learning points for other insurance markets to consider;
2. Modelling is useful but cannot provide all the answers. Despite being a recognised earthquake zone, a magnitude 9 event in this area was considered extremely unlikely and a tsunami of this severity was also not considered. We now know that it is possible;
3. The event outcome in isolation can be characterised as a significant rather than life-threatening hit on profits/capital for insurers and reinsurers;
4. There has been a hardening of rates, terms and conditions for Japan treaty reinsurance business, primarily but not exclusively in property classes. Further hardening is expected in the April 2012 treaty renewal season and insurers operating in Japan are under pressure from reinsurers to demonstrate strong portfolio management and to provide more granular risk detail;
5. Some underinsurance has come to light in loss surveys and accordingly, some commercial insureds will be encouraged to purchase higher limits (inevitably at a higher price) and/or retain more risk;
6. Compared to earthquake prone areas in other developed markets, Japan has a low penetration of earthquake coverage and a very low penetration of associated coverage, such as business interruption or contingent business interruption. After the 1994 Northridge earthquake in California, the significant spike in demand for earthquake coverage led not just to an increase in the penetration of earthquake cover but also to a change in the way that many corporations structured and

bought their earthquake protection. Larger deductibles and additional high-end XL reinsurance layer(s) became more prevalent. It remains to be seen whether or not similar changes will emerge in Japan.

In combination, points 4 and 5 above suggest there will be intense discussion between domestic insurers and their major corporate customers through to and beyond the next major renewal season in April 2012. Domestic demand for earthquake capacity is increasing and ultimate capacity providers in the reinsurance market are likely to require considerably improved rates, terms and conditions for such capacity. The problem may be that domestic insurers are uncomfortable with imposing on their large corporate customers the level of improvements required by the international reinsurance market. Despite being exposed to significant catastrophe risk, the Japan property market has a long, stable and profitable record with participation heavily influenced by the strength of relationships. If reinsurers press too aggressively, domestic companies may seek to reduce or eliminate their participation. Equally, earthquake capacity is a limited commodity and if domestic companies fail to secure sufficient improvement of terms, they may find reinsurance capacity extremely hard to find. Over the coming months, the Japan non-life market will need to work closely with international reinsurance brokers and global reinsurers to identify a solution which allows Japanese industry to achieve the cover they need going forward.

### Regulation

A significant amount of deregulation that has occurred in the Japan non-life insurance market over the last 15 years. The GIAJ has produced an excellent summary of this, which is available via the "Publications" section of their English website at [www.sonpo.or.jp/en](http://www.sonpo.or.jp/en) (please see pages 27-28 of the "General Insurance in Japan Fact Book 2008-2009"). Suffice to say that the Japan Financial Services Agency (and their regulatory predecessors) has made considerable progress, although there still remain some outstanding issues e.g. differential regulatory treatment of Japan Post and some *kyosai* mutuals. Whilst deregulation has progressed, in some areas e.g. opening of the broker channel, more modest change in business culture or practice means the market has not developed the opportunity that the deregulation intended to create.

A common theme over the past few years has been the strengthening of consumer protection. This includes the introduction of a new insurance contract law, obliging insurers (amongst other things) to ensure their documentation and processes are easier to understand and properly explained to policyholders and the requirement that all insurers (and brokers) are members of an authorised alternative dispute resolution (ADR) organisation. In international insurance markets where ADR organisations have been present for some years, they have helped to improve the relationship that insurers have with their customers. By more proactively engaging their customers on claims, insurers seek to minimise the number of claims settled by ADR. Customers in turn, due to the existence of the ADR organisation, gain some reassurance that they will not be unfairly treated by insurers. I see no reason why the emergence of ADR organisations in Japan should not have the same positive effect.

With this strengthening of consumer protection, insurers continue to dedicate a great deal of time and effort into providing customers with accurate, timely and easy to understand information upon which to base their decisions. There are two sides to this coin, however, as consumers (particularly personal lines customers) should now be expected to rely upon the information provided to take stronger personal responsibility for entering into insurance contracts. Other than a relatively small (but growing) segment of consumers who proactively use the emerging direct distribution channels to investigate and purchase the most appropriate products for their needs, most consumers still abdicate this responsibility to an agent (representative of the insurer) or directly to the insurer. Whilst legally, Japanese consumers do bear, more or less, the same personal responsibility for entering into insurance contracts as their counterparts in other developed markets, attitudinally there does still seem to be a gap. Japanese consumers still seem to have a weaker understanding of such contractual responsibility or a belief that somebody else (the agent perhaps?) will look after their interests. Undoubtedly, these consumers need further education to help them better understand and execute their personal contractual responsibility – the Government and the insurance industry both have important roles to play in fulfilling this need.

*Key Challenges for the  
Japan Non-Life  
Insurance Market*

In our opinion, Japan has the ability to recreate domestic demand and shake off the current period of stagnancy. In order to do so, however, certain challenges must be overcome. Further deregulation would be necessary in specific areas but the key issue lies in market business practice.

1. With the emergence of alternative financial (insurance) centres in the region, Japan should take steps to revitalise the business environment, in a manner sufficient to encourage new foreign inwards investment.
2. Education is required to ensure that customers understand the fundamental difference between a broker acting in the interest of the customer and an agent acting in the interest of the insurer. Whilst domestic insurer staff and agents do provide a high level of customer service, this is different to genuine (independent) broker services.
3. As Japan recovers from the Great East Japan Earthquake, a period of adjustment will be necessary in the non-life market. How this adjustment is managed and what form it takes may have a significant effect on how the market purchases insurance and reinsurance going forward. Will new purchasing behaviour drive fuel new demand or will the market fall back on existing business practice?
4. There would seem to be scope to raise the per capita spend on non-life insurance to a level more commensurate with international peers. This may involve a number of different initiatives but one key area that should be considered, particularly in commercial lines business, is creating complete freedom around products and pricing. This would emphasise coverage based on customer specific requirements, rather than on what products the market is currently offering. An active broker channel would also support this activity. There is a concern that current market concentration may be hindering the level of choice available to customers.

5. With improvements made to the customer-facing processes and documents of insurers and the introduction of support mechanisms such as ADR organisations, consumers need to be held accountable for their personal responsibility in entering insurance contracts. Ongoing educational support will be required in this area to support consumer awareness and understanding of this issue.
6. Outstanding 'level playing field' issues need to be addressed in respect of Japan Post and *kyosai* / SASTI (Small Amount & Short Term Insurance) business.

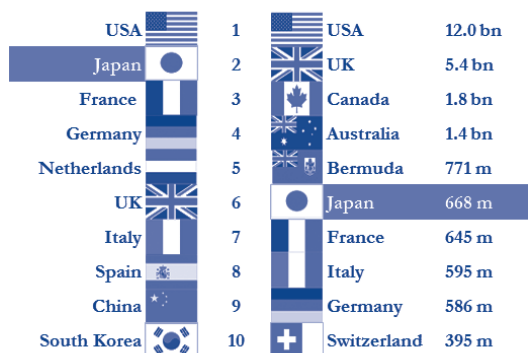
*Lloyd's in Japan*

Lloyd's has long, strong and valued relationships in Japan. Lloyd's appointed its first Japan agent in 1868 and for the last 143 years has supported the non-life insurance market through events like the Great Kanto earthquake (1923), the Ise-Wan typhoon (1959), Typhoon Mireille (1991) and the Hanshin-Awaji (Kobe) earthquake (1995). Lloyd's will continue to support the market through and beyond the Great East Japan Earthquake of 2011.

Japan is the world's 2nd largest non-life market\* and is Lloyd's 6th largest source of premium income\*\*. The majority of such income reaches the Lloyd's market in the UK by way of reinsurance, with a more modest amount of business being written through Lloyd's local office in Tokyo, Lloyd's Japan Inc. (LJI).

**\* Top 10 World Non-Life Insurance Markets**

Source: Axco Insurance Information Services (2010)



**\*\* Lloyd's Top 10 Non-Life Insurance Markets (GWP US\$)**

Source: Xchanging (2010)

In addition to the significant reinsurance support that Lloyd's provides to the Japan market, in recent years two of the top three insurance groups in Japan have become members of Lloyd's and trade in the market through their own managing agency operations. The third group remains a long-term investor in the Lloyd's market. All three groups have a comprehensive understanding of how Lloyd's functions and how the unique features of the Lloyd's market can contribute to their own strategic ambitions.

Lloyd's is a broker market but the Japan distribution dynamics described above mean that, in addition to brokers, LJI derives business through agents or other market access channels. With such strong connections built on direct participation and reinsurance already established, LJI is uniquely placed to work as a friendly collaborator with the market, providing underwriting support and capacity for extended or specialist coverage to be sold through the existing distribution network of domestic insurers.



## 5.

### Underwriting & Planning Department

The Toa Reinsurance Company, Limited

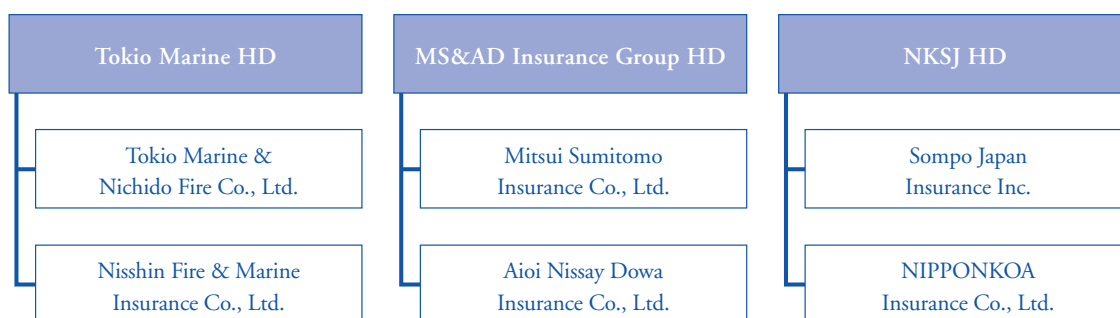
#### Market Trend

#### (1) Business Trend in Domestic Market

In fiscal 2010, net premium income of the 8 major domestic non-life insurance companies was almost flat year-on-year. On the other hand, ordinary profit fell significantly due to claims incurred resulting from the Great East Japan Earthquake in March 2011 (Earthquake insurance policies subject to the “Act on Earthquake Insurance” — policies covering dwelling risks — have no effect on the operating results of non-life insurance companies because they release catastrophe reserves equal to the claims incurred).

#### (2) Industry Reorganization

MS&AD Insurance Group Holdings, Inc. and NKSJ Holdings, Inc. were established in April 2010. As a result, the non-life insurance market is dominated by three major groups including Tokio Marine Holdings, Inc. In October, Aioi Nissay Dowa Insurance Co., Ltd. was formed as a result of the merger between Aioi Insurance Co., Ltd. and Nissay Dowa General Insurance Co., Ltd, both of which came under MS&AD Insurance Group Holdings, Inc. Group companies involved in related business are also being consolidated and reorganized to improve the group's profitability.



#### (3) Business Expansion into Overseas Markets

Given the mature state of the non-life insurance market in Japan, non-life insurance companies have been expanding their overseas businesses, especially in Asian emerging countries where growth rates are remarkably high.

Recent major overseas initiatives are summarized as follows.

Date	Company Name	Recent Overseas Initiatives
April 2010	Tokio Marine Holdings, Inc.	Reached a basic agreement on establishment of a joint venture life and non-life insurance company in Saudi Arabia.
May 2010	Sompo Japan Insurance Inc.	Acquired a 100% equity stake in Singapore-based Tenet Insurance Company Limited.
June 2010	Mitsui Sumitomo Insurance Co., Ltd.	Signed a basic agreement on a strategic tie-up with Hong Leong Group, a major conglomerate in Malaysia.
June 2010	Tokio Marine Holdings, Inc.	Opened a Canton branch of Chinese subsidiary.
July 2010	Tokio Marine & Nichido Fire Insurance Co., Ltd.	Opened a representative office in Cairo.
July 2010	Mitsui Sumitomo Insurance Co., Ltd.	Gained approval to prepare for establishment of a Jiangsu branch of Chinese subsidiary.
November 2010	Sompo Japan Insurance Inc.	Acquired shares in Turkey-based Fiba Sigorta Anonim Sirketi.
January 2011	Tokio Marine Holdings, Inc.	Gained approval to establish a Jiangsu branch of Chinese subsidiary.
January 2011	Aioi Nissay Dowa Insurance Co., Ltd.	Gained approval to prepare for establishment of a Zhejiang branch of Chinese subsidiary.
April 2011	Mitsui Sumitomo Insurance Co., Ltd.	Acquired a stake in a company engaged in takaful business under Malaysia-based Hong Leong Group.
May 2011	Sompo Japan Insurance Inc.	Reached an agreement on acquisition of additional shares in Malaysia-based Berjaya Sompo Insurance (making the company a subsidiary).
May 2011	Mitsui Sumitomo Insurance Co., Ltd.	Reached a basic agreement on a comprehensive insurance business alliance with Mapfre S.A., the top insurance company in Spain and Central and South America.

#### (4) Product Trends

In April 2011, the Non-Life Insurance Rating Organization of Japan increased the standard premium rate for compulsory automobile liability insurance, which all owners and drivers of automobiles and motor bicycle are obliged to have, for the purpose of protecting victims of accidents covered by the insurance. For a class of business involving a high degree of public responsibility such as compulsory automobile liability insurance, the standard premium rate is determined by the Non-Life Insurance Rating Organization of Japan on a “no loss, no profit” basis with the aim of breaking even. All non-life insurance companies are required to utilize the standard rate. The rate was increased because insurance claims paid exceeded premiums due to a recent increase in insurance claims. The increase in the rate will take place in two stages in 2011 and 2013 to alleviate the burden on policyholders.



## (5) Regulations on Co-operatives

In accordance with the 2005 revision of the Insurance Business Law, the unregulated co-operatives which had not previously been controlled under a specific law, also became subject to regulations under the Insurance Business Law with a view to protecting policyholders. However, many co-operatives found it difficult to comply with the regulations immediately. In November 2010, the government further revised the Insurance Business Law to allow these organizations to continue conducting co-operative insurance business as “authorized specific insurance organizations” provided certain conditions are satisfied. It was decided that the revised law would be reviewed after 5 years.

### *Overview of Results for Fiscal 2010*

The operating results of the 25 companies in the General Insurance Association of Japan for fiscal 2010 are as follows:

Net premium income totaled 6,971.0 billion yen in all lines of business, down 0.1 billion yen on a year-on-year basis. The detailed figures show that income increased 29.8 billion yen in automobile insurance due to the revision of premium rates, while it declined 46.8 billion yen in fire insurance.

Net claims paid declined 49.1 billion yen on a year-on-year basis to 4,318.7 billion yen due to a decrease in miscellaneous casualty insurance and fire insurance despite the continuing upward trend in automobile insurance. Insurance claim payouts related to the Great East Japan Earthquake in March 2011 were limited in fiscal 2010. Reserves for outstanding claims have been established for payouts accruing in fiscal 2011 and beyond.

Operating and general administrative expenses related to insurance underwriting were 1,192.2 billion yen, down 27.8 billion yen on a year-on-year basis, because of cuts to system-related expenses, etc. As a result, the net expense ratio decreased 0.4% to 34.6%.

The net underwriting loss was 183.2 billion yen, an all-time high, owing to provisions for outstanding claims in preparation for insurance claim payouts resulting from the Great East Japan Earthquake described above.

Ordinary profit (including return on asset investments) decreased 116.2 billion yen on a year-on-year basis to 234.4 billion yen, and net income also decreased 79.3 billion yen to 127.5 billion yen. This is because the gross return on asset investments increased 109.6 billion yen on a year-on-year basis to 481.2 billion yen due to an increase in interest and dividend income, which benefited from a rise in dividends received and an increase in gains on sales of securities resulting from the sale of stock.

### *Regulatory Topics*

#### (1) Trend in Solvency Regulation

As a result of revision of the implementing regulations for the Insurance Business Law, new calculation standards will be applied to the solvency margin ratio from the fiscal year ending March 2012. The new standards include a limit on items included in margin, an increase in the risk coefficient confidence level for general insurance risk, price fluctuation risk, risk arising in a subsidiary company, and a requirement that earthquake risk for fire insurance be calculated by a risk model.

The solvency margin ratio, which has previously been calculated for non-consolidated insurance companies, will be also calculated for all insurance groups on a consolidated basis from the fiscal year ending March 2012.

In addition, the Financial Services Agency (FSA) is considering introducing an economic value-based solvency margin ratio. Field tests have already been conducted for all insurance companies in fiscal 2010.

#### (2) Launch of Financial ADR System (alternative dispute resolution system in the financial sector)

In October 2010, the financial ADR system was launched to provide added protection for users of financial institutions.

Disputes between financial institutions and their users had previously been resolved through litigation only. This burdened users in terms of expense and time.

In contrast, the financial ADR system has simple procedures and allows users to resolve disputes at a low cost and within a short timeframe. Under the financial ADR system, if a dispute arises, the user makes an application to a certified dispute resolution body satisfying standards determined by the FSA, and the dispute resolution body that receives the application puts forward a fair, neutral settlement proposal. The system requires financial institutions to accept dispute resolution petitions from their users and respect settlement proposals put forward by certified dispute resolution bodies.



### (3) Revision of Insurance Inspection Manual

The Insurance Inspection Manual, a guidebook used by the FSA during insurance company inspections, has been revised comprehensively with effect from April 2011.

The revision involved a review of the whole structure of the manual. Each category consists of three layers — “I. System development by executive”; “II. System development by management”; “III. Specific problems” — and clarifies their roles and responsibilities. In addition, a PDCA cycle must be built up in order to constantly improve and elaborate on each layer. A “bottom-up verification process” has also been introduced to confirm whether management recognizes problems and any measures taken. Categories have been restructured and a new “integrated risk management system” has been established.

*Fiscal 2010 Data on  
Losses from Major  
Natural Disasters*

#### (1) Earthquake

As for the Great East Japan Earthquake in March 2011, earthquake insurance claim payouts based on the “Act for Earthquake Insurance” were above 1.09 trillion yen as of July 28, 2011 (released by the General Insurance Association of Japan). The amount is over fourteen times greater than the 78.3 billion yen paid out for the Great Hanshin-Awaji Earthquake, previously the highest amount paid out on earthquake insurance claims in Japan. Going forward, payouts are expected to increase further as the above amount covers only about 95% of insurance claims received.

#### (2) Wind and Flood Damage

There were no significant losses from windstorm or flood during fiscal 2010.

#### *Main Topics in the Market*

#### (1) Market Loss of the Great East Japan Earthquake in the Japanese Life Insurance Industry and the Industry's Actions Thereafter

In terms of market loss of the last massive earthquake in the industry, the Life Insurance Association of Japan currently expects 200 billion yen of claims payment, although in the circumstances, where the extent of all damage caused in the earthquake is unclear, it is likely that the estimated amount of claims payment will fluctuate to a significant degree. The current estimated amount is four or more times as large as that of the Great Hanshin-Awaji Earthquake in 1995 (48.8 billion yen), which was the record claims payment resulting from a disaster/accident in Japan. This underlines the fact that the Great East Japan Earthquake is the biggest disaster or accident in Japan since WWII.

However, there is no doubt that the amount of claims payment resulting from the earthquake has a limited impact on the financial conditions of Japanese life insurance companies. In the Japanese life insurance industry, the annual payout of insurance benefits usually amounts to around 19 trillion yen, and even payout of death benefits including accidental death benefits stands at about 3 trillion yen. Furthermore, the current estimated amount — 200 billion yen — is deemed to be a conservative estimate. If the actual payout exceeds the current estimated amount, the excess is unlikely to be particularly large.

Even though the insurance benefit payout has a limited impact on our industry, Japanese people were hit hard by the earthquake, and the industry was required to bear a significant degree of social responsibility as Japan set out on the journey to recover from the earthquake.

In the circumstances, in line with the designation of areas covered by the Accident Rescue Law, the Life Insurance Association of Japan extended a grace period for premium payments of up to 6 months for policyholders who had suffered damage, and immediately decided on a simple and quick payment system for claims payments and policyholder loans, etc., by partially waiving requirements on documents for payment. Furthermore, the Association subsequently announced the following 5 actions:

- 1) Non-application of exemption clause in the event of an earthquake; (See note below)
- 2) A contribution of 300 million yen as a donation to damaged areas through the Japanese Red Cross Society;
- 3) Placement of condolence advertisements in national and local newspapers;
- 4) Placement of advertisements listing each member company's inquiry counter;
- 5) Items on rescue efforts in damaged areas.

(Note) The clause in Japanese life insurance policy conditions states that insurance companies are exempted from paying accidental death benefits, etc., other than for ordinary death benefits when an increase in payments affects an assumed rate for calculating risk premium rate for accidental death.



In addition, the Association subsequently decided on another 3-month extension of the grace period for premium payments and initiated an inquiry system for life insurance policies in damaged areas.

Under this system, insurance companies are being asked to participate in a survey on the existence of policies when policyholders who have suffered damage fail to claim insurance benefits because they are not sure which companies carry risks under their policies.

To operate the system, the Association set up an in-house inquiry center for the policies in damaged areas. The center acts as a window through which all 47 members of the Association are asked to survey the existence of policies.

## (2) Effects of TEPCO on Life Insurance Companies

Facing a radioactive leakage, Tokyo Electric Power Company, Incorporated (TEPCO), which had been considered one of the most stable investees in Japan, became a company responsible for paying large amounts of compensation with concerns over whether it could continue business operations independently. As a result, the price of TEPCO's shares, which were trading above 2,000 yen before the earthquake, temporarily experienced a sharp decline to the 200 yen level.

If the monopoly supplier of power in the capital city area is forced to fail, it is clear that the problem will not end with the failure of a power company. Therefore, a focus is still being maintained on what form of bailout the central government adopts for the power company in light of the national interest.

Major Japanese institutional investors with a large exposure to TEPCO are also becoming increasingly concerned about the power company as speculation mounts that it will be nationalized. In particular, the investors have been most concerned, since the occurrence of the earthquake, about outstanding bonds amounting to 5 trillion yen or more.

TEPCO has raised funds by issuing bonds. So-called "electric power bonds" were considered safe investments next to government bonds given the constant revenues the electricity business generated.

Electric power bonds were mainly purchased by life insurance companies, banks, pension funds and private investors. A view that became accepted was therefore that financial institutions underwriting a number of the electric power bonds would be forced to record major losses from the bonds as bond yields increased rapidly due to increased speculation on nationalization. As a result, bank and insurance stocks were also affected.

However, some consider that the central government will ultimately give certain guarantees to avoid an electric power bond default, as the bonds are held by a wide range of investors, so that bond prices are now stabilizing.

In contrast, the market is now taking a severe stance on stocks for which no dividends will be paid in the future.

The list of major shareholders in TEPCO includes major Japanese life insurance companies such as Dai-ichi Life Insurance Company, Limited and Nippon Life

Insurance Company. The decline seen in the share price resulted in the market capitalization of the power company falling from 3,459.9 billion yen before the earthquake to 575.3 billion yen as of May 19. It is expected that the decrease in market capitalization will cause shareholders to record major impairment losses significantly in excess of the insurance benefit payout resulting from the earthquake.

### *Trends among Life Insurers*

#### (1) Acceleration in Overseas Initiatives of Japanese Life Insurance Companies

Japanese life insurance companies have accelerated their overseas business expansion initiatives.

Meiji Yasuda Life Insurance Company announced a capital and business alliance with German-based Talanx AG and an equity and business alliance with Indonesia-based PT Avrist Assurance on November 5, 2010 and November 8, 2010, respectively. The insurer subsequently announced on January 7, 2011 that it had reached an agreement with Haier Group, the largest electronic appliance maker in China, on a strategic business alliance relating to the management of Haier Meiji Yasuda Life Insurance Company Limited. To gain a foothold in overseas life insurance business, the insurer announced that its business would be expanded and promoted in overseas life insurance markets, saying “we aim to make the business profitable over the medium term by initially entering mainly emerging markets with partners and gradually inputting management resources.”

Dai-ichi Life, which became the first incorporated insurer among major Japanese life insurers in April 2010 and listed its shares at the same time, announced in December 2010 that it had entered into an agreement on the acquisition of all shares in its Australian affiliate TOWER Australia Group Limited, 28.96% of which are owned by the insurer. According to the insurer, further growth in the protection type of insurance products is expected in the Australian life insurance market, where it has enjoyed a continuous pattern of stable growth backed by a strong economy, and the combination of Tower's competitive advantage in the protection type of insurance products and the insurer's capital will enable it to boost its business base in the Australian market to a considerable extent.

Nippon Life, the leading Japanese insurance company, announced in April 2011 that it would acquire a 58 billion yen stake in India-based Reliance Life Insurance Company Limited, making it the second Japanese life insurance company to enter the Indian market following Dai-ichi Life's launch of a joint venture life insurance company with a national bank. This equity holding will be the largest equity investment made in Asia by Japanese life insurers. On the strategy of pursuing overseas initiatives, Yoshinobu Tsutsui, the president of Nippon Life, said “We will share know-how, enter into a business alliance, exchange human resources and hold equity by having a competitive and reliable partner. We would like to implement this steadily on a step-by-step basis.”



In the last few years, we have seen a rapid increase in overseas expansion among Japanese life insurers. It is clear that this is a solution to the shrinkage in the Japanese market resulting from the declining population and these overseas initiatives are likely to accelerate further in future. However, it seems likely to take time to offset the shrinkage in the Japanese market given the scale of the markets in the countries insurers have entered.

## (2) Ownership Change of Three Companies under AIG's Umbrella Completed

As for American Life Insurance Company (brand name: ALICO Japan), AIG Star Life Insurance Co., Ltd. and AIG Edison Life Insurance Company, although three companies were under the American International Group, Inc. umbrella so far, it was decided in March 2010 that ALICO Japan would be sold to U.S.-based MetLife, Inc. along with the US ALICO headquarters. The insurer changed its brand name to MetLife Alico and started operations in April 2011.

On the other hand, it was determined that AIG Star Life and AIG Edison Life, for which a disposal suspension had been released, would finally be purchased by U.S.-based Prudential Financial, Inc. In February 2011, Gibraltar Life Insurance Co., Ltd., one of Prudential's life insurance business units in Japan, completed an acquisition of shares in both insurers.

As a result, acquirees of Star Life and Edison Life became subsidiaries of Gibraltar Life and continue to operate their non-bancassurance businesses for now under their existing corporate name. The business is to be transferred to Prudential Gibraltar Financial Life Insurance Co., Ltd., a subsidiary of Gibraltar Life.

These transactions made Prudential Group a leading foreign life insurance group in Japan with ownership control of 5 life insurers: Prudential Life, Gibraltar Life, Prudential Gibraltar Financial Life, Star Life and Edison Life.

Compared with the situation before the life insurance sector crisis during the late 90s, Prudential Group has rapidly expanded over the last decade by acquiring 7 life insurers: the former Nissan Mutual Life Insurance Company, Kyoei Life Insurance Co. Ltd., Yamato Life Insurance Co., Ltd., Taisho Life Insurance Co., Ltd., Chiyoda Mutual Life Insurance Co. Mutual Company, Toho Mutual Life Insurance Company and Saison Life Insurance Company, in addition to the Prudential Life established by the group.

## (3) Corporate Name Changed from Mitsui Sumitomo MetLife to Mitsui Sumitomo Primary Life

In October 2010, Mitsui Sumitomo MetLife Insurance Co., Ltd. became a wholly owned subsidiary of MS&AD Insurance Group Holdings, Inc. after MetLife, a partner in the joint venture, sold its equity stake to MS&AD Insurance Group for 22.5 billion yen.

Mitsui Sumitomo MetLife took advantage of this opportunity to change its corporate name to Mitsui Sumitomo Primary Life Insurance Company, Limited in April 2011.

The insurer was established in September 2001 and started operations in October of the same year. It had offered variable annuities through the bancassurance channel, but it recently recorded sluggish performance in an acquisition of new business under the weak investment environment. It is focused on how it can play a role as a strategic subsidiary in the bancassurance channel of MS&AD Insurance Group in future.

#### (4) Number of Sales Representatives Exceeds 250,000 and Upward Trend in Persistency Rate Seen

The number of sales representatives, which had trended downward for a long time, has increased for three consecutive years and returned to the 250,000 level.

The number of sales representatives reached about 380,000 at the end of fiscal 1990, the peak of the bubble economy, before decreasing for seventeen consecutive years until the end of fiscal year 2007 when it reached the 240,000 level. However, it has maintained an upward trend over the last few years, partially due to contributions made by improving employment conditions and weaker recruitment across the Japanese economy.

In line with the above trend, the lapse/termination ratio and the persistency rate have also improved over the last few years.

Following the “Nonpayment of claims problem,” which became a social problem in fiscal 2007, insurers have focused on action to keep existing policyholders (through visiting them and confirming their insurance policy details), which is likely to have led to the above results. The Japanese life insurance industry, which had long been criticized for its so-called turnover problem (meaning a large number of employees and a large number of dropouts), is gradually beginning to change its nature.

### *Trends in Business Performance*

The fiscal year 2010 results for 47 life insurance companies in Japan were as follows:

- **Total Amount of New Business**

During fiscal year 2010, the total insured amount of new business for individual life, which is confirmed in all 47 companies, increased by 6.2% from the previous fiscal year to 62.9 trillion yen owing to strong sales of whole life insurance. Regarding individual annuity, the total insured amount of new business decreased by 16.2% from the previous year to 6.9 trillion yen due to weak sales of variable annuity products through the Bancassurance channel.

- **Total Amount of In-force Contracts**

As of the end of fiscal year 2010, the total insured amount of in-force business



for individual life decreased 2.6% from the previous fiscal year to 879.6 trillion yen, due to the sluggish performance of whole life insurance with term rider and interest sensitive whole life insurance, which are main products for traditional companies and many foreign-affiliated companies. As for the number of in-force policies for individual life, it reached 121.9 million thanks to the strong sales of medical insurance.

On the other hand, total insured amount of in-force business for individual annuity was 95.7 trillion yen, up 1.6% from the previous fiscal year, representing the eighth consecutive annual increase. The number of in-force policies for individual annuity also increased, up 3.5% from the previous fiscal year to 19 million. This is because fixed annuity products grow steadily, instead of variable annuity, which was a driver for growth before worldwide economic turmoil.

The total insured amount of in-force business for group life decreased by 0.4% from the previous fiscal year to 371.5 trillion yen.

- **Annualized Premiums**

The total of annualized premiums from new business decreased 14.1% from the previous year to 2.7 trillion yen as a result of the decrease in individual annuities. As for in-force business, annualized premiums totaled 21.8 trillion yen, up 1.9% from the previous fiscal year, due to an increase in individual insurance despite a drop in individual annuities.

- **Premiums Revenues / Total Assets**

Total premium revenues increased 1.0% to 34.5 trillion yen in all 47 life insurance companies. Total assets also increased by 0.7% from the previous year to 320.7 trillion yen, regardless of the damage from the Great East Japan Earthquake

## Product Trends

### (1) A series of launches of new cancer insurance products

Over the last year or so, we have seen a series of launches of new cancer insurance products.

The American Family Life Assurance Company of Columbus (AFLAC), a pioneer and driver of cancer insurance in Japan, launched new cancer insurance products which are named as “*Ikirutamenoganhoken Days*” in March 2011. This product expands the scope and maximum amount of benefit payments for outpatients, given the current situation whereby the main patients of cancer treatment have shifted from inpatients to outpatients.

In January, Asahi Mutual Life Insurance Company started to offer “*Daburunsonae*,” a new product combining medical care insurance and cancer insurance. This packaged product was developed for bancassurance and insurance stores.

A new cancer insurance product launched by Sompo Japan Himawari Life Insurance Co., Ltd. in November 2010 has established a benefit for medical care

delivered for outpatients and is characterized by the benefit being paid even in the case of being not hospitalized and abolition of the maximum total number of days for which benefit payments can be made.

Online life insurer NEXTIA Life Insurance Co., Ltd. launched "*Kacchito ganhoken*," a ten-year term cancer insurance product, and "*Kacchito shushinhoken*," a whole life cancer insurance product, in July 2010. The latter in particular is on track to become a key product.

In addition, AXA Life Insurance Co., Ltd. and ORIX Life Insurance Corporation started offering "*AXA no 'Syunyu bosyo' no ganhoken*" in June 2010 and "*Believe*" in March 2010, respectively.

Each and every product has features unique to the issuing insurer, as well as related services and various forms of customer support and information.

### (2) Second Boom in Nursing-Care Insurance

Following the start of the national long term care insurance system in 2000, many life and non-life insurers launched private long term care insurance products and some insurers entered the nursing care business. Ten years or more have now passed since the Long-Term Care Insurance Act was implemented and a series of long term care insurance products have been launched. This rush of new products heralds a second boom in this field.

Insurers have sought to expand third sector insurance over the last few years, though little interest in long term care insurance products resulted in flat sales volumes. Traditionally, this is probably because we are conscious of "death" and "hospitalization" regardless of our age and are not conscious of the "nursing-care" option until we become elderly and have no desire to take out long term care insurance. Why then have insurers now launched this type of products?

Tokio Marine & Nichido Life Insurance Co., Ltd. and Sony Life Insurance Co., Ltd. launched new products in November 2010, with both products enjoying a solid sales trend. Indications are that for "*Nagaiki shien shushin*" launched by Tokio Marine & Nichido Life, the product concept favored is one of enabling people to enjoy a long life by offering compensation for nursing care over their entire lives.

A whole life long term care insurance (low surrender value type) product launched by Sony Life has been well received for the adequate nursing care-related services it provides.

"WAYS," a product offered by AFLAC in 1985 that led to its entry into the long term care insurance market, is attracting interest due to its high savings feature and has achieved strong sales through the bancassurance channel.

Most long term care insurance products have benefit payment criteria linked to the national long term care insurance system. The "Smile care" product of American Life is characterized by paying an annuity when impediments to ADL (activities of daily living) continue for 180 days or a designated status arises due to dementia continuing for 90 days.



In its 3-year business plan starting in April 2011, Meiji Yasuda Life stated that it would grow its presence in the long term care area as its fourth major product following death insurance, annuity insurance and medical care insurance. This major domestic life insurer also announced that it would develop new services by utilizing a network of nursing care providers established as its group company and enter the nursing-care service facility business.

### *Regulatory Trends*

#### (1) Greater Need to Build an Integrated Risk Management System

It is becoming increasingly necessary to build an integrated risk management system based on economic valuation in the insurance industry.

The FSA's comprehensive Guideline for Insurance Companies Supervision, which was revised in 2009, established "integrated risk management" as a financial soundness evaluation item and indicated that periodic reports should be made to the board of directors on the adequacy of insurers' required capital.

To reflect revisions to the supervisory guideline, the FSA published the "Proposals on Revisions of the Inspection Manual for Insurance Companies" in December 2010. The proposals newly include an "integrated risk management system" category for the examination of insurers' aggregate risk management systems.

Solvency II, a new framework for required capital regulations to be implemented in Europe, and an exposure draft of International Financial Reporting Standard (IFRS) 4 also mandate that required capital be calculated based on economic valuation. In 2010, the FSA conducted a field test on solvency regulation based on economic valuation.

The field test showed that assumptions such as calculation methods and risk coefficients are fundamentally consistent with those of Solvency II, etc., and in-house models developed by insurers in its own right are covered. Preparations are just now being made to move toward full implementation of integrated risk management.

## Supplemental Data: Results of Japanese listed non-life insurance groups (company) for fiscal 2010, ended March 31, 2011 (Non-Consolidated Basis)

(Unit: Millions of yen, %)

	MS & AD Holdings			NKSJ Holdings		Tokio Marine Holdings		Fuji	Toa Re
	Mitsui Sumitomo	Aioi	Aioi Nissay Dowa	SOMPO JAPAN	NIPPONKOA	Tokio Marine & Nichido	Nisshin		
Net Premiums Written	FY 2010	1,232,945	1,097,341	1,256,639	620,615	1,742,746	134,063	265,451	125,354
	FY 2009	1,203,007	794,050	312,666	1,258,896	633,336	1,736,082	131,876	270,837
Net Claims Paid	FY 2010	765,938	692,854	817,961	397,444	1,094,259	81,582	159,439	74,212
	FY 2009	771,996	490,574	196,965	855,048	403,857	1,096,461	77,900	160,937
Underwriting Profit (Loss)	FY 2010	(50,399)	(33,369)	(9,716)	(24,991)	(31,118)	(5,868)	(9,609)	(2,877)
	FY 2009	(15,945)	(4,092)	(10,280)	(2,585)	2,293	81,792	(1,945)	15,100
Ordinary Profit (Loss)	FY 2010	31,770	16,079	20,541	(319)	145,754	2,517	14,833	4,647
	FY 2009	35,786	37,380	10,059	50,318	29,384	147,401	6,423	9,062
Net Profit (Loss) for the year	FY 2010	22,881	(11,417)	12,124	(6,437)	100,713	1,520	7,735	3,807
	FY 2009	25,458	18,166	3,060	42,774	13,123	94,456	4,281	5,090
Total Assets	FY 2010	5,799,005	3,364,309	4,786,371	2,459,190	8,670,008	428,509	918,361	482,194
	FY 2009	5,971,982	2,423,293	1,106,262	5,029,232	2,592,464	9,708,046	439,481	933,155
Ratio 1	FY 2010	68.3	68.2	72.5	69.6	67.5	66.2	64.8	59.2
Loss Ratio (%)	FY 2009	70.4	67.3	73.9	69.4	67.9	64.6	64.6	59.5
Ratio 2	FY 2010	33.9	35.6	33.7	35.8	33.5	37.3	35.0	30.2
Expense Ratio (%)	FY 2009	34.5	35.5	34.1	35.8	34.0	39.2	35.9	30.9
Ratio 3	FY 2010	2.37	2.36	2.21	2.08	2.00	1.53	1.87	2.56
Yield on Investments (Income) (%)	FY 2009	2.38	2.38	2.28	2.06	1.53	1.56	2.09	2.20
Ratio 4	FY 2010	3.05	2.97	2.07	2.40	3.93	3.14	4.72	2.66
Yield on Investments (Realised Gains / Losses) (%)	FY 2009	2.43	3.15	2.68	2.47	2.37	3.23	1.00	3.86
Ratio 5	FY 2010	768.8	681.6	748.6	642.9	823.8	736.6	720.8	768.1
Solvency Margin Ratio (%)	FY 2009	839.4	755.9	800.0	742.5	852.6	747.7	602.0	793.2

Sources: Each company's Financial Statements of FY2010

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