The Toa Reinsurance Company, Limited

Japan's Insurance Market 2014

Japan's Insurance Market 2014

Contents **Page**

To Our Clients
Tomoatsu Noguchi
President and Chief Executive, The Toa Reinsurance Company, Limited 1

1. Features of Japan's Non-Life Insurance Market and Aioi Nissay Dowa Insurance Co., Ltd.'s Midterm Management Strategy
Hisahito Suzuki
President, Representative Director
Aioi Nissay Dowa Insurance Co., Ltd. 2

2. Life Insurance Market in Japan
Ikuo Kudoh, F.I.A.J.
Deputy General Manager, Actuarial & Budgeting Dept.
Sumitomo Life Insurance Company 11

3. Convergence Capital and Its Influence on the Japan Non-Life (Re)Insurance Market
Jonathan Oatley
Managing Director, Guy Carpenter 17

4. The Direction of Recent Amendments to the Insurance Business Law Related to Insurance Sales Regulations
Itaru Adachi
Attorney at Law 22

5. Trends in Japan's Non-Life Insurance Industry
Underwriting & Planning Department
The Toa Reinsurance Company, Limited 28

6. Trends in Japan's Life Insurance Industry
Life Underwriting & Planning Department
The Toa Reinsurance Company, Limited 33

Supplemental Data: Results of Japanese Major Non-Life Insurance Groups (Company) for Fiscal 2013, Ended March 31, 2014 (Non-Consolidated Basis) 40

To Our Clients

It gives me great pleasure to have the opportunity to welcome you to our brochure, *Japan's Insurance Market 2014*. It is encouraging to know that over the years our brochures have been well received even beyond our own industry's boundaries as a source of useful, up-to-date information about Japan's insurance market, as well as contributing to a wider interest in and understanding of our domestic market.

During fiscal 2013, the year ended March 31, 2014, the Japanese economy remained on a moderate recovery track as personal consumption was robust, reflecting improvement in the labor market and rising personal income, while corporate earnings increased against the backdrop of the positive impact of the Abe administration's economic policies and more favorable export conditions.

In the non-life insurance industry in Japan, net premium income trended upward centering on premiums from fire insurance and automotive insurance, supported by increases in the number of new housing starts and automotive sales, while also benefiting from the revision of insurance premium rates and insurance products.

In the life insurance industry in Japan, both the number and the amount of new policies trended upward, reflecting brisk sales of medical insurance and whole life insurance. On the other hand, although the number of policies in force increased in line with buoyant sales of new policies, there was little growth in the amount of policies in force, in view of the recent trend toward greater emphasis on medical coverage and less emphasis on death protection.

In the reinsurance market, there was excess reinsurance capacity owing to the improved financial condition of reinsurance companies and the large amount of capital flowing into the reinsurance market. Thus, reinsurance premium rates softened, resulting in intensified competition among reinsurers.

In these circumstances, in accordance with the Forward 2014 medium-term management plan launched in 2012, the Toa Re Group implemented the initiatives described below to realize the corporate vision articulated in the plan. Utilizing sophisticated expertise and intelligence (E&I), we provide peace of mind with high-quality solutions and services with the goal of being a growing, profitable global reinsurance group trusted by all stakeholders.

By endeavoring to act as an exemplary reinsurance company, we are resolved to fulfill our mission: "Providing Peace of Mind."

In conclusion, I hope that our brochure will provide a greater insight into the Japanese insurance market and I would like to express my gratitude to all who kindly contributed so much time and effort towards its making.

Tomoatsu Noguchi
President and Chief Executive
The Toa Reinsurance Company, Limited

Features of Japan's Non-Life Insurance Market and Aioi Nissay Dowa Insurance Co., Ltd.'s Midterm Management Strategy

Hisahito Suzuki
President, Representative Director
Aioi Nissay Dowa Insurance Co., Ltd.

This article begins with an overview of the features and profitability of Japan's non-life insurance market, and then reviews the corporate reorganization of Japan's non-life insurance industry. Given these market and industry trends, the article then explains the midterm management strategy of the MS&AD Group and Aioi Nissay Dowa Insurance, and our initiatives to further enhance growth, earnings and soundness.

1. Japan's Non-Life Insurance Market and Industry Reorganization

(1) Features of Japan's Non-Life Insurance Market

Fiscal 2013 net premium income for the 27 non-life insurance companies that are members of the General Insurance Association of Japan totaled ¥7,771.3 billion. The size of this market has not changed significantly over the past decade.

Automobile-related insurance accounts for a major share by line of business. In fiscal 2013, automobile insurance (48.4%) and compulsory automobile liability insurance (12.8%) together accounted for around 60% of the overall non-life market, in which number of automobile ownership and new vehicle sales would significantly affect the scale of these markets. The next largest segment by volume was fire insurance (14.8%), which is affected by the number of housing starts and corporate spending trends. Next came casualty insurance such as liability insurance (11.9%), accident and health insurance (8.8%), and marine and transport insurance (3.3%).

Table 1: Net Premium Income

(Billions of yen)

Fiscal	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Net premium income	7,437.2	7,412.0	7,485.4	7,537.2	7,470.0	7,161.8	6,971.1	6,971.0	7,116.1	7,371.8	7,771.3

Source: The General Insurance Association of Japan, *Factbook*

Table 2: Net Premium Income by Line of Business (Fiscal 2013)

(%)

LOB	Automobile	Compulsory automobile liability	Fire	Casualty	Accident & Health	Marine and transport
Percentage	48.4	12.8	14.8	11.9	8.8	3.3

Source: The General Insurance Association of Japan, *Factbook*

The profitability of the non-life insurance market has trended downward over the past several years due to factors such as increases in the number of automobile accidents and natural disasters. Consequently, the combined ratio exceeded 100% from fiscal 2008 through 2012.

Table 3: Loss Ratio, Operating Expense Ratio and Combined Ratio

(%)

Fiscal	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Loss ratio	55.3	63.6	60.6	62.0	62.8	66.6	68.1	67.5	83.4	70.4	64.1
Operating expense ratio	33.2	32.6	32.1	32.2	33.2	35.1	35.0	34.6	33.8	33.0	32.3
Combined ratio	88.5	96.2	92.7	94.2	96.0	101.7	103.1	102.1	117.2	103.4	96.4

Source: Compiled by Aioi Nissay Dowa Insurance from data available on the General Insurance Association of Japan website.

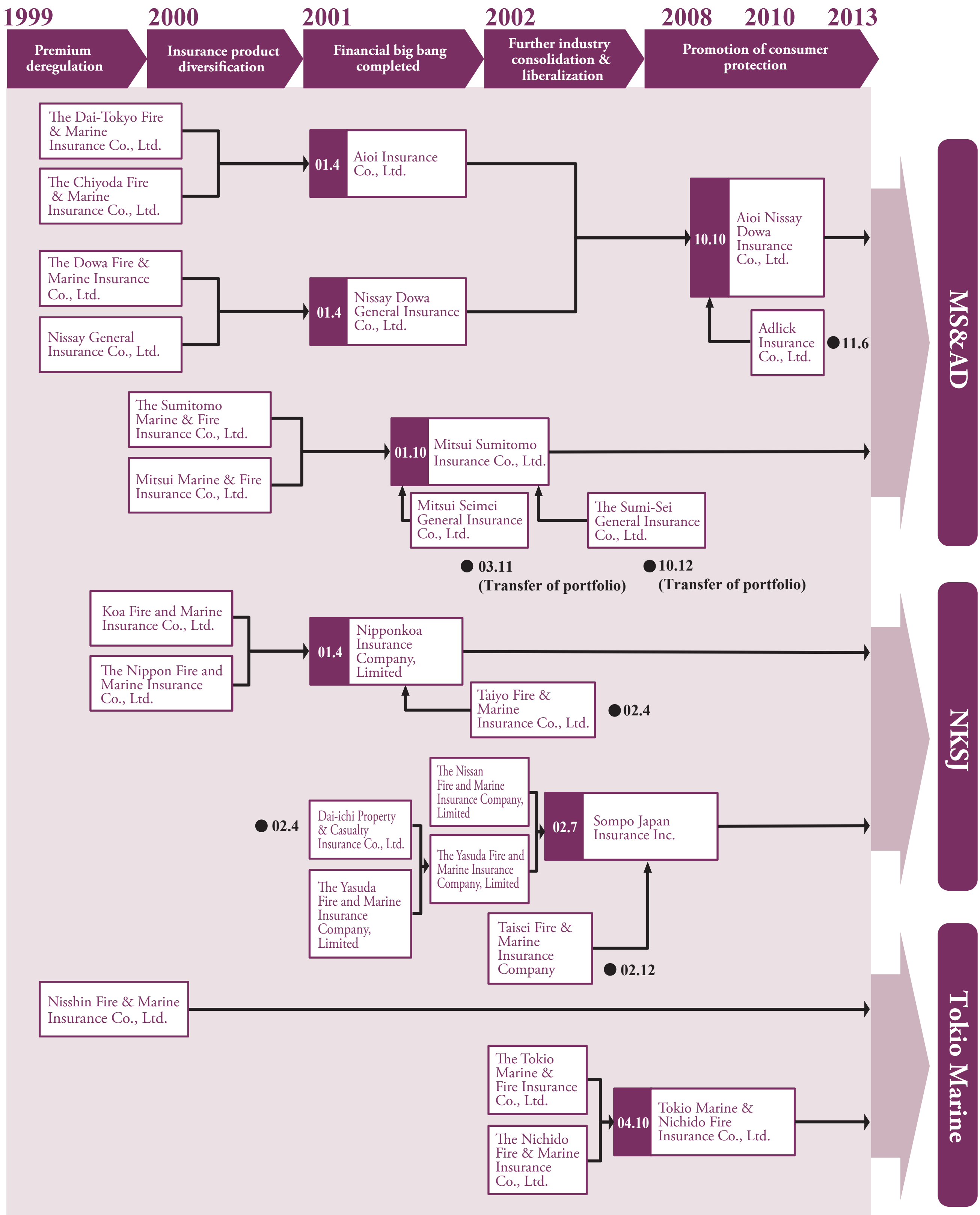
Improving these relatively low profitability circumstances requires enhancing the profit from automobile insurance, which accounts for the largest share of the market. This is a major priority for the entire non-life insurance industry. While raising rates, non-life insurance companies have steadily improved profitability in ways such as reviewing* the age-based rating scheme and introducing a new class rating scheme for policyholders who have had accidents.

* In 2009, the General Insurance Rating Organization of Japan (GIROJ) revised the reference loss cost rate after a six-year interval. Given the greater risk profile of older drivers, the GIROJ also introduced a rating system that reflects risk differentials for named insureds according to their age. In addition, in 2011 the GIROJ revised the premium table applied to drivers who have had accidents with a view to ensuring fair treatment of policyholders. With these changes in place, non-life insurance companies implemented a succession of product revisions.

(2) Industry Reorganization

Issues such as new product development costs and intensified premium competition brought on by ongoing deregulation from the second half of the 1990s heightened the need to raise management efficiency by scale expansion, which resulted in industry reorganization through mergers. The first round of reorganization in 2001 consolidated the 14 listed insurance companies into 8. Other factors that contributed to the reorganization were the protracted stagnation of the Japanese economy after the end of the bubble economy in the early 1990s and the looming impact of the low birth rate and aging population.

Under these circumstances, additional mergers and acquisitions took place in the non-life insurance industry, with the MS&AD Insurance Group and NKSJ Group emerging in April 2010. Along with the Tokio Marine Group, the industry consolidated into three mega non-life insurance groups that together account for more than 90% of total non-life premium income in Japan.

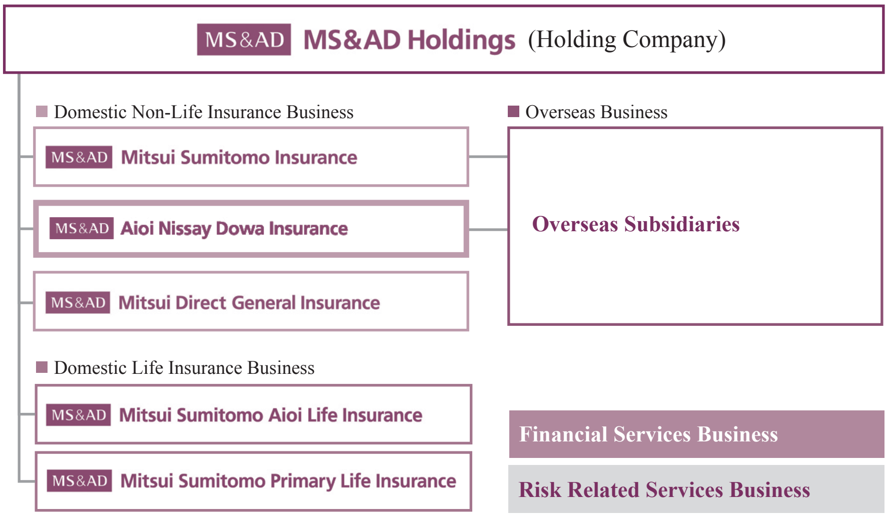


Source: Compiled by Aioi Nissay Dowa Insurance from data available in the General Insurance Association of Japan's *Factbook*.

2. Our Position within the MS&AD Insurance Group

Overview of the MS&AD Insurance Group

The MS&AD Insurance Group was established in April 2010 through the integration of Mitsui Sumitomo Insurance Co., Ltd., Aioi Insurance Co., Ltd., and Nissay Dowa General Insurance Co., Ltd., with MS&AD Insurance Group Holdings, Inc. as the Group's holding company.



3. Aioi Nissay Dowa Insurance's Vision (Midterm Management Plan "AD Next Challenge 2017")

(1) Term of Plan and Positioning

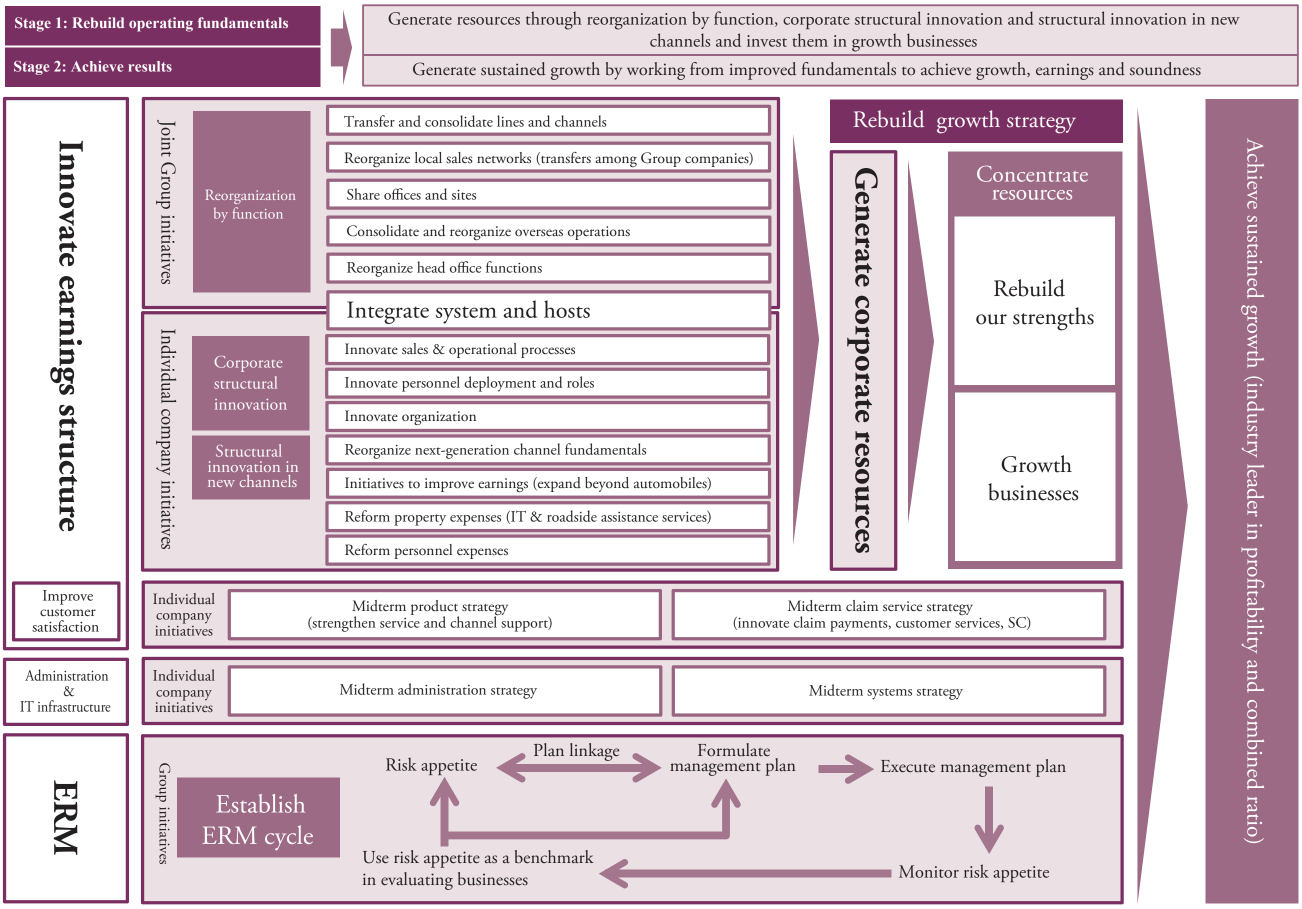
Aioi Nissay Dowa Insurance started its new midterm management plan, "AD Next Challenge 2017", on April 1, 2014.

We will execute the plan over four years from fiscal 2014 through 2017. The first two years will be Stage 1, during which we intend to transform our corporate structure and restructure our operating fundamentals. The final two years will be Stage 2, during which we intend to produce results as one of the Group's core non-life insurance companies.

(2) Fundamental Approach of the Midterm Management Plan

Our priority during Stage 1 will be rebuilding our growth strategy. We will execute the shared Group initiative of reorganization by function and our company-specific initiatives of corporate structural innovation and new channel structural innovation to generate corporate resources in the form of personnel, expenses and capital that we can allocate quickly in businesses in which we are strong and growing.

We will generate sustained growth in Stage 2 as a result of the initiatives in Stage 1.



(3) Specifics of the Midterm Management Plan

① Reorganization of the MS&AD Group by Function

Reorganization by function is a shared MS&AD Group initiative. Its significance and objectives in each area are as follows:

- Reorganize marine, aviation and motor channels as well as local sales networks to give the Group an aggregate number one position in each business segment and region;
- Reorganize third sector insurance to achieve the number one position in non-life owned life insurance operation by exercising comprehensive Group strengths;
- Pursue Group efficiencies by sharing bases and reorganizing overseas businesses; and
- Enhance governance by the holding company by reorganizing head office functions.

② Key Corporate Structural Innovation Initiatives

- Sales framework innovation

We will consolidate ancillary sales operations, such as bookings at sales offices, to main branch central administration departments in order for sales offices to concentrate more on sales promotion.

- Role innovation

  We will innovate roles and work processes for operations, sales divisions, claim services divisions, and head office employees based on qualifications.
- Organizational innovation

  We will review local operating frameworks in ways such as regrouping main branches and branches to fundamentally reform the organizations for claim services, regional operating divisions and the head office.

③ Key New Channel Structural Innovation Initiatives

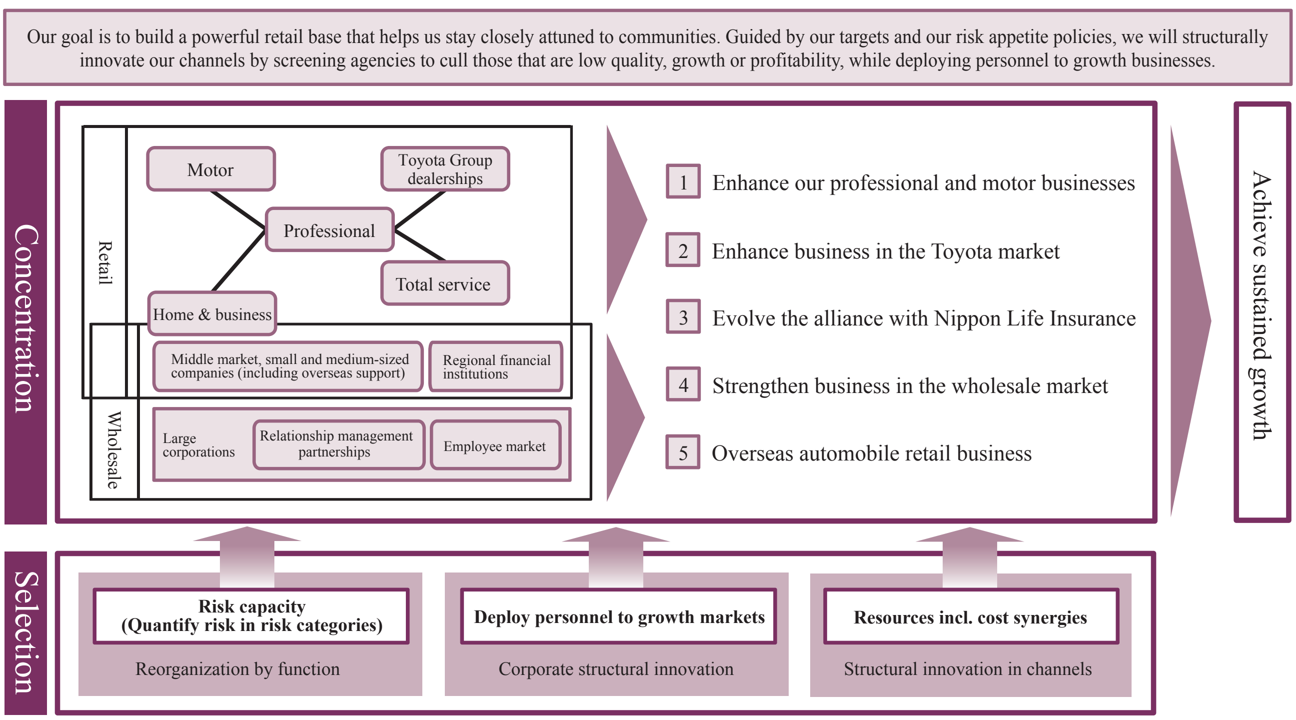
We will significantly enhance sales potential through new channel structural innovation initiatives designed to create new sales networks, and improve and strengthen internal administrative processes.

- Reinforce recruitment of potential professional insurance agents who will work for Aioi Nissay Dowa Insurance until they establish their own agencies affiliated with the Group, and also enhance the sales capabilities of sales personnel
- Reinforce internal administrative control processes at large agencies
- Enhance agency quality to build an agency network that would get support from customers

④ Rebuilding Domestic Growth Strategy

i. Direction for Rebuilding Domestic Growth Strategy

We will rebuild growth strategy in Japan by allocating corporate resources in the form of personnel, expenses and capital generated from the above ① to ③ into four main areas, i.e., a) professional and motor channels; b) Toyota and Nippon Life Insurance markets; c) wholesale market; and d) overseas automobile retail market.

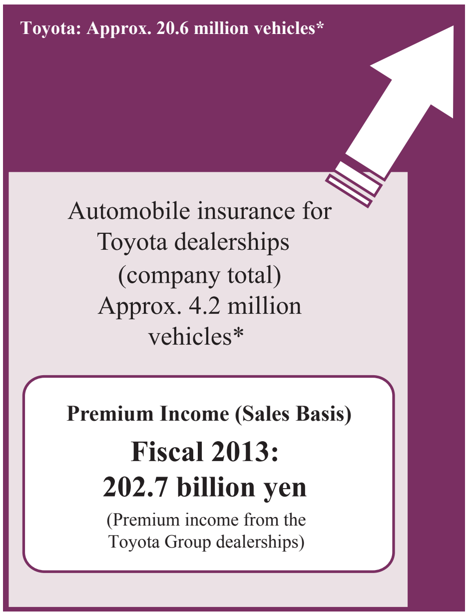


ii. Toyota and Nippon Life Insurance Markets

Joint initiatives involving our business partners Toyota Motor Corporation and Nippon Life Insurance Company that expand our insurance underwriting business are the most significant advantage for us.

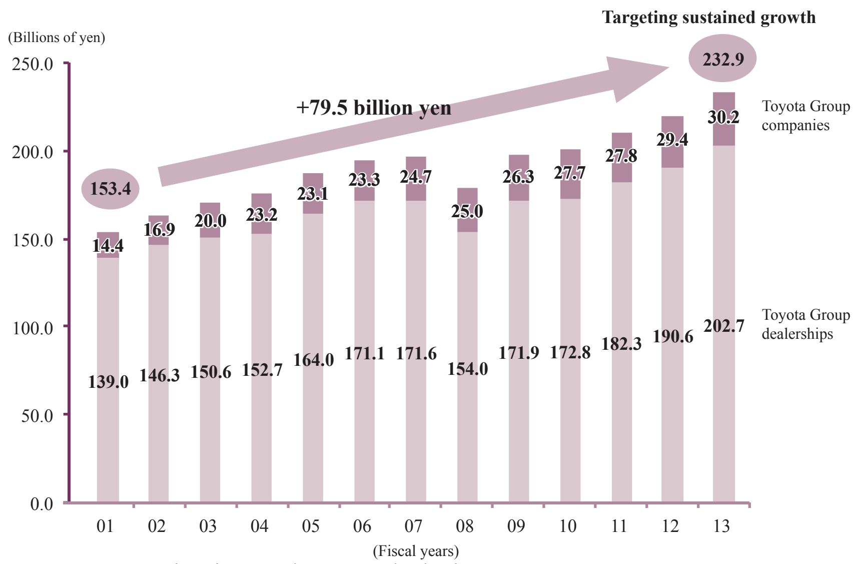
First we are generating sustained growth by expanding the insurance underwriting business at Toyota automobile dealerships. This involves not only selling insurance to Toyota customers who purchase new Toyota automobiles but also strengthening sales to existing Toyota owners where we still have potential to expand.

Toyota Dealership Market



*Aioi Nissay Dowa Insurance estimate

Premium Income from the Toyota Market

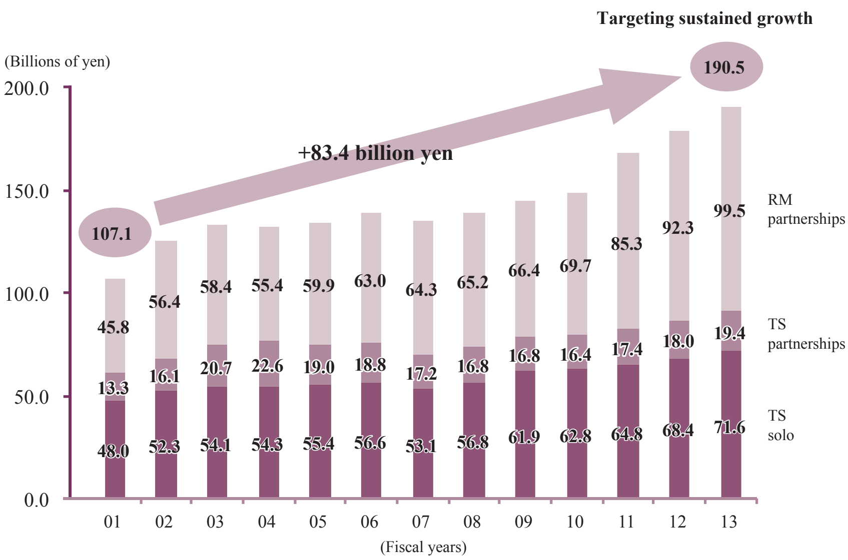


Note: Premium income data on a sales basis

We also see the potential for growth in the Nippon Life Insurance policyholder market, where we are generating sustained growth by accelerating unified initiatives with Nippon Life Insurance to expand non-life insurance sales.

Nippon Life Insurance Policyholder Market

Premium Income from the Nippon Life Insurance Market



Note: Premium income data on a sales basis

(4) Establishment of Enterprise Risk Management (ERM)

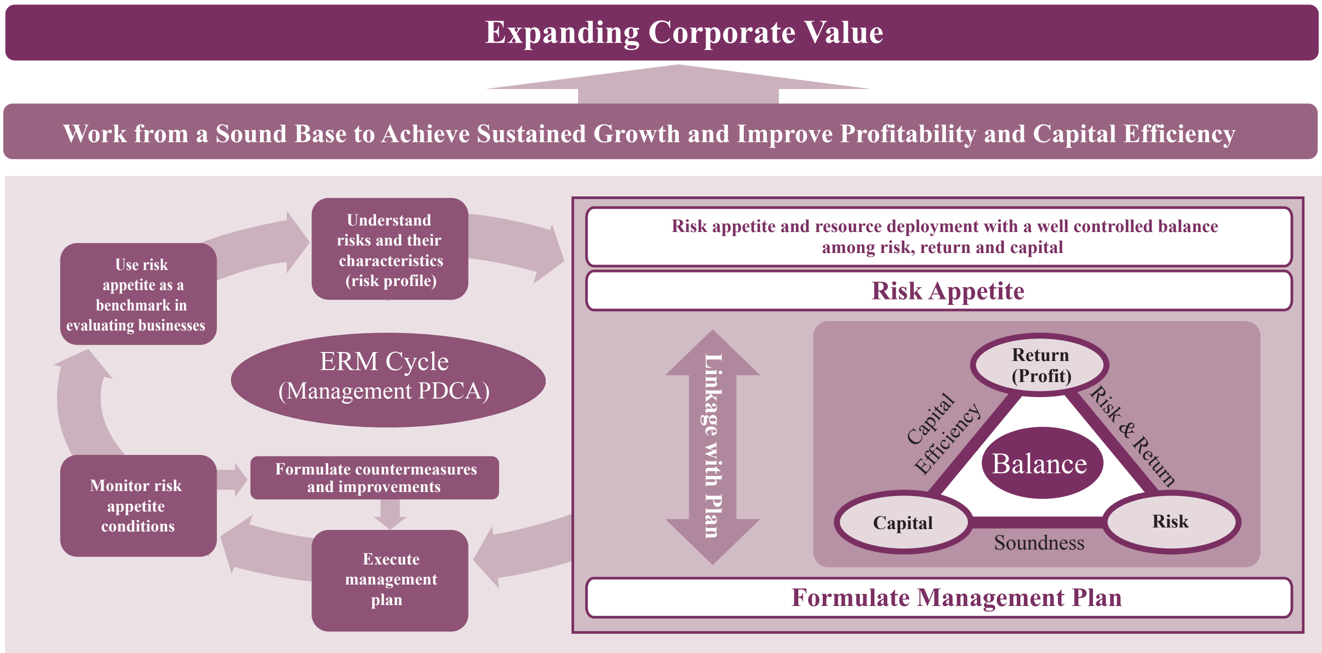
① ERM Objectives

We are implementing ERM to reinforce integrated management of risks, capital and returns so that we can appropriately and promptly address our various management issues, such as transforming our business portfolio through reorganization of functions, improving profitability, and dealing with natural disasters and changes in the financial environment. With strong financial ground, we will realize sustained growth and improve profitability and capital efficiency and enhance our corporate value.

② ERM Cycle

As one of the core companies of the MS&AD Group, Aioi Nissay Dowa Insurance has established a similar ERM cycle to that the Group employs to understand risk quantitatively and qualitatively from a companywide perspective. Armed with this knowledge, we are basing risk appetite on a well-controlled balance among risk, return and capital to enhance corporate value by working from our strong financial basis to achieve sustained growth, improved profitability and capital efficiency.

MS&AD Group ERM Summary



(5) Strategic Challenges Based on Risk Appetite Policy

① Reinsurance Strategy

Diversifying both domestic and overseas underwriting risks is one of the keys in our risk appetite policy. We will therefore strengthen our reinsurance strategy such as controlling domestic natural catastrophic risks by maintaining appropriate retention and cession while carefully expanding profit focused overseas inward reinsurance. Ensuring sound risk control, we will generate better returns on risk by diversifying underwriting risks.

② Overseas Automobile Retail Business

Our focused commitment of resources to the overseas automobile retail business will generate growth and expand returns on risk. Representative initiatives involve transferring authority to local operations to raise organizational flexibility and efficiency, and raising the efficiency of overseas operations largely by taking effective advantage of the reorganization of functions. We will also invest to increase the number of countries in which we do business to establish the foundation for profitable operations.

③ Natural Disaster Risk Management

We will address the rising risk of natural disasters by balancing risk and return while maintaining conservative reinsurance coverage and sustaining increased provisions to the contingency reserve to ensure a sufficient risk buffer.

In closing, we will steadily implement our midterm management strategy and further strengthen growth, earnings and soundness for the MS&AD Group and Aioi Nissay Dowa Insurance, so that we can increase the MS&AD Group's corporate value.

2. Life Insurance Market in Japan

Ikuo Kudoh, F.I.A.J.
Deputy General Manager, Actuarial & Budgeting Dept.
Sumitomo Life Insurance Company

The needs of consumers in Japan's life insurance market are evolving as a result of changes in social structure. This article discusses circumstances in the focus areas of nursing care, medical care and savings.

1. Environment Surrounding the Japanese Life Insurance Industry

(1) Public and Private Healthcare Insurance Programs

Social security system in Japan adopts what is called “universal insurance and pension coverage” policy and it is compulsory for every citizen in Japan to participate in the public social healthcare insurance program. This program serves to decrease the burden of payment for medical treatment borne by individual patients, sharing the cost derived from illness and injury on a societal level and, furthermore, assuring an equal opportunity for everyone to receive high quality advanced medical treatment. Also, there is a ceiling for the amount of monthly payment for medical treatment borne by individuals according to their ages and income levels. This makes it possible to keep the payment of individual participants below the ceiling amount for any medical treatment as long as the treatment is within the coverage under the program, regardless of the actual amount of treatment expenses.

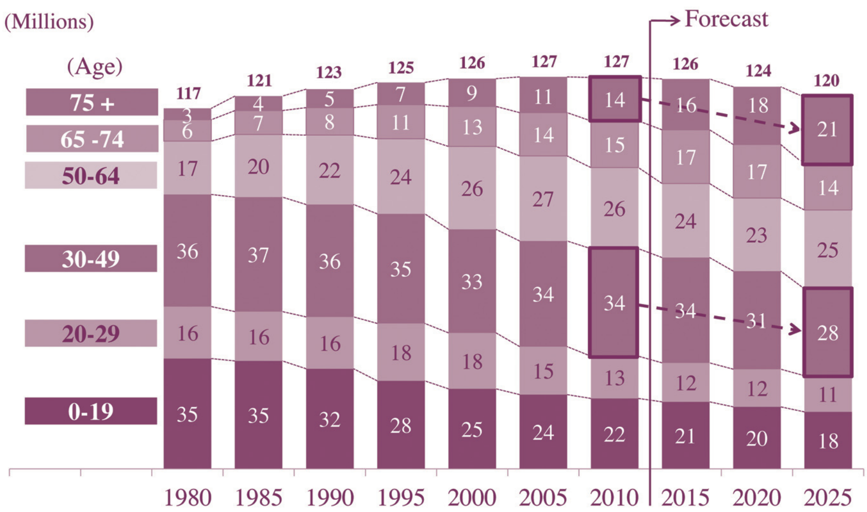
In this regard, the medical and health insurance provided by the private insurers in Japan typically compensates the damages for the self-borne medical costs exceeding the ceiling amount and non-covered costs under the program, for example, travelling and living expenses related to treatment or hospitalization, loss in income due to long-term hospitalization or expenses for “advanced medical treatment” which are not recoverable under the program. The sum insured in the private medical and health insurance is typically determined as a fixed amount.

(2) Population and Households

Japan has been experiencing a lowering birth rate and aging demographic, and facing a declining population. The beginning of a declining trend in the working age population (age 15 to 64) was already identified back in 1996, and the nation's overall population has been on a downward trend since 2005. As of October 1, 2013, the total population in Japan was 127.3 million, of which the number of people aged 65 or over against total population (population aging rate) was 25.1%.

In the future, the number of people in the over 65 years old group, especially the “over 75 years old” group is expected to grow, while the population of the “30 to 49 years old” group is anticipated to decline, indicating a potential shrinkage in the domestic private consumption.

Figure 1: Changes in Population by Age Group

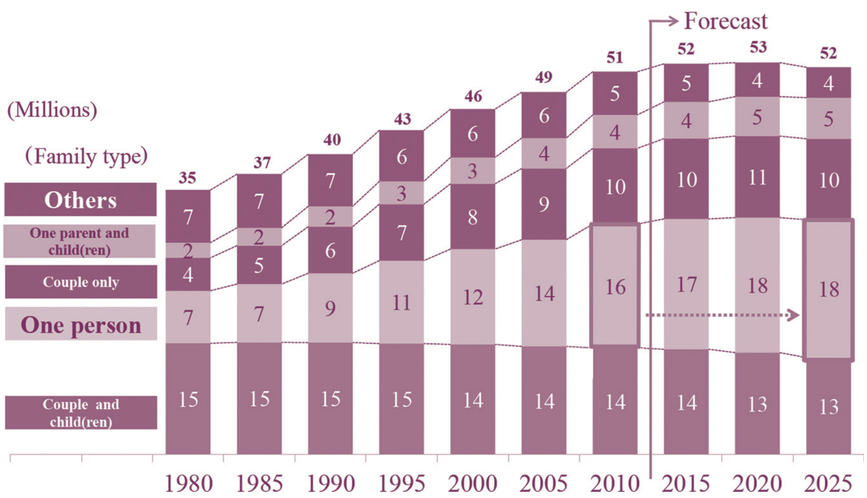


(Figures as of October 1, each calendar year)

Source: "Estimated Population of Japan" National Institute of Population and Social Security Research, "Population Census" the Ministry of Internal Affairs and Communications

Amid a trend in declining population, there has been a change in the composition of a family as well. A "typical family" used to comprise "parents and two children" – four in total. Currently, the number of "single-person families" has shown a rising trend and its proportion of the total has been increasing; notably it has been the largest group of family type since 2007. In the future, the number of "single-person families" is expected to increase further as the number of unmarried persons aged 50 or over significantly grows.

Figure 2: Number of Private Households by Family Type



(Figures as of October 1, each calendar year)

Note: Members of the above households do not include nursing home residents and similar status persons. The households comprising three families or other types of households are included in "Others."

Source: "Population Statistics," National Institute of Population and Social Security Research

2. Changes in Life Insurance Market in Japan

(1) Aging Population

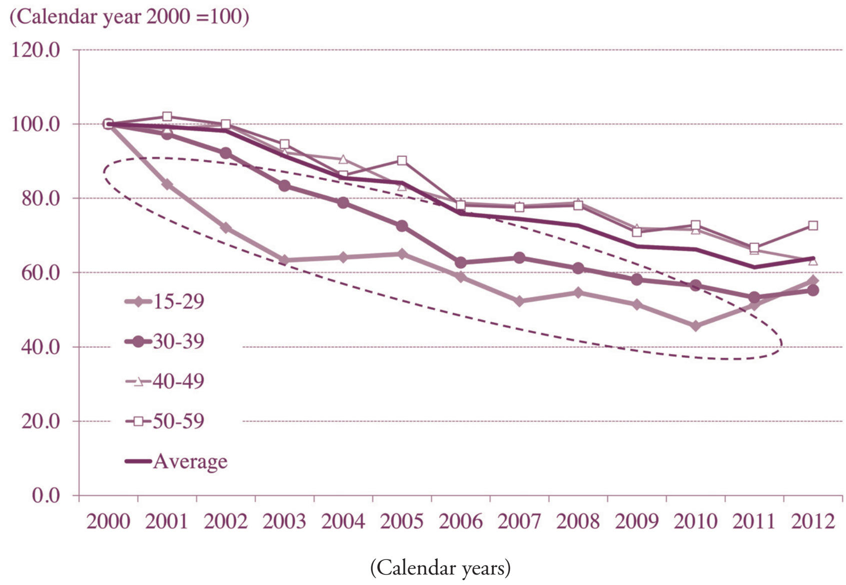
The total population of Japan is decreasing, while the proportion of the total relating to people aged 60 or over continues to increase. As the people in that age group are likely to be more concerned with risks associated with longevity rather than death, insurance products targeting elderly people, such as whole life medical insurance, are expected to be more popular in the market. In anticipation of the coming of an aging society, there are growing needs for more credible and value added customer services.

(2) Young Generation is Reluctant to Buy Life Insurance in Japan

It is notable that the number of life insurance policyholders, especially in the young age group, has been on a declining trend. Several reasons for this reluctance could be considered, including: (1) As the security level in the office or the work place, such as the ID check at the entrance, have been tightened, it has become more difficult for individual sales agents to access the young people who will be potential customers; (2) Diversity in lifestyle leads more young people to be unmarried or young families to remain childless; and (3) A worsening environment in terms of disposable income makes the purchase of life insurance less affordable.

Figure 3: Changes in Insurance Premiums by Age Group of the Household* Head

* Two or More Person Households, Workers' Households



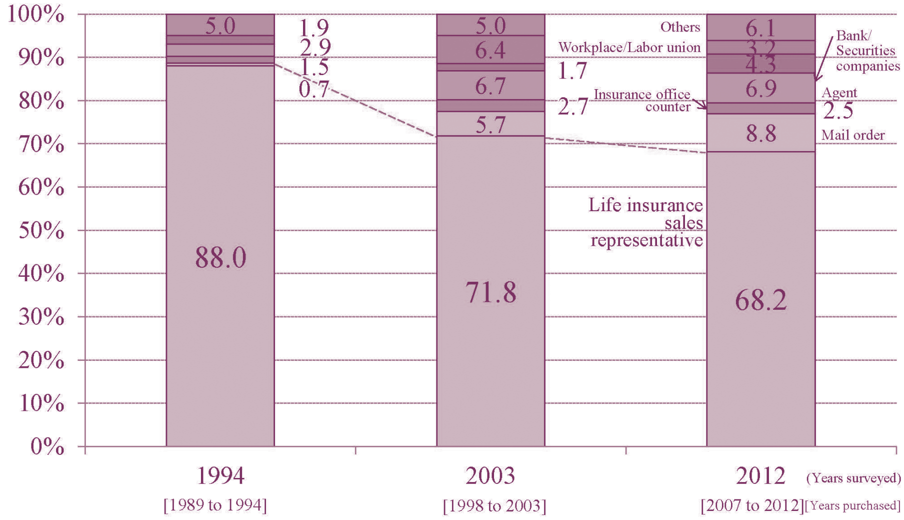
Source: "Family Income and Expenditure Survey," the Ministry of Internal Affairs and Communications

(3) Distribution Channels

Historically, the majority of life insurance products were sold by sales agents tied with a single life insurance company. However, a growing number of products are now being sold through new channels including bancassurance, insurance outlets and Internet, thereby providing those who are seeking to purchase insurance policies with more diversified channels.

In terms of the distribution channels through which consumers took out insurance policies, as the most recent survey underlines, consumers can choose insurance from a wider range of channels than in the past. However, the tied agent channel remained the largest distribution channel in Japan as nearly 70% of consumers still purchased policies through this channel.

Figure 4: Sales Channels for Most Recent Contracts



Source: "National Survey on Life Insurance," Japan Institute of Life Insurance

3. The Prospects of the Life Insurance Market

Potential Growth Areas (Nursing Care (Long Term Care), Medical Insurance and Savings for Longevity)

In Japan, total premium income of life insurers was 37.1 trillion yen and "basic profits" reached 3.2 trillion yen for the period ended March 2013. That represents the underlying profitability of the life insurers for the year.

(Trillions of yen)

Fiscal	2008	2009	2010	2011	2012
Premium income	34.0	34.1	34.4	36.2	37.1
Basic profits*	2.1	2.8	2.6	3.0	3.2

Source: The Life Insurance Association of Japan, "Life Insurance Fact Book"

* Basic profits: a popular performance indicator of profits or losses of life insurance companies for core insurance businesses, excluding capital gains/losses and extraordinary gains/losses.

In view of a lowering birth rate and an aging population, together with the growing number of single-person families arising from the diversification of lifestyles, the pure protection market such as term life is anticipated to decline. Meanwhile the importance of the life insurance market is expected to grow further, centered in the areas of nursing care (LTC), medical insurance and savings for longevity.

(1) Nursing Care (LTC)

The beneficiaries of the public nursing care services are obliged to pay 10% of total service fees in Japan. In practice, taking care for the elderly often requires several additional costs other than nursing care service fees, such as ordinary living expenses, loss of family income due to necessary care leave, the alteration of dwelling house to enhance barrier-free accessibility and the meal delivery service fees. The actual cost of "total nursing care expenses" after considering the compensation from the public nursing care insurance has to be funded by those who require nursing care and needs to be prepared by "self-effort", for example, to purchase private nursing care insurance. Looking ahead, this "self-effort" portion is inevitably likely to grow with the aging population.

(2) Medical Insurance

According to data on the medical insurance market, insurance policies in force as of the end of fiscal 2012 stood at 69 million, with the average daily hospitalization benefit per policy amounting to 5,921 yen. Considering that the estimation (Sumitomo Life estimates) of the average self-borne payment necessary for hospitalization would be 13,000 yen per day, the above hospitalization benefits per policy do not contribute to even half of the necessary amount, indicating that this area has great growth potential for insurers.

(3) Savings

According to the "Flow of Funds Accounts Statistics" conducted by the Bank of Japan, the balance of personal financial assets as of the end of fiscal 2012 was approximately 1,500 trillion yen. Among these assets, the balance of cash and deposits stood at 849 trillion yen, representing approximately 60% of the total. Although one should keep in mind that these assets include sole proprietors' funds allocated for business use, some portion of these savings are very likely to be switched to pensions or other insurance products as the need to manage longevity risk grows in later life.

As discussed above, the aging of society and other factors have brought unprecedented circumstances to Japan's life insurance market. Considering the high penetration rate of life insurance in Japan, some believe that the room for growth in the death protection segment is limited. However, growth is expected in the areas of nursing care, medical care and savings because customers' needs have evolved as a result of changes in the structure of society. Life insurance companies that accurately identify these evolving needs can create opportunities to expand their business by providing products and services.

Japan is not the only country with an aging population, which is an issue that will have an impact in many countries around the world. Current and future changes in Japan's life insurance market and how Japan's life insurance companies deal with them will have various implications for global insurance industry.

3. Convergence Capital and Its Influence on the Japan Non-Life (Re)Insurance Market

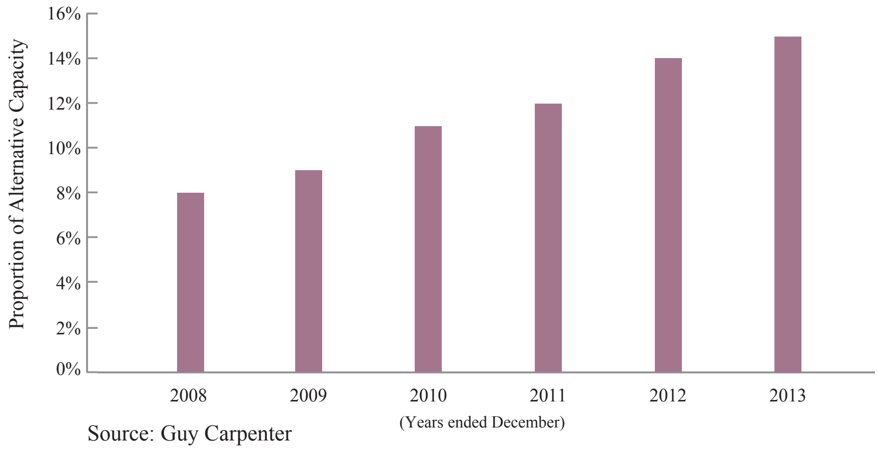
Jonathan Oatley
Managing Director, Guy Carpenter

1. A Global Perspective

Dedicated capital in the reinsurance sector reached near record levels at the end of 2013 having risen to 322 billion U.S. dollars. Guy Carpenter estimates this to be approximately 8% in excess of normal capital levels given historical underwriting trends. Of particular note within this number was the 10 billion U.S. dollars of alternative, or "convergence," capital that made its way onto reinsurers' balance sheets in 2013. We look here at the growing influence of alternative capital in the reinsurance sector, its impact on the Japan non-life (re)insurance market and offer some pointers for the future.

Capacity emanating from alternative markets now accounts for approximately 50 billion U.S. dollars, some 15% of global property catastrophe reinsurance limit. Figure 1 illustrates how alternative capacity as a percentage of global property catastrophe limit has almost doubled since 2008 as cedents have increasingly utilised catastrophe bonds, industry loss warranty (ILW) products and collateralized reinsurance (including retrocessional reinsurance placed on this basis) to deliver a cost efficient source of risk transfer.

Figure 1: Alternative Capacity as a Percentage of Global Property Catastrophe Reinsurance Limit



Source: Guy Carpenter

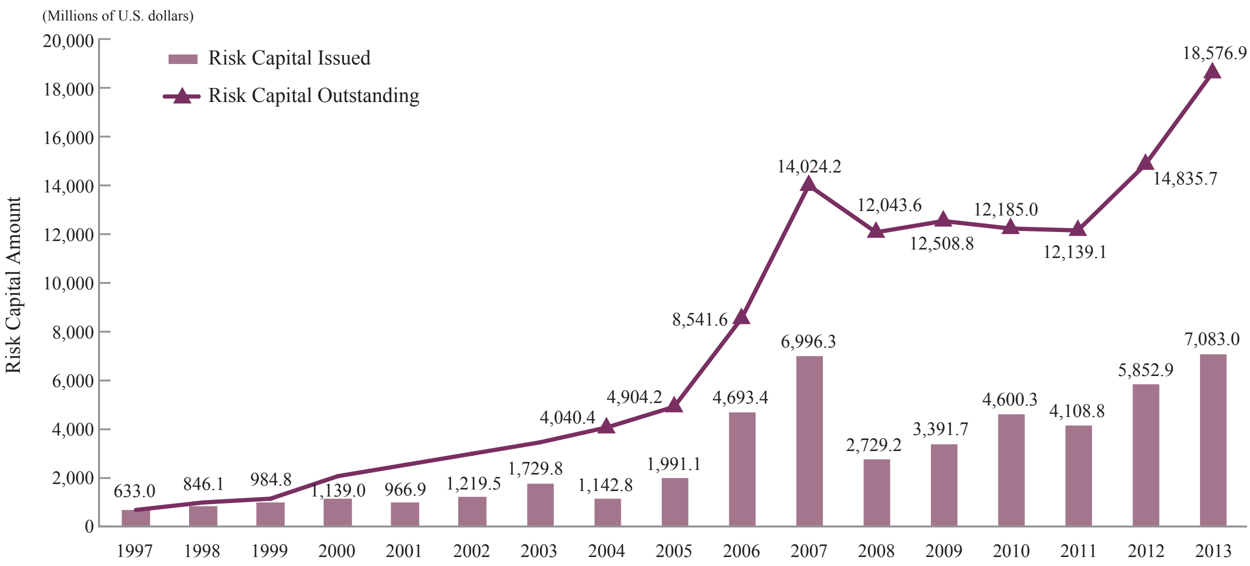
The impact of this new alternative capital has been most acute in the property catastrophe market – and to a sizeable extent, the retro market – as investors have been attracted by the segment's uncorrelated returns and relatively attractive yields. The U.S. property catastrophe reinsurance market in particular has seen material price reductions driven by the increased competition.

In 2014, we have begun to see evidence of alternative capital providers extending their influence into other spheres of the reinsurance market. For instance, third-party capital backed reinsurers seeking to move into longer-tail lines have emerged, demonstrating a growing willingness on the part of investors to explore casualty lines. This new capacity is likely to benefit cedents with more negotiating leverage and, ultimately, improved pricing, structure and coverage – just as it has done in the U.S. property catastrophe space.

In addition to seeking out opportunities in new classes, we have also seen increased appetite for the alternative capital to diversify their reinsurance portfolios geographically. To date, whilst this has been evidenced more in the retro and catastrophe bond arenas than in the traditional UNL market, the growing level of interest is unmistakeable.

Pension funds have been a major contributor to the growth in new capital. Their focus on relatively remote peak peril catastrophe risk has contributed in driving strong growth in the catastrophe bond market during 2013, with issuance reaching a record high of 7.1 billion U.S. dollars, surpassing the previous peak of 2007. Risk capital outstanding also reached an all-time high of 18.6 billion U.S. dollars last year (see Figure 2). Some of the capacity previously deployed via ILWs has shifted into indemnity based products due to their reduced pricing and increased availability.

Figure 2: 144A Catastrophe Bond Issuance and Capital Outstanding – 1997 to Year End 2013

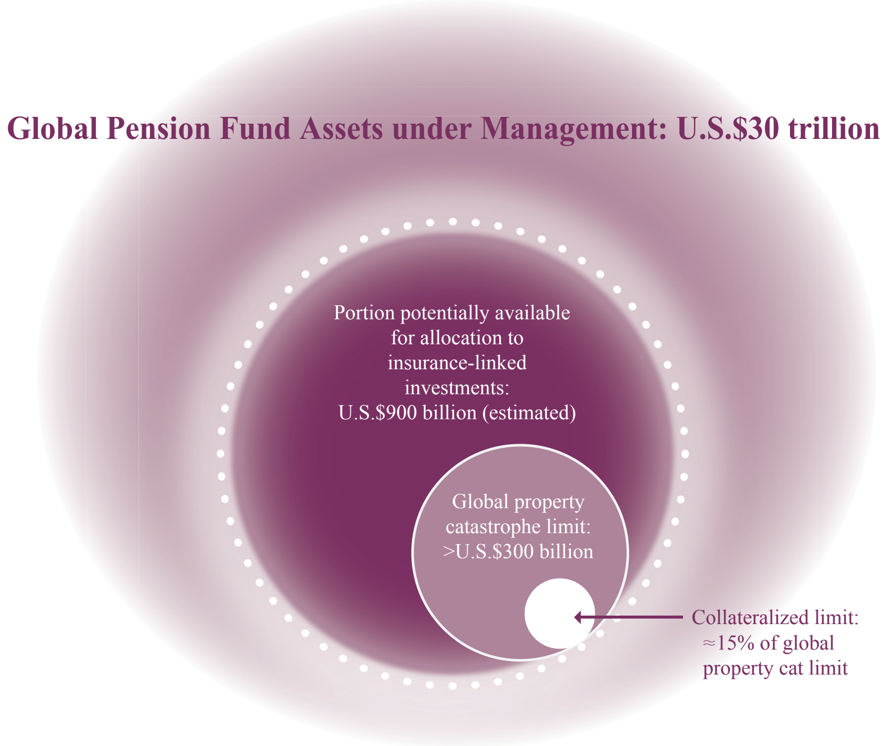


Source: Guy Carpenter

Indeed, the growth in alternative capital has in some instances resulted in ILS catastrophe risk pricing decoupling from price expectations in the traditional reinsurance market, with ILS products in some cases offering the most competitive terms for reinsurance buyers. Lower cost of capital assumptions for alternative capital providers has enabled the ILS market to provide very competitive pricing for certain peak risks. Strong appetite for U.S. hurricane catastrophe bonds during 2013 tightened spreads in the secondary market by an average of approximately 45% on a weighted notional basis since issuance in 2012. Despite the significant decrease in ILS pricing over the last 12 months, investor demand continues to be robust.

Impressive as the growth in alternative capacity has been, this should be viewed in the context of the proportion of pension fund capital currently being allocated to reinsurance. Pension funds alone are worth around 30 trillion U.S. dollars (see figure 3). Based on Guy Carpenter's analysis of possible capital allocation percentages to the (re)insurance space in consultation with sector experts, a maximum of 900 billion U.S. dollars of this amount could potentially be available for insurance-linked investments. This figure is, of course, much greater than required in the current market, demonstrating the existing convergence-driven supply excess and helping to explain the move into alternative classes and geographies.

Figure 3: Pension Fund Capital under Management and Allocations into Reinsurance



Source: Guy Carpenter, JP Morgan Asset Management

When we weigh up the size of the current global catastrophe reinsurance market (Guy Carpenter estimates this to be approximately 300 billion U.S. dollars) and take into account the fact that pension funds have so far made very small investments in reinsurance relative to their overall size, it is evident that a modest increase in pension fund participation in the property reinsurance segment could have a significantly greater impact than has been seen to date.

2. Japan Non-Life Reinsurance Market at April 1, 2014

Just two years after one of the most challenging of treaty renewals, following the Great East Japan Earthquake of March 2011 and Thailand Floods of November 2011, the market experienced a seismic shift in the balance of supply and demand. Key factors of influence on the supply side were reinsurers with strong balance sheets and a desire to grow, abundant capacity – in the main due to foreign exchange depreciation of the Japanese yen and the availability of cheap and broad retrocession cover, the relatively high starting position of Japanese pricing compared to historical levels, and a reasonably benign loss environment in the global market. At the same time, there were a number of factors driving reduced demand on the part of buyers, most notably the recent mergers and acquisitions in the Japanese non-life insurance market, cedents themselves with improved balance sheets, instances of corporate restructuring, and the combination of perils in catastrophe covers.

The consequence of this culmination of factors was a highly competitive environment, prompting reinsurers to defiantly defend the shares that they did hold, with a significant softening of terms and conditions inevitably following. Frenzied competition for market share led to considerable over-placement on many covers. Oversupply of capacity for catastrophe lines was at its greatest for many years, despite efforts to control offerings to the market.

In summary, on the property side, Japanese reinsurance buyers generally enjoyed significant price and cost reductions in most main lines, allowing them to achieve or even exceed pre-renewal targets. In earthquake lines, abundant capacity was available from traditional reinsurers who remained eager to write this class, both as earthquake standalone or as part of the increasing amount of combined peril excess of loss purchased by non-life companies. In general, stand-alone capacity reduced in the non-life sector but increased in the mutual segment. Earthquake excess of loss pricing reduced across all portions of the market, with earthquake pro rata commission rates generally returning to pre-Tohoku levels or higher. Improved balance sheets for major buyers reduced the pressure to buy top end windstorm capacity covers and some of the purchases made in recent years were discontinued, allowing this capacity to be redeployed elsewhere. As with earthquake, windstorm rates fell across all segments of the market. Pricing of Japanese wind peril returned to near-historic lows.

In the context of pricing and capacity targets being comfortably met, Japanese buyers continued to favour their long-term, traditional reinsurance partners, many of whom had paid losses from the Great East Japan Earthquake and Thailand Floods. New reinsurers and those wishing to expand were generally frustrated in their ambitions. The direct impact of alternative capital providers in Japan therefore remained quite limited for 2014. Ultimately, Japanese buyers did not need to explore new or alternative capital; they were readily able to achieve the required pricing and capacity with known suppliers.

However, while the direct impact of alternative capital was not necessarily overtly witnessed, there remained a clear sense that traditional reinsurers were in some way responding to the potential of this sector of the market. Traditional players, who had been increasingly “feeling the heat” of the alternative capacity in the U.S. property catastrophe markets in particular, appeared keen to demonstrate the value of their product and proven continuity.

It could also be argued that the presence and activities of alternative capital in the retro market have served to increase the availability and reduce the cost of retro, thereby indirectly benefiting Japanese buyers. However, with so many softening factors at play, the real impact here may be considered marginal.

It is in the catastrophe bond arena where we have perhaps seen the greatest influence of alternative capital in Japan to date. Recent catastrophe bond activity and the considerable interest generated in competitively priced, yen denominated and indemnity-based products can be taken as clear evidence of this new willingness to write peak zone catastrophe risk outside of the United States.

In summary though the total amount of Japanese property catastrophe limit written by alternative capacity remains appreciably less than this globally representative 15% figure.

3. The Road ahead and Questions We Should Ask

The global reinsurance market has undoubtedly undergone dramatic change over the past 24 months, with a significant influx of convergence capital from institutional investors seeking access to the reinsurance space. Increased responsiveness and innovation by traditional reinsurers have also accompanied this influx of third-party capital. Whilst there may be limited evidence of any meaningful impact on the Japanese non-life market to date, we cannot conclude that this will continue to be the case in the foreseeable future.

There are several key questions that we may wish to ask with the Japanese (re)insurance market in mind.

Should we question the permanence of this new capital? The current pension fund allocation to the reinsurance space is fairly modest. Our observations suggest that the capital supporting the convergence capacity is increasingly stable institutional money that has spent years evaluating the catastrophe risk asset class and made a long-term commitment to reinsurance. The answer would appear then to be no – although it will be wise to maintain a close watch on its activities and responsiveness to market dynamics.

What if a large catastrophe event should occur? Based on limited past experience, indications are that investors have typically remained in markets, or even grown participations, as pricing has adjusted in response to loss activity. However, it is important to raise a note of caution, as only time will tell us how alternative capital reacts to losses.

What if investment returns elsewhere improve? Although some allocations to reinsurance may exit once investment returns in other comparable asset classes pick up, the commitment to the sector from such a broad range of institutional investors suggests this to be a permanent asset allocation strategy.

Finally, how might this impact Japanese reinsurance renewals going forward? Investors are likely to continue or even increase their allocations to reinsurance in the coming years, seeking further class of business and geographical spread. Given the relatively low penetration that this alternative sector currently enjoys in Japan, it appears reasonable to predict that investors will continue to target peak zone Japanese earthquake and windstorm exposure. This will likely give rise to further excess reinsurance capacity being available for Japanese catastrophe risk, further tilting the supply-demand equilibrium in the favour of the Japanese reinsurance buyer should they choose to open the door to this new capacity.

4. The Direction of Recent Amendments to the Insurance Business Law Related to Insurance Sales Regulations

Itaru Adachi
Attorney at Law

1. Foreword

All insurance companies, whether financial institutions that sell insurance over the counter or other businesses that market insurance, have always been acutely aware of the state of regulations that govern approaches to selling insurance and soliciting membership in organizations that provide insurance. This paper generally refers to all such activities as insurance sales.

Nevertheless, the Revised Insurance Business Law[1] that was enacted by the 2014 ordinary session of Japan's National Diet (the 186th Diet) is expected to broadly impact all businesses associated with insurance sales.

This paper discusses recent trends in the amendment of the Insurance Business Law that are relevant to insurance sales regulations. Please note that all opinions in this paper are those of the writer.

2. Amendments to the Insurance Business Law

(1) Overview of Proposed Amendments to the Insurance Business Law

On March 14, 2014, the Cabinet decided on the Draft Proposal of Amendments to the Insurance Business Law. This draft proposal was submitted to the 186th Diet and passed on May 23, 2014.

The Revised Insurance Business Law is based on a report[2] titled "New Insurance Products/Services and Solicitation Rules" (the Report) issued publicly on June 7, 2013 by the "Working Group on the Provision of Insurance Products/Services" of the Financial Services Administration's Financial System Council. The amendments follow five themes: 1) establishment of basic rules for selling insurance; 2) upgrading of regulations governing insurance sales representatives; 3) regulatory easing related to overseas operations; 4) regulatory easing related to insurance brokers; and 5) regulatory easing to enable customer services aligned with actual conditions.

All of these themes are likely to affect insurance businesses, but the impact on insurance sales operations of numbers 1) and 2) above would be particularly pronounced. This paper will therefore focus on discussing these two themes for the amendment of the Insurance Business Law.

As a review of the rules for selling insurance, the Report covered "Restructuring/clarification of the scope of applicability of solicitation rules." It restructured and clarified the basic concept of insurance sales by restructuring and clarifying the interpretation of the scope of applicability of the Insurance Business Law to address new insurance solicitation processes such as the emergence of comparison websites and prospective client introduction services. Items that are not included in the latest amendments to the Insurance Business Law may well be addressed by revision of the Comprehensive Guidelines for Supervision of Insurance Companies (the "Insurance Supervision Guidelines").

Concerned with "New insurance products/services," the Report covered "sales of new insurance products" (fertility treatment insurance and insurance under which policyholders can receive goods/services from partner companies through cashless procedures), "expansion of operational scope of insurance company groups" (lifting of the ban on operation of nursery schools by insurance companies), and "greater utilization of concerted activity systems." Although these items were among those not included in the amendments to the Insurance Business Law, "expansion of operational scope of insurance company groups" may well be accomplished through future revision of the enforcement order for the Insurance Business Law.

(2) Establishment of Basic Rules for Insurance Sales

① Introduction of the Obligation to Ascertain Customer Wishes and Requirements

The existing Insurance Business Law does not specifically stipulate an obligation to ascertain customer wishes and requirements. In practice, however, the Insurance Supervision Guidelines already call for insurance providers to uphold the principle of suitability at the time of sale by requiring them to prepare an "intention confirmation document" for submission to customers to confirm their true intentions and needs.

In contrast, the Revised Insurance Business Law creates a legal obligation to understand customer needs at the time of sale and propose insurance plans that meet them. This obligation is called "the obligation to ascertain customer intentions" below.

According to the Revised Insurance Business Law, "officers, employees and sales representatives of domestic and foreign insurance companies and insurance brokers" ("insurance sales representatives" below) must do the following to satisfy the obligation to ascertain customer intentions:

1. Ascertain customer intentions;
2. Propose an insurance policy that meets customer intentions, and explain the content of the policy; and
3. Provide an opportunity when concluding the policy for customers to confirm that the content of the insurance policy matches their intentions.

These three items also require evidence from this process that the customer is expressly able to understand the reason for purchasing the policy.

However, the Revised Insurance Business Law does not specify methods for meeting these three obligations when selling insurance. Each salesperson must therefore use their creativity and ingenuity to meet their obligation. However, future revisions to the Insurance Supervision Guidelines will likely indicate standards that must be met and examples of specific means for doing so.

Fulfilling the obligation to ascertain customer intentions will not be all that difficult if the customer's intentions are clear from the beginning. However, customer intentions are often unclear throughout the sales process. Given the obligation to ascertain customer intentions, sales representatives will need to use their creativity and ingenuity to supplement existing sales materials and other resources.

Of note, the obligation to ascertain customer intentions extends to soliciting membership in an organization that provides insurance as well as outright insurance sales. This is discussed in ③ below.

② Introduction of the Obligation to Provide Information

The existing Insurance Business Law regulates the provision of information when selling insurance in ways such as prohibiting misrepresentation and obligating explanation of important matters when explaining insurance to customers; prohibiting false disclosure; prohibiting failure to explain disadvantages when selling alternative policies; prohibiting misleading comparisons with other insurance; prohibiting categorical judgments; and prohibiting misrepresentation of material issues.

Among these regulations, “important matters” are described within the obligation to explain them as information that insurance companies and insurance sales representatives are obligated to provide to customers (policyholders and insured persons). These “important matters” are generally understood[3] to be “matters that significantly affect the decision whether or not to conclude an insurance policy,” but suffice it to say that the wording is hardly clear and unambiguous.

At the same time, the Insurance Supervision Guidelines stipulate an obligation to explain the content of the “policy summary” and “information that should be brought to the consumer’s attention.” Current sales practices allow[4] sales representatives to fulfill this obligation through means such as providing written documents, policy guides and policy provisions, which are considered to be prima facie explanation of “important matters.”

In this context, the Revised Insurance Business Law creates a legal obligation when selling insurance to provide product and related information necessary for the customer to decide if a policy is suitable (the “obligation to provide information”).

A Cabinet Office Ordinance (Insurance Business Law Enforcement Order) will presumably specify the content and delivery of the information that is subject to the obligation to provide information, so specific details are not yet clear. However, the items included in the “policy summary” and “information that should be brought to the consumer’s attention” will likely be retained in the obligation to provide information. The obligation to provide information may also include information about important ancillary services such as roadside assistance and direct payment services, as well as information that is relevant to comparison sales, such as the scope of products compared and the reasons for recommending particular products.

The method for providing information for highly individualized and specialized insurance such as insurance that covers business risks and for insurance that carries small premiums will likely be based on factors such as customer knowledge rather than a standardized method.

Also, soliciting membership in an organization that provides insurance as well as insurance sales will carry the obligation to provide information, which will be covered in ③ below.

③ Soliciting Membership in an Organization That Provides Insurance

According to the existing Insurance Business Law, soliciting membership in an organization that provides insurance is treated differently[5] than selling insurance. Essentially, therefore, the existing Insurance Business Law imposes the regulations for providing information on the sale of insurance covered in ② above, but does not impose them[6] on soliciting membership in an organization that provides insurance.

In contrast, the Revised Insurance Business Law in principle[7] imposes the same obligation to understand customer intentions and provide information on soliciting membership in an organization that it imposes on selling insurance.

(3) Upgraded Regulations for Sales Representatives

① Introduction of the Obligation to Develop and Reinforce Insurance Sales Systems

The existing Insurance Business Law imposes an obligation on insurance companies to develop and reinforce relevant systems, but does not impose this obligation on insurance sales representatives, including insurance agencies. The existing Insurance Business Law already calls for direct examination of insurance sales representatives, but the plans for developing and reinforcing systems at insurance agencies only call for insurance companies to provide instruction and management for agency sales representatives.

In contrast, the Revised Insurance Business Law retains the existing regulations that obligate insurance companies to instruct insurance sales representatives and adds a legal obligation for insurance sales representatives to develop and reinforce their systems (the "obligation to develop and reinforce relevant systems") according to the size and characteristics of their business to properly conduct insurance sales.

A Cabinet Office Ordinance (Insurance Business Law Enforcement Order) defines the obligation to develop and reinforce relevant systems of insurance sales representatives, just as it does the similar obligation of insurance companies. However, the Revised Insurance Business Law stipulates the following five points for the obligation to develop and reinforce relevant systems (numbers one through three parallel the obligation to develop and reinforce relevant systems of insurance companies):

1. Explanation of important matters to customers during the insurance sales process;
2. Proper handling of customer information acquired through the insurance sales process;
3. Ensuring that the relevant insurance sales obligations are fulfilled when a third party handles the insurance sales process;
4. Disclosure of the items being compared when engaging in comparison sales involving two or more insurance companies or similar organizations; and
5. In the case of a franchisor, formulation and proper implementation of policies for supervising the insurance sales operations of its franchisees (insurance salesperson supervision).

Considering these points, the Cabinet Office Ordinance (Insurance Business Law Enforcement Order) and the Insurance Supervision Guidelines are likely to require insurance sales businesses to formulate internal rules and regulations, provide training, conduct internal audits and otherwise comply according to their size and characteristics.[8]

② Authority for Obtaining Reports from and Onsite Examination of Subcontracted Sales Representatives

The existing Insurance Business Law clearly specifies the authority of insurance companies for obtaining reports from and conducting onsite examinations of their subcontracted sales organizations, but does not do so for insurance sales organizations including insurance agencies that are subcontracting sales.

In contrast, the Revised Insurance Business Law clearly specifies[9] the authority of insurance sales representatives for obtaining reports from and conducting onsite examinations of their subcontracted sales organizations.

(4) Enforcement Timeline

The basic rules for insurance sales as per (2) above and the regulations for developing and reinforcing sales representative organizations as per (3) above that are components of the Revised Insurance Business Law will be enforced within two years of the official announcement date (June 30, 2014) by Government Ordinance (Order for Enforcement of the Insurance Business Law).

The expected goal for amending the Insurance Supervision Guidelines in connection with the Revised Insurance Business Law is approximately six months from the official announcement date.

Notes:
1. Please refer to the Financial Services Agency (FSA) website (http://www.fsa.go.jp/common/diet/) for the text of the law.
2. Please refer to the FSA website (http://www.fsa.go.jp/news/24/singi/20130611-2/01.pdf) for the text of the report. An overview of the report is available in the manuscript "Outline of the Report of the Working Group on the Provision of Insurance Products/Services" (NBL1006, Page 13).
3. Yamashita, Tomonobu. "Insurance Business Law," page 169 and others.
4. Please refer to "Interim Summary of Issues on Sales and Solicitation of Insurance Products in accordance with Suitability Rule" by The Study Team on Insurance Product Sales and Solicitation, July 8, 2005, Note 11 on page 7.
5. The Insurance Business Law defines "insurance solicitation" as "agent or intermediary for conclusion of an insurance contract" (Insurance Business Law, Article 2, Paragraph 26). Please refer to "Overview of Public Comments and Financial Services Agency Views on 'Proposal for Partial Amendment of the Insurance Business Law Enforcement Order, Proposal for Related Financial Services Agency Notification Proposal, and Proposal for Partial Revision of the Enforcement Order for Banks'" contained in the "Result of Collection of Opinions on 'Proposal for Partial Amendment of the Insurance Business Law Enforcement Order, Proposal for Related Financial Services Agency Notification Proposal, and Proposal for Partial Revision of the Enforcement Order for Banks'," FSA, December 21, 2007, page 26, "Other," number 4, and other sources.

6. Exceptions apply to the use of group policies with the intent to circumvent measures to preclude harmful outcomes. Please refer to the above “Financial Services Agency Views,” page 26, “Other,” number 4, and other sources.
7. Exceptions are i) when parties with a special relationship as defined by Cabinet Ordinance induce relevant group insurance policyholders and relevant insurance policyholders to become members; and ii) when it can be reasonably expected as specified by Cabinet Ordinance that a relevant policyholder will properly provide required information to a person joining an insurance policy for relevant group insurance. Specific details are delineated by a Cabinet Ordinance (Insurance Law Enforcement Order). However, the “parties with a special relationship defined by Cabinet Ordinance” in i) are assumed to be those commissioned by the group serving as the policyholder, and “when it can be reasonably expected as specified by Cabinet Ordinance that a relevant policyholder will properly provide required information” in ii) is assumed to refer to a group to which the organization classification standards apply.
8. Examples relevant to the issue of size of business include the use of benchmarks such as whether the company is a sole proprietorship or has numerous branches and employees. Examples relevant to the issue of business characteristics include the use of benchmarks such as whether the company is doing business in accordance with management and instruction from an insurance company, whether it is conducting comparison sales involving two or more insurance companies, and whether it is providing instruction or other services to sales representatives and so is conducting operations independently of management and instruction from an insurance company.
9. In addition to the above, there is debate about the provision of books and records (Revised Insurance Business Law Article 303) and submission of business reports (Revised Insurance Business Law Article 304) related to certain sales representatives.

5. Trends in Japan's Non-Life Insurance Industry

Underwriting & Planning Department
The Toa Reinsurance Company, Limited

1. Trends in Business Results of Non-Life Insurance Companies for Fiscal 2013

In fiscal 2013, the twenty-seven non-life insurers comprising the members of the General Insurance Association of Japan reported total net income of 214.3 billion yen, up 47.2 billion yen from the previous fiscal year, partially due to improved profits in automobile insurance, the effect of the weaker yen and higher stock prices, and solid overseas operations. Although heavy snowfall in February 2014 had a certain impact on all insurers,* all three mega groups achieved record net profits.

Net premium income in all lines of business increased to 7,771.3 billion yen, up 399.5 billion yen from the previous fiscal year, mainly owing to the effect of revised products and premium rates for automobile insurance and higher sales volume resulting from solid new car sales.

On the other hand, net claims paid declined to 4,560.3 billion yen, down 214.6 billion yen from the previous fiscal year despite the effect of the heavy snowfall. The loss ratio improved by 6.3% to 64.1 %.

Operating and general administrative expenses related to insurance underwriting increased by 21.8 billion yen to 1,168.4 billion yen. However, the net expense ratio fell by 0.7% to 32.3%.

The combined ratio improved by 7% to 96.4%.

As a result of the above, ordinary profits for the non-life insurers increased by 36.8 billion yen from the previous year to 414.6 billion yen. A breakdown of these profits suggests that the strong business results in the current fiscal year were driven by a large increase in returns on asset investments as well as the strong underwriting profits (up 85.7 billion yen from the previous year).

As their financial statements indicate that they face certain limits on growth in domestic operations, the existing trend is expected to persist in that non-life insurers will aim to shift to a business structure in which overseas operations and life insurance business become revenue sources.

* Effect of Heavy Snowfall in February 2014

According to the announcement by the General Insurance Association of Japan, the record-breaking heavy snowfall experienced in the Kanto region in February 2014 caused the industry as a whole to pay insurance claims of 253.6 billion yen (as of April 30, 2014), a historic high for insurance claims paid out for a snowfall. Among past natural disasters excluding the Great East Japan Earthquake, the amount paid is the fourth largest on record.

The huge insurance claim payments made were due to the snowfall occurring in areas where people generally have less interest in preparing for a heavy snowfall. In many cases, insurance claims were paid under fire insurance and automobile insurance contracts due to damage to buildings such as roofs and garages broken by the weight of the snow. Discontinued factories and other factors also pushed up insurance claim payments.

2. Trends in Non-Life Insurance Industry

(1) Industry Consolidation in Insurance and Mutual Aid Businesses

The non-life insurance market is now oligopolistic in Japan, with the three mega non-life insurance groups (Tokio Marine Group, MS&AD Group and NKSJ Group) accounting for 86.4% of total net premium income across the whole industry as of the end of March 2014.

Among the three mega groups, in the NKSJ Group, the merger of Sompo Japan Insurance Inc. and Nipponkoa Insurance Co., Ltd. is scheduled to occur on September 1, 2014. These two insurers started joint operations in April 2013 and have increased their operational efficiency. The merger will make the new company the largest non-life insurance company in Japan in terms of non-consolidated premium income, with net premium income amounting to 2,082.1 billion yen (the sum of figures appearing in the two merging companies' non-consolidated financial statements for the year ended March 2014).

MS&AD Holdings started implementing full functional consolidation within the group in April 2014 as the second phase of its business merger. This consolidation is aimed at clarifying the business missions of Mitsui Sumitomo Insurance Company, Limited and Aioi Nissay Dowa Insurance Co., Ltd., the core non-life insurers within the group, and at optimizing their functions to create synergy. The group eventually plans to reduce costs by about 50 billion yen (from 2011) through such functional consolidation, system integration, etc.

Tokio Marine & Nichido Fire Insurance Co., Ltd. reached an agreement with the National Mutual Insurance Federation of Agricultural Cooperatives (JA Kyosai) on comprehensive business cooperation in May 2013. As part of this move, in March 2014, the two parties agreed on basic cooperation-related matters in areas involving agricultural risk; they will publicize the establishment of a center specializing in examining indemnities and services related to agricultural risk, and will continue to explore the potential for an extensive service offering across the board between the mutual aid and insurance businesses.

Among other insurers outside the three mega non-life insurance groups, Fuji Fire and Marine Insurance Company, Limited and AIU Insurance Company, Ltd. – insurance companies under the umbrella of the AIG Japan Group – announced in July 2013 that they would implement a business merger after combining in the second half of 2015.

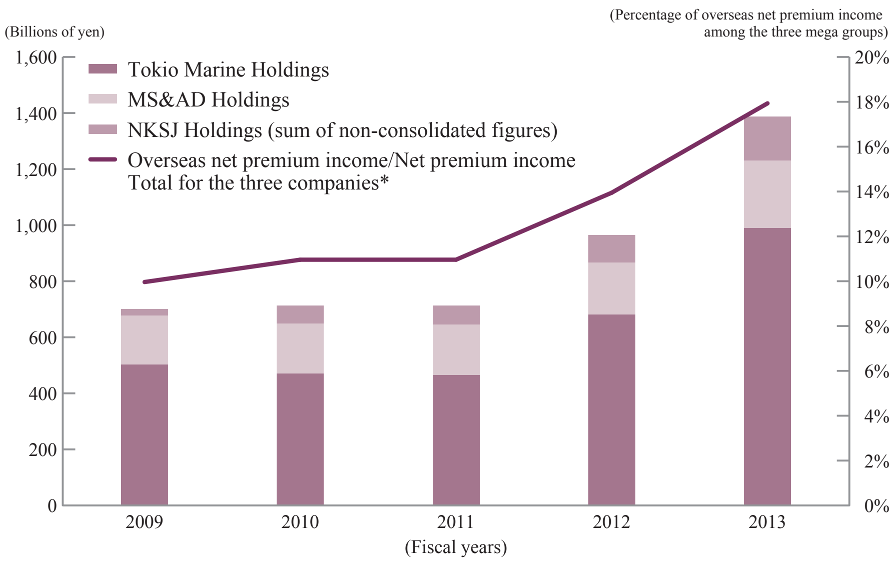
As discussed above, non-life insurers are looking to invest in growth areas including life insurance business and overseas operations, and to increase their profits by raising operational efficiency through mergers and business cooperation aimed at cutting costs.

(2) Expanding Overseas Business

At a time when there is little prospect of significant market expansion in Japan due to an ever-decreasing birthrate and the aging population, non-life insurance companies are seeking to expand their business bases in emerging countries with rapidly increasing populations and high economic growth. In particular, the three mega groups are actively implementing business cooperation and engaging in M&A transactions with local insurance companies, regarding overseas operations as a driver of growth in these groups.

Overseas premium income among these groups has developed as follows. The figures indicate that non-life insurance companies have further accelerated the growth of their overseas operations over the past few years. In particular, Tokio Marine Holdings generated net premium income exceeding 1,000 billion yen in fiscal 2013, partially due to the effect of the weaker yen. Overseas insurance operations account for 63.7% of net income at Tokio Marine Holdings, 21.3% at MS&AD Holdings, and 26.1% in the NKSJ Group (based on figures reported in financial statements for the fiscal year ended March 2014). In addition to expanding their life insurance business, the source of non-life insurance companies' profits has also changed significantly.

Figure 1: Trends in Overseas Net Premium Income among the Three Mega Groups



* Based on aggregated figures appearing in the financial statements of these non-life insurance groups

Table 1: Major Overseas Operations in the Three Mega Groups (from 2013 to 2014)

Date	Name of Company	Overseas Operations
April 2013	Tokio Marine Holdings	Converted its investee Nile General Takaful Company S.A.E. into a subsidiary (Egypt)
December 2013	Tokio Marine Holdings	Reorganized the framework of its European operations (established an intermediate holding company by transferring stocks within the group)
December 2013	MS&AD Holdings	Converted an Australian management company into an insurance company to open a local subsidiary
February 2014	Tokio Marine Holdings	Tokio Marine Kiln invested in a U.S. agency
April 2014	NKSJ Holdings	Opened a representative office in South Africa
April 2014	Tokio Marine Holdings	Obtained approval to change a range of businesses belonging to a Chinese subsidiary
April 2014	NKSJ Holdings	Obtained approval to change a range of businesses belonging to a Chinese subsidiary
May 2014	NKSJ Holdings	Completed acquisition of Canopius Group Limited stock
May 2014	MS&AD Holdings	Obtained approval to change a range of businesses belonging to a Chinese subsidiary
May 2014	Tokio Marine Holdings	Invested in CITIC (China)

3. Trends in Products and Regulation

(1) Effect of the Consumption Tax Rate Hike

In Japan, with its rapidly decreasing birthrate and aging population, the consumption and local consumption tax rates were hiked to 8% in April 2014 and will be raised further to 10% in October 2015 to ensure a source of revenue is available to pay for social security. The hike to 10% is subject to improving economic conditions.

Partially due to the consumption tax rate hike, major non-life insurance companies are set to increase their automobile insurance premiums by about 2% after this autumn. According to an estimate made by the General Insurance Association of Japan, raising the consumption tax rate to 10% would force the insurance industry as a whole to bear an additional financial burden of about 180 billion yen.

(2) Sophistication of ERM Promoted by the Regulatory Authorities

In the revised Insurance Core Principles (ICPs) adopted by the International Association of Insurance Supervisors (IAIS) in October 2011, one provision introduced requires the authorities to supervise insurance companies and groups to ensure they implement enterprise risk management (ERM) and own risk and solvency assessment (ORSA) practices. The Japanese Financial Service Agency in February 2014 revised its Comprehensive Guidelines for the Supervision of Insurance Companies and the Insurance Inspection Manual.

The revision introduced notable changes in areas such as enterprise risk management, which was treated as a component of financial health in the existing supervisory guideline, being seen as a separate item. Annual Supervisory Policies for Insurance Company for Program Year 2013 – which the Agency published on September 6, 2013 – indicates that "the promotion of more sophisticated risk management" is a priority area. The policy goes on to clarify that in "the promotion of enterprise risk management," the Agency will examine the introduction of ORSA reports. Given this, the aforementioned revision is based on this policy and is considered one of the actions leading toward the introduction of ORSA reports.

Additionally, in major activities concerning international insurance regulations, particularly the passage of a bill concerning Solvency II at the European Parliament in March 2014, the introduction of economic value-based solvency regulations and insurance supervisory accounting given developments at the International Accounting Standards Board (IASB) are under parallel consideration in Japan, with regulations and a supervisory system being put together to encourage insurance companies to adopt more sophisticated risk management practices.

6. Trends in Japan's Life Insurance Industry

Life Underwriting & Planning Department
The Toa Reinsurance Company, Limited

1. General Topics related to the Life Insurance Market

Effect of the Consumption Tax Rate Hike

In April 2014, the consumption tax rate was increased to 8%, the first rise in 17 years (the last hike from 3% to 5% was implemented in 1997).

The goal of the consumption tax rate hike is to ensure a source of revenue is available to meet increased social security costs resulting from a falling birth rate and an aging population. Although the purpose of the consumption tax rate hike is to ensure a source of revenue is available to meet social security costs, it had not been implemented until now because of concerns about its effect on the long-standing deflationary economy.

The government expects that the economy will slow down temporarily due to reaction to a last-minute surge in demand associated with the tax rate hike, though it will recover on a fiscal year basis underpinned by solid domestic demand. Private research agencies have also made projections largely similar to those of the government.

It can be said that the tax rate hike will have no direct effect on life insurance, because premiums paid and insurance claims received by life insurance policy holders are not subject to consumption tax.

However, the life insurance industry may be indirectly affected by the hike through declining demand for life insurance and a deteriorating asset investment environment if a decline in consumer spending and real estate investment resulting from the tax rate hike is not temporary and causes a recession.

At present, the hike is having no noticeable effect on the life insurance industry. The government is keeping to its policy of raising the consumption tax rate again to 10% in October 2015. Therefore, life insurance companies appear to be taking measures to hold on to customers and achieve good returns on investment.

2. Overview of Business Results for Fiscal 2013

The fiscal 2013 business results for 43 life insurance companies were as follows:

• **Total Amount of New Business**

The total insured amount of new business declined for both individual life and health and individual annuity due to the effect of higher premiums for insurance products on which the assumed interest rate was reduced because of the standard prospective yield reduction implemented in April 2013. It decreased by 6.3% from the previous fiscal year to 66.8 trillion yen for individual life and health, while it decreased by 6.5% to 8 trillion yen for individual annuity.

• **Total Amount of In-force Business**

The total insured amount of in-force business for individual life and health declined to 857.5 trillion yen, down 0.5% from the previous fiscal year, as it declined among major life insurance companies while remaining steady among subsidiaries of non-life insurance companies and foreign life insurance companies. For individual annuity, it increased for the eleventh consecutive year to 103.8 trillion yen, up 0.3% from the previous fiscal year, mainly due to steady growth among major life insurance companies.

• Annualized Premiums

The total of annualized premiums from new business decreased to 2.7 trillion yen, down 6.1% from the previous fiscal year, as a result of the decrease in individual life and health and individual annuity. As for in-force business, annualized premiums totaled 24.4 trillion yen, up 2.6% from the previous fiscal year, due to the increase in individual life and health, despite the decrease in individual annuity.

• Premium Revenues / Total Assets

Total premium revenues declined to 35.8 trillion yen, down 6.0% from the previous fiscal year, due to the effect of higher premiums for insurance products on which the assumed interest rate was reduced because of the standard prospective yield reduction implemented in April 2013. Total assets rose to 350.6 trillion yen, up 1.6% from the previous fiscal year, due to a rise in the value of investment assets.

3. Trends in the Life Insurance Industry

(1) Major Life Insurance Companies Introduce the Japanese Approach to Business in Asia

Major Japanese life insurance companies are starting to explore new products and sales channels in Asia.

Over the past few years, major Japanese life insurance companies have actively invested in and purchased life insurance companies in Asia. At the end of last year Dai-ichi Life Insurance Company invested in the Indonesian firm Panin Life, and Meiji Yasuda Life Insurance Company invested in Thai Life. In May 2014, Sumitomo Life Insurance Company purchased a 40% stake in a life insurance subsidiary of Bank Negara Indonesia. Nippon Life Insurance Company is expected to purchase a 20% stake in Indonesian firm Sequis Life within this year.

Amid such a vibrant Asian M&A scene, a key issue emerging in the overseas strategy of major life insurance companies is transmission of know-how accumulated in Japan to local life insurance companies to generate larger revenues from overseas operations.

For example, in July, Dai-ichi Life will offer variable insurance for which insurance value will depend on investment performance in Vietnam. After acquiring a local life insurance company in 2007, the insurer had mainly offered savings-type endowment insurance there. Going forward, however, it aims to gain customers in middle- and high-income groups, seeking new investments by expanding its product lineup. It also established an asset management subsidiary in February prior to selling the variable insurance.

Sumitomo Life, which last year invested in the largest Vietnamese insurer Bao Viet Holdings, will also offer a full range of insurance products over the counter in banks. The insurer will provide training programs for bank clerks and know-how on the development of exclusive products to make its bancassurance channel as large as its existing main channel, its sales staff.

Japanese life insurers are making new product offerings in Asia to gain local market share with original products and services, making the best use of their features.

Asian life insurance markets are at a developing stage akin to the high-growth period experienced in Japan. While mortality insurance has yet to fully penetrate the market, Japanese life insurance companies are expected to gradually apply the experience they have gained in Japan and their know-how to local markets, with the view that insurance needs similar to those in Japan will increase with income and the aging of the population.

(2) Consolidation in the Japanese Market

We are seeing the consolidation of life insurance companies progress through acquisitions and mergers.

Orix Corporation has decided to purchase Hartford Life Insurance K.K. which is the Japanese subsidiary of major U.S. life insurance company, Hartford Financial Services Group, Inc. After the acquisition, Orix will merge the insurance company with its affiliate Orix Life Insurance Corporation. The acquisition is expected to close by summer, and the merger will be implemented after fall 2015.

Orix, which has maintained its policy of expanding its insurance business, is strengthening its fiscal base and growing new business through the planned merger.

NKSJ Holdings has decided to sell Sompo Japan DIY Life Insurance Co., Ltd., a group subsidiary engaged in online and mail-order sales of cheaper insurance products, to Dai-ichi Life. The group intends to increase management resource efficiency by integrating its life insurance business with its affiliate NKSJ Himawari Life Insurance, Inc.

Meanwhile, Dai-ichi Life will offer cheaper insurance products through the new company formed after the acquisition of Sompo Japan DIY Life. The insurer said that the acquisition was aimed at meeting various customer needs. At the same time, it will convert Dai-ichi Frontier Life into a wholly owned subsidiary and construct a comprehensive group-wide lineup covering cheaper products to savings-related products.

During discussions on the global introduction of stringent capital controls to insurance companies, one issue that has arisen is foreign life insurance companies selling and contracting their operations in Japan. Consolidation may become an accelerating trend in Japanese markets going forward.

(3) Life Insurance Companies Increasing Investment in Risk Assets

Life insurance companies are increasing the amount invested in relatively high-risk assets such as foreign bonds, equities and real estate.

The main investment activities of the major life insurance companies are as follows:

Nippon Life: Following the increase of 450 billion yen in fiscal 2013, further increase of foreign bonds not hedged against foreign exchange risk in fiscal 2014;

Sumitomo Life: Investments and loans worth 100 billion yen in growth sectors including energy and medical and nursing care over the next three years;

Meiji Yasuda Life: Increasing allocation of funds to high-return assets such as Japanese and foreign stocks and foreign bonds from the current 30%;

Dai-ichi Life: Actively investing in real estate such as sites for rental condominiums and photovoltaic power plants.

These active investments among life insurers are underpinned by two factors.

The first factor is that the risk-free government bond yield remains stable and low at around 0.6%. In contrast, life insurance companies commit themselves to provide a promised yield of around 1% for new life insurance policy holders. It is natural for life insurers to allocate a portion of their assets to U.S. bonds, with the 10-year bond yield sitting just below 3%, and to real estate investments with an expected yield of 3% or more.

The second factor is that the larger amount of life insurers' equity capital helps make it easier for them to take risk. The solid business results recorded for the year ended March 2014 show that this factor is reflected in the reversal of the "negative spread" phenomenon across the whole industry according to the decrease of existing insurance policies with a high promised return over the past several years.

However, the recent increase in investment in risk assets among life insurers does not mean immediate changes in their conventional asset investment policy, with a focus on government bonds.

As previously indicated by specialists, life insurers hold ultra-long duration liabilities while owning assets with a duration shorter than their liabilities. There is no change to the situation whereby for life insurers the issue is to resolve the mismatch between assets and liabilities.

Furthermore, the greater investment in risk assets seen among life insurers in recent years is based on the assumption that government bond yields will remain low for the time being. For life insurers hoping to make progress in duration matching, it is truly a case where they feel compelled to do something they would rather avoid.

(4) Dai-ichi Life Acquires a U.S. Life Insurance Company for Approximately 580 Billion Yen

Dai-ichi Life is in the final stage of its purchase of Protective Life Corporation, a medium-sized U.S. life insurance company (premium income in 2013: approximately 3.0 billion U.S. dollar, ranking 36th in the United States).

The amount of the transaction will exceed 580 billion yen (at the exchange rate of 102 yen/U.S. dollar), the largest M&A transaction ever of a foreign company by a Japanese insurance company.

The transaction will enable the company to fully develop its overseas operations, which have previously focused on Asia. Its premium income from overseas operations will double, accounting for more than 10% of total premium income of the company.

Overseas Operations of Dai-ichi Life

Country	Year of Market Entry	Investment Ratio	Premium Income
Vietnam	2007	100%	9.2 billion yen
Thailand	2008	24%	41.8 billion yen
Australia	2008	100%	220.5 billion yen
India	2009	26%	12.6 billion yen
Indonesia	2013	40%	28.3 billion yen

To help finance the purchase, the company planned to issue up to 250 billion yen in new shares through a public stock offering. It listed its shares on the Tokyo Stock Exchange in 2010 and has since adopted a strategy of financing through stocks to accelerate its overseas operations through M&A.

One trend apparent across the whole Japanese financial sector is to offset low growth in the domestic market by expanding overseas business through M&A transactions. It is expected that this transaction by Dai-ichi Life will further strengthen this trend toward globalization, while the management skills of each company in global markets will be tested.

4. Developments in Products

(1) Japan Post Insurance Launches New Educational Insurance Product

On April 2, 2014, Japan Post Insurance Co., Ltd. started offering the new educational insurance product "Hajime no kampo."

Educational insurance has traditionally been one of the core products for Japan Post Insurance. The insurer had a more than a 70% share of total new business for this product in 2001. However, its market share declined to somewhere in excess of 30% in 2012, as the insurer's products recently became less competitive with rival savings-related products beginning to attract significant demand.

Japan Post Insurance applied to the Financial Services Agency for approval of its new product in September 2012 to strengthen the competitiveness of its educational insurance. However, the problem of claim-payment failures, which came to light in November the same year, brought the approval process to a standstill. New product approval was realized as a result of the FSA and the Ministry of Internal Affairs and Communications (which is responsible for managing the Japan Post Group) accepting measures such as inspections and strengthening customer dealings conducted by the insurer after this problem was detected. This is a long-awaited new product offering for Japan Post Insurance.

Additionally, the growth strategy of Japan Post Insurance is certainly having an effect on the share price of its parent company Japan Post, which is aiming to list on the stock exchange in spring 2015. Japan Post Insurance thus aims to strengthen sales activity and increase sales of other insurance products utilizing the launch of the new educational insurance product.

The Japan Post Insurance network of more than 20,000 postal offices nationwide poses a significant threat to major life insurance companies. It would be fair to say there is a degree of consternation about these Japan Post Insurance initiatives.

(2) Signs of Developing Competition in Insurance Premiums

Some major life insurance companies have reduced their premium rates.

The following insurance premium reductions have been made by major life insurance companies:

Nippon Life: Reduced premiums for core products combining mortality insurance with medical insurance, etc., in April 2014. Especially to gain new customers, ranges of reductions for customers in their 20s were around 7%;

Dai-ichi Life: Aims to establish a subsidiary dealing with cheaper medical insurance during fiscal 2014 and to launch sales in the second half of fiscal 2015;

Sumitomo Life: Began selling cheaper medical insurance via its subsidiary Medicare Life Insurance and had more than 200,000 policies in force at end of fiscal 2013.

These recent premium reductions have been implemented mainly because the stage has been set for positive sales measures to be taken as the financial position of major insurers improves. In addition, the emergence of new sales channels has also had an effect on premium reductions. Among these channels, "insurance shops," where customers can compare the details and prices of the products of several insurance companies according to their needs, have become more widespread over the past several years. Major life insurance companies for which the core sales channel is their sales staff cannot ignore such shops.

The Japanese market has been described as a mature market given the falling birth rate and the aging population. While online life insurers have also begun offering cheaper products, price competition has not extended to the whole market and has

been limited until now. In this environment, such activities among major life insurance companies accounting for the large share of the market may promote price competition in the industry and affect future market share.

5. Developments in Regulation

Review of the Method for Calculating the Standard Prospective Yield for Savings Products

In fiscal 2015, the FSA will revise the notice setting out the method for calculating the “standard prospective yield,” a yield used for calculating the standard policy reserve.

The standard prospective yield is to be used as a “reference” for the promised yield, a yield employed for calculating insurance premiums. The revision will apply to savings products including single-payment whole life insurance and individual annuity insurance.

The revision is also designed to prepare for increasing long-term yields in future given the BOJ’s inflation target of 2%.

Under the conventional method, the standard prospective yield is determined by reference to the lower of the average yields on 10-year government bonds for the last three years and the last ten years. This method is problematic in that the standard prospective yield has begun to rise long after the rise in interest rates.

The revision will thus change the frequency with which the standard prospective yield is calculated from once a year to four times a year, and will mean that the average yield for a shorter period be used by reference to the lower of the averages for the last three months and the last twelve months.

The revision will allow insurance companies some flexibility in reviewing their promised yields on savings products and setting premium rates according to changes in interest rates. Competition for private financial asset portfolios worth a total of approximately 1,600 trillion yen, including time deposits and mutual funds, will also become fiercer.

Supplemental Data: Results of Japanese Major Non-Life Insurance Groups (Company) for Fiscal 2013, Ended March 31, 2014 (Non-Consolidated Basis)

(Unit: Millions of yen, %)

		MS&AD Holdings		Tokio Marine Holdings		NKSJ Holdings		Fuji	Toa Re
		Mitsui Sumitomo	Aioi Nissay Dowa	Tokio Marine & Nichido	Nisshin	SOMPO JAPAN	NIPPONKOA		
Net Premiums Written	**Fiscal 2013**	**1,386,533**	**1,144,629**	**1,966,380**	**137,286**	**1,413,818**	**668,375**	**273,161**	**147,420**
	Fiscal 2012	1,313,831	1,103,234	1,869,681	138,766	1,327,361	638,863	272,537	131,203
Net Claims Paid	**Fiscal 2013**	**823,665**	**691,799**	**1,137,545**	**78,536**	**822,285**	**413,767**	**146,641**	**134,786**
	Fiscal 2012	887,436	726,151	1,185,621	85,227	843,762	436,647	158,618	141,644
Underwriting Profit (Loss)	**Fiscal 2013**	**(7,326)**	**(28,815)**	**(13,275)**	**1,612**	**(32,844)**	**(29,725)**	**5,705**	**(9,743)**
	Fiscal 2012	(9,710)	6,692	7,390	(1,145)	(25,704)	8,786	(12,321)	(2,935)
Ordinary Profit (Loss)	**Fiscal 2013**	**101,998**	**27,897**	**146,535**	**4,740**	**68,079**	**49,685**	**17,019**	**(372)**
	Fiscal 2012	65,366	25,859	156,125	4,596	65,058	64,580	(4,651)	8,369
Net Profit (Loss) for the Year	**Fiscal 2013**	**58,047**	**13,107**	**90,823**	**3,350**	**27,350**	**22,173**	**5,803**	**1,722**
	Fiscal 2012	42,657	18,862	58,650	2,639	29,137	33,332	(11,067)	4,489
Total Assets	**Fiscal 2013**	**6,098,017**	**3,257,180**	**8,374,225**	**418,313**	**4,838,707**	**2,260,231**	**857,372**	**468,875**
	Fiscal 2012	5,901,413	3,236,851	8,292,198	410,930	4,745,077	2,293,170	880,805	474,907
Ratio 1 Loss Ratio (%)	**Fiscal 2013**	**65.0**	**65.0**	**63.0**	**63.9**	**64.6**	**67.8**	**59.4**	**91.4**
	Fiscal 2012	73.4	70.4	68.7	68.0	70.6	74.8	63.3	108.0
Ratio 2 Expense Ratio (%)	**Fiscal 2013**	**32.0**	**34.5**	**30.2**	**32.5**	**31.4**	**34.0**	**35.8**	**23.2**
	Fiscal 2012	32.4	34.1	31.0	33.6	32.8	34.8	34.6	28.9
Ratio 3 Yield on Investments (Income) (%)	**Fiscal 2013**	**2.54**	**2.55**	**2.45**	**1.40**	**2.20**	**2.34**	**1.50**	**2.91**
	Fiscal 2012	2.31	2.36	2.19	1.30	2.28	2.15	1.33	2.11
Ratio 4 Yield on Investments (Realised Gains / Losses) (%)	**Fiscal 2013**	**3.95**	**3.08**	**3.61**	**1.57**	**4.04**	**5.54**	**2.28**	**3.46**
	Fiscal 2012	3.04	1.81	3.84	2.52	3.93	4.15	2.10	3.86
Ratio 5 Solvency Margin Ratio (%)	**Fiscal 2013**	**600.3**	**754.0**	**685.4**	**837.1**	**713.3**	**653.0**	**782.2**	**815.1**
	Fiscal 2012	581.3	649.1	665.3	636.6	645.6	534.0	562.6	767.2

Sources: Each company's financial statements of fiscal 2013

The Toa Reinsurance Company, Limited
6, Kanda-Surugadai 3-chome, Chiyoda-ku, Tokyo 101-8703, Japan
http://www.toare.co.jp

VEGETABLE OIL INK

Printed in Japan