Management Issues of Life Insurance Companies

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「生保会社の経営課題」英語版に寄せて

この度、公益財団法人アジア生命保険振興センターより英語版の機会を頂きまして誠に有難うございます。感謝、申し上げます。

本書は、日本の生保が経済環境の変化とともにどのような対応を繰り広げてきたかを見ています。日本を取り巻く経済環境は著しく変化しています。なかでも人口減少と少子高齢化は日本経済に活気を失わせています。

1950年代後半から60年代までの高度経済成長期では、毎年のように10%前後の高い所得の伸びが続いていました。多くの若い世帯が成長を牽引し、大量の生産と消費を生み出していました。すべてが拡大の方向へダイナミックに動いていったのです。

生保もその動きに合わせるように、代表的経営指標の保有契約高を確実に増やしていきました。死亡保障を中心とした定期付き終身保険や定期付き養老保険などがサラリーマン世帯に浸透し、世帯加入率は90%を超えていました。

日本の成長も生保の動きも、根底には若い世帯が大きな原動力となっていました。豊かな生活への強い願望が成長力を高め、そして生活上のリスクを抑える手段として保障型の生保商品も伸びていきました。

当時の広告用ポスターは、どの生保も若い夫婦が二人あるいは三人の子供と仲良く手をつなぐ構図が用いられていました。若い世帯が多くを占めていた時代の象徴的な現象と言えます。

その後、1970年代から安定成長期に入り、成長力にかつての勢いが見られなくなりました。しかし、80年代後半にはバブル経済が突如として発生し、人々の暮らしに活気が見られましたが、それも束の間の出来事に過ぎませんでした。

1990年以降は、バブル経済の崩壊から長い低迷状態が続き、失われた30年とも呼ばれたりしています。生保にとって日本経済が成長力を失ったのも大きなマイナス要因でありますが、日銀の長期にわたる超低金利政策も生保を苦しめています。大量の資金を持つ生保にとって、あまりにも運用環境が厳し過ぎるからです。

このように生保は、日本経済の浮沈とほぼ同じような動きを展開しています。もちろん、日本経済がかつてのような高度成長が再現できれば、生保も同じ

歩調を歩むと考えられます。

しかし、わが国は人口減少と少子高齢化という日本の長い歴史のなかでも初めての重い課題を背負わされています。簡単に克服できるものではありません。日本経済の低迷状態は予想以上に長引くように思われます。同時にわが国の生保は日本を基盤とする限り、成長が見込めないように感じられます。

そうした隘路に陥った日本経済のなかで、生保がどのような対応策を講じているのでしょうか。本書ではその姿を2010年代を対象にしながら描いています。具体的には一部の大手相互会社による株式会社への組織形態の変更や、資産と負債を総合的に管理するALMなどが挙げられます。

このほかに海外企業の買収戦略も積極的に取られています。新たな生保市場を求めて欧州からアジアに至るグローバルな展開を見せています。とりわけ、アジアの市場は魅力的です。かつての日本のように若い世帯が多数を占めているからです。蓄積されたノウハウを駆使しながら、飛躍的な活躍が期待されます。

海外進出は単にわが国の生保だけでなく、現地の方々にとっても好ましい結果を生み出します。長い時間を掛けて培った商品や販売チャネルの知識が、直接的あるいは間接的にアジアの生保市場を拡大の方向へ進ませていくでしょう。

そのためにも日本の生保市場の動きを知ることは必要です。成長著しいアジアの国々にとって生保の果たす役割は、ますます高まっていきます。その意味からも日本の経験が役立つのではないでしょうか。

その一方で、若さに溢れたアジアの国々も、成長がいつまでも続くとは限りません。日本のように低迷状態に陥る時期がいずれ訪れるかもしれません。経済的に成熟した国は、人口減少と少子高齢化という現象を抱える傾向にあるからです。そのことも日本が参考になるのではないしょうか。

生保だけでなく経済の発展段階を知るためにも、本書がその助けになれば幸いと思っています。

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On preparing an English-language version of *Management Issues of Life Insurance Companies*

Thank you very much for this opportunity to prepare an English-language version of my book as granted by the Oriental Life Insurance Cultural Development Center. I am truly grateful.

For this book, I sought to determine how Japanese life insurance companies have attempted to accommodate changes in the economic environment. The economic environment in which Japan exists has been undergoing dramatic changes. The shrinking population, dwindling birthrate, and aging of the society in particular have combined to sap the Japanese economy of its vigor.

During the years of spectacular economic growth between the second half of the 1950s and the 1960s, income rose at a phenomenal rate of around ten percent a year. Many young households provided the engine for this growth and helped generate large volumes of production and consumption. Everything back then was moving dynamically toward expansion.

In line with these societal trends, life insurance companies, too, managed to steadily increase the total amount of insurance in force, a management indicator commonly associated with this industry. Whole life insurance with term rider plans primarily designed to provide death protection and fixed-term endowment insurance plans spread among households headed by businessmen, such that over ninety percent of households had signed up for such plans.

The growth of Japan and changes affecting life insurance companies were both spurred heavily by young households. The strong desire for a better life on the part of individuals enhanced growth. As a means of mitigating risks to living standards, protection-type life insurance products also came to be sold in greater numbers.

Life insurance companies invariably chose to depict a young couple, either with two or three children, happily holding hands in advertising posters of the day. This pattern reflected an era in which young households were largely at the center of attention in most spheres of life.

The 1970s subsequently heralded the arrival of an era of stable growth, during which time the vigor of the past could no longer be seen in the growth of the economy. In the latter half of the 1980s, however, a bubble economy appeared suddenly to inject vigor into the lives of people; but this proved to be

nothing more than a fleeting phenomenon.

Since the collapse of the bubble economy in the 1990s, a long period of stagnancy has persisted. These years are known as the Lost Decades or Lost Thirty Years. While the fact that the Japanese economy lost its potential for growth has caused life insurance companies to be negatively affected, the ultra-low interest rate policy embraced by the Bank of Japan has also encumbered life insurance companies. This is because this policy renders the investment environment unduly harsh for life insurance companies with large amounts of funds.

In this way, life insurance companies have experienced ups and downs largely in concert with the Japanese economy. Of course, it is conceivable that life insurance companies would be able to keep pace with the Japanese economy if the high levels of growth we have seen in the past were to be somehow restored.

However, Japan is facing dire challenges that have never before arisen in her long history: a shrinking population, dwindling birthrate, and aging society. These are not challenges that will be easily overcome. This state of economic stagnation in Japan appears set to persist for far longer than one might have expected. At the same time, Japanese life insurance companies are unlikely to see any prospects for growth emerge as long as their main market is based in Japan.

What sorts of solutions will life insurance companies formulate given the state of the Japanese economy, which finds itself struggling with a bottleneck? Their efforts are depicted in this book with a focus on the 2010s. Specifically, I have highlighted changes in organizational structure as reflected in the transformation of certain major mutual companies into stock companies; asset liability management (ALM), an approach to comprehensively managing assets and liabilities; and other pertinent matters.

In addition, I have proactively examined the strategy by which overseas companies are being acquired. Companies have been expanding globally from Europe to Asia in search of new life insurance markets. Above all, the Asian market is ideal since the population appears to consist largely of young households as did Japan many years ago. Dramatic activity can be expected while accumulated know-how is wielded.

Foreign expansion will give rise to positive benefits not just for Japanese life insurance companies but also for local people in these overseas markets. Knowledge pertaining to products and sales channels cultivated over a long

period of time will directly and indirectly steer the Asian life insurance market onto a path of growth.

For this purpose as well, it will be necessary to understand how the Japanese life insurance market is changing. The role to be played by life insurance companies will become increasingly important for Asian countries that are rapidly growing. In this sense as well, it would be reasonable to assume that the Japanese experience would be helpful.

At the same time, Asian countries full of young people will not experience ongoing growth forever. It is possible that a time will come when they too will undergo Japanese-style stagnation. This is because economically mature countries tend to come face to face with the challenges of a shrinking population, dwindling birthrate, and aging society. No doubt, Japan will also be a model for these countries to study in this regard.

It would please me greatly to know that this book might help readers learn more about not just life insurance companies but also the stages of economic growth in general.

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Introduction

The economic environment in which the insurance industry operates is changing at a dizzying pace. The biggest contributing factors behind this change are the dwindling birthrate and an aging population. As the Japanese population continues to shrink, the number of children is decreasing and society is steadily aging. We also cannot ignore structural changes in society that are taking place in terms of increasing numbers of single-person and double-income households.

When we talk about life insurance, we invariably associate it with insurance that is payable on death. In typical cases, life insurance is taken out for the sake of the family to which the husband, who is the primary breadwinner for his household, belongs. Normally, a significant amount of insurance money is to be paid out to the wife, as the spouse, in the event that the husband dies. In the parlance of those who work in the insurance industry, the husband is the insured person as well as the policyholder who pays the insurance premiums for his policy. The beneficiary of the insurance money will be the wife as the spouse of the husband.

However, the preconditions underpinning the selling of death insurance (life insurance that is payable on death) have changed. This is due not just to the fact that there are fewer young people getting married, but also to an increase in the number of couples who continue to earn two incomes even after getting married. Thus, the role played by death insurance is being attenuated.

Instead, demand is rising for life insurance that addresses personal concerns. Roughly speaking, insurance can be divided into two categories. The first is known as third-sector insurance, examples of which consist of health insurance, cancer insurance, and nursing-care insurance.

Under the Insurance Business Act, life insurance that covers people and that pays beneficiaries a certain amount of insurance money is known as first-sector insurance. In contrast, property or non-life insurance (insurance against loss) that pays a non-fixed amount of insurance money while covering property (things) is known as second-sector insurance.

You might think that health insurance and the like come under the scope of first-sector insurance since they cover people. However, the insurance money that is paid is not known in advance, which means that it is a non-fixed amount. In this way, these forms of insurance also satisfy some of the elements of second-sector insurance.

Therefore, they are separately categorized as third-sector insurance. Whether you are single or married, there is always the chance that you might run into health or nursing-care-related issues. Third-sector insurance plans are insurance plans that will continue to grow in popularity.

At the same time, savings-type life insurance products are also enjoying a greater profile these days as insurance that addresses personal needs. While whole-life insurance and endowment insurance are also typical examples of life insurance that features a savings component, individual annuity insurance is believed to be the most easy-to-grasp example of a savings-type life insurance product.

Since public pensions are, fundamentally speaking, current disbursement schemes whereby currently working people pay insurance money to the elderly, they depend on population demographics in terms of age. They are stable if there are many people who belong to the younger generation and become unstable if, on the other hand, there are many elderly citizens. The combination of a dwindling birthrate and an aging population is shaking the very foundation on which public pensions rest.

Thus, individual annuity insurance plans and other savings-type life insurance products play an important role in supplementing public pension schemes. This is unlikely to change so long as we can see no real signs of improvement with respect to the dwindling birthrate and aging population. This clearly accounts for the fact that savings-type life insurance products are outpacing protection-type life insurance products when it comes to growth among life insurance options.

Whereas public pensions are current disbursement schemes that are dependent on population demographics in terms of age, savings-type life insurance products are funding methods, which means that they function in a supplementary sense. Seen in this light, the raison d'être of savings-type insurance products can be understood. On the other hand, efforts must be ceaselessly undertaken to ensure that life insurance products can yield high levels of asset management results for these funding methods.

As it is widely known, assumed interest rates are set for life insurance products. This is the minimal investment yield promised by each insurance plan. Effective asset management must be carried out for a life insurance plan to ensure that actual investment yields exceed the assumed interest rate

Of course, asset management constraints may be eased somewhat if the

assumed interest rate is set low. However, the price of life insurance products would rise in such a case and cause people to avoid purchasing them. Thus, the assumed interest rate must be set as high as possible. For this reason, life insurance is constantly beset by asset management issues.

The asset management environment in Japan, however, remains quite severe. Since the 1990s, which is when Japan's bubble economy collapsed, interest rate levels have been sinking and stock prices have continued to flounder. Moreover, the yen has been on a rising path over the years. Under these circumstances, one finds it difficult to achieve the desired management results. As the demand for savings-type life insurance products increases, high levels of management yields are sought. Unfortunately, the life insurance sector finds itself mired in the reality of a harsh asset management environment.

In this way, the life insurance industry is facing significant changes. There is a shift underway from a structure based primarily on protection-type life insurance products to one that is based on savings-type life insurance products, and from an era in which the asset management environment is characterized by high interest rates to one of low interest rates. Furthermore, the Japanese economy cannot be expected to grow at a dramatic clip given that the population is shrinking. It would be difficult to see just the life-insurance market expanding as economic activities in Japan stay stagnant.

Various management issues affecting life insurance companies against the backdrop of a severe economic environment will be explained in an easy-to-understand manner in this book, with reference made to financial reports issued yearly. The period we will be focusing on extends from the fiscal year that ended in March 2010 to the fiscal year that ended in March 2017. While this period is short, we believe that the transformation that life insurance companies have been undergoing can be clearly discerned through this process.

For example, these life insurance companies have, in terms of their form, become stock companies. While key life insurance companies used to primarily consist of mutual companies, a few have begun to change into stock companies. The approach to asset management is also changing. Interest is shifting to a greater degree to government-issued bonds due to a strategic focus on revising the solvency margin ratio and prolonging duration.

In looking at sales channels for life insurance products, we see that there is no longer a reliance on just conventional selling by exclusive career agents. Products are also being sold more by bank tellers, but it is the emergence of

independent agencies that is garnering attention. On a related note, the issue of sales commissions has come to be identified as a matter to be addressed and may be of the greatest interest to clients.

The economic environment in which life insurance companies operate appears to be undergoing even more major changes. The shift by the Bank of Japan to unprecedented easing measures marked by negative interest rates is putting pressure on asset management by life insurance companies. Since the Japanese economy remains unable to extricate itself from a state of deflation, life insurance companies are focusing on not just the domestic market but also overseas markets. By proactively acquiring overseas insurance companies, they are pursuing globalization.

These themes are examined for each fiscal year. The draft copy of this book was written to report, in an easy-to-understand manner, situations that had become problematic in the life insurance sector each time financial results were announced by life insurance companies. A summarization of contents has accordingly been made on a chapter-by-chapter basis. Thus, you are invited to read this book by imagining that you are being taken on a journey back in time.

The life insurance market prior to the time period explored in this book is examined in my book The Changing Life-Insurance Industry In Connection With Financial Results (Zeimukeiri Kyokai, 2009). In the book, the life insurance market as it existed between the fiscal year that ended in March 2002 and the fiscal year that ended in March 2009 is described. I recount how the industry escaped the clutches of a crisis in life insurance and was able to embrace sound management practices.

By reading that book in conjunction with this one, I believe that you will be able to correctly ascertain what has been happening in the life insurance market over an even longer period of time. I hereby advise you of the existence of this other book for reference purposes.

September 2017
Yasuo Kofuji

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Part 1: Announcing financial results for the fiscal year that ended in March 2010

(1) Financial results as affected by stock market conditions

The financial results for life insurance companies for the fiscal year that ended in March 2010 were announced. Perhaps due in part to the lessening of the impact that the worldwide financial crisis was having on the industry, many life insurance companies enjoyed better management results over the previous year. Nevertheless, this did not mean that all life insurance companies reported similarly favorable financial results. For some life insurance companies, a delay in recovery could be seen.

Figure 1-1 sets forth important data for assessing the management contents of thirteen major life insurance companies. If we look at the growth indicator consisting of "insurance premiums and other earnings", we see that many life insurance companies reported higher revenues, but there were still five life insurance companies that reported lower revenues.

A closer examination of these polarized movements reveals that sales of annuity insurance by bank tellers was a determining factor. This is because life insurance companies that actively sold products through tellers reported an overall growth in revenue, but those that faltered in selling products through tellers reported lower overall revenue.

If we focus next on profitability indicators, we see that three life insurance companies managed to go from negative to positive figures in terms of basic profit. Basic profit comprises the basis of profit corresponding to the core business of the company and equals the aggregate of the three surplus factors. All life insurance companies reported significant improvements in unrealized gains on securities. Whereas five companies were in the red when it came to after-tax profit a year before, all thirteen companies reported that they were operating in the black by this measure. Insofar as we can assess from these profitability indicators, these life insurance companies were able to escape from a critical situation.

Next, in looking at soundness indicators, we see that all life insurance companies reported higher real net assets and improved solvency margin ratios, an indicator that is unique to insurance companies. The 200% standard as required by the Financial Services Agency was satisfied by wide margins.

Figure 1-1. Financial results for major life insurance companies for the fiscal year that ended in March 2010

		(1) Growth indicator		(2) Profitability indicators			(3) Soundness indicators	
		Insurance premiums and other earnings	Bank teller sales	Basic profit	Unrealized gains or losses on securities	After-tax profit	Real net assets	Solvency margin ratio
Domestic	Nippon	48,174	3,815	5,050	24,015	2,520	68,062	1,006.0
		(▲4.4)	(▲12.9)	(▲6.5)	(10,486)	(38.8)	(28.1)	(101.6)
	Dai-ichi	37,005	7,977	3,779	8,514	556	33,216	953.5
		(12.5)	(102.8)	(18.8)	(1,565)	(2.5 times)	(22.9)	(185.4)
	Meiji Yasuda	32,824	8,007	2,914	12,049	1,427	35,006	1,187.5
		(22.2)	(260.5)	(▲11.5)	(5,400)	(14.7)	(20.6)	(88.8)
	Sumitomo	30,637	9,429	3,868	1,906	1,086	18,777	955.1
		(20.9)	(176.6)	(160.4)	(▲1,068)	(2.1)	(22.5)	(117.9)
	T&D	18,983	2,914	1,310	2,289	242	11,347	1,120.6
		(14.7)	(37.1)	(return to profitability)	(▲254)	---	(31.4)	(299.9)
	Fukoku	9,201	(2,824)	719	958	261	6,157	1,127.6
		(17.7)	(133.4)	(▲4.7)	(▲360)	(▲54.0)	(19.3)	(119.2)
	Sony	7,001	7	639	199	461	5,634	2,637.3
		(5.8)	(813.4)	(68.4)	(509)	(36.6)	(5.8)	(576.8)
	Mitsui	6,404	3	478	756	46	3,892	702.1
		(▲13.9)	(▲99.5)	(return to profitability)	(▲327)	---	(29.5)	(100.1)
	Asahi	5,099	85	249	341	334	3,235	608.0
		(▲3.3)	---	(▲23.8)	(▲796)	---	(43.9)	(24.9)
Foreign-affiliated	Alico	13,174	903	1,204	1,877	484	7,581	1,248.4
		(▲6.9)	(▲65.0)	(24.9)	(▲2,821)	---	(305.2)	(448.3)
	Aflac	12,315	79	1,580	▲1,259	410	5,008	939.3
		(5.9)	(117.4)	(7.0)	(▲4,019)	(▲30.3)	(172.9)	(165.7)
	Prudential	9,875	774	867	1,099	209	6,296	1,262.7
		(6.6)	(151)	(▲3.6)	(▲629)	(19.5 times)	(63)	(359.8)
	Axa (return to profitability)	7,009	1,030	542	1,570	523	5,248	1,081.4
		(▲5.7)	(10.1)	(return to profitability)	(645)	---	(36.8)	(262.8)

Note: Unit: hundred million yen; ▲ denotes a negative value; [-] indicates that a comparison cannot be drawn. The lower figure in each square is the percentage change over the preceding fiscal year.

Provided, however, that the lower figure in squares coming under the unrealized gains or losses on securities column is the figure for the fiscal year that ended in March 2009 and the lower figure in squares coming under the solvency margin ratio column is the amount by which the figure increased or decreased over the previous fiscal year.

In attempting to paint a picture of life insurance companies based on these three types of management benchmarks, we realize that profit from valuation

gains on held stocks helped to improve the management picture for these companies. The prices of held stocks, which had plummeted in the financial crisis that hit in the fall of 2008, managed to recover, which in turn caused unrealized gains on securities to suddenly rise and led to improvements in profitability indicators and soundness indicators.

Since the financial results of these companies were excessively bad in the fiscal year before the impact of the financial crisis was directly felt, the figures presented on this page might appear to show improved financial results. However, these figures simply show that a management structure that relies on profit from valuation gains on held stocks will give rise to such results.

If we, in this connection, examine the core components of the actual management conditions at these companies, we see that life insurance companies that are making less basic profit through their primary operations are notable. There is growing polarization between life insurance companies that are enjoying growth in terms of insurance premiums and other earnings, and life insurance companies that continue to flounder in this sense. The pattern by which this trend is being supported by the selling of annuity insurance plans by tellers has been completed.

The selling of annuity insurance strongly tends to be determined as a function of asset-management results. Stock price trends are an important factor. If we get right down to the financial results for this fiscal year, we can determine that a rise in stock prices on the rebound after the financial crisis helped to promote the selling of annuity insurance, which was then reflected in insurance premiums received and other earnings.

(2) Measures for producing a breakthrough in the floundering insurance industry

Ultimately, the financial results for this fiscal year represented nothing more than the result of stock market conditions having a direct impact on these companies. Leaving this aside, management at life insurance companies remained unstable. As expected, life insurance companies are fundamentally tied to protection-based operations. At the core of these operations are death-protection-type products. If more of these products are sold, certain progress will be indicated for insurance premiums and other earnings. Increases in the mortality gain and expense profits, which are elements comprising the three surplus factors for an insurance company, will lead to an increase in the basic

profit and, by extension, an increase in the net profit.

A company that relies only on annuity insurance suffers not only from a lack of stability but also an inability to increase profits. Thus, a life insurance company's pattern of handling death-protection-type products is an important factor in predicting its management results.

However, flagship death-protection-type products offered by modern life insurance companies continue to flounder. Emblematic of this is the total amount of individual insurance policies in force. Ever since this amount for the industry as a whole hit a peak of 1,500 trillion yen in fiscal year 1996, there has been no respite in its continuing decline.

The declining birthrate that is overwhelming the Japanese economy is putting downward pressure on death-protection-type products and fortifying the serious tapering of profits for life insurance companies. If this situation were to persist, it would place the very future of life insurance companies at risk. Of course, a reversal of the declining birthrate would represent an ultimate tailwind for life insurance companies, but the chances of this happening are virtually nil. The declining birthrate will almost certainly continue.

As a way to overcome their stymied operations, life insurance companies have been trying to cultivate overseas markets with a primary focus on Asia. Major Japanese life insurance companies have already made a foray into emerging countries in Asia that are growing at phenomenal rates: China, India, and Vietnam.

To succeed in such overseas markets, mergers and acquisitions (M&As) are essential. A fair amount of capital is required for this purpose. To attain this goal, companies must break down conventional frameworks to their very core.

The transformation of life insurance companies into stock companies has been drawing attention as an effective means of breaking down conventional frameworks. The shift from mutual companies to stock corporations is expected to trigger the demolition of an obstructed life insurance industry. At the same time, profits are being pursued to such an extent that these companies are afraid that they are engaging in risky conduct.

In this connection, let us explore below the transformation of life insurance companies into stock companies, a topic in which many people in the industry are obviously interested.

Part 2: The transformation of life insurance companies into stock companies has begun

(1) The severe management environment in which life insurance companies operate

We have discerned a number of features by looking at the financial results reported by major life insurance companies. A theme of the greatest interest these days for the life insurance industry is the transformation of the Dai-ichi Life Insurance Company into a stock company. The transformation of this company, the second largest in the industry, into a stock company and the listing of its stocks on the Tokyo Stock Exchange are believed to have acted as quite a shot in the arm for other life insurance companies.

Among major life insurance companies, we see that the Daido Life Insurance Company and Taiyo Life Insurance Company became stock companies in 2002 and 2003, respectively. The Taiyo Life Insurance Company and Daido Life Insurance Company established the T&D holding company and managed to list its stocks on the market in 2004. The Mitsui Mutual Life Insurance Company also became a stock company in 2004. Compared with these examples, however, the case of the Dai-ichi Life Insurance Company was clearly larger by an order of magnitude.

As reflected in its name, the Dai-ichi Life Insurance Company is the first life insurance company in Japan to be constituted as a mutual company. However, a resolution to transform the company into a stock company was adopted at a general meeting of policyholders held in June of the previous year. It was then decided that business would be developed under a new organizational structure beginning in April 2010. With total shareholders numbering 1,371,000, a new corporation whose shareholder count easily exceeded even that of NTT's 1,030,000 shareholders was born.

The drastic changes affecting the economic environment in which Japanese life insurance companies operate were what prompted this change to a stock company. While you can point to such changes in the social environment as the increase in the number of single-person households and increase in the number of dual-income families, there is no doubt that the shrinking population, a situation caused in large part by a falling birthrate, is the biggest factor.

More precisely speaking, the biggest factor is the shrinking of the working-age population, which consists of people between the ages of 15 and 64 years.

Overcoming this situation represents an extremely difficult challenge, such that no reversal in the shrinking of the population is likely to occur in the future.

These changes represent a headwind for life insurance companies that are in business to provide people with economic security. There is a need to steer management resources towards growth areas while changing conventional business operations. There is a limit to a company's ability to do this while remaining a mutual company. In order to expeditiously develop a new business model, an entity needs to become a stock company.

(2) Advantages of becoming a stock company

What are the advantages of becoming a stock company in order to satisfy these requirements? This form of organization is superior in terms of financing. A mutual company has no choice but to gradually amass a portion of its surplus funds. Alternatively, it can engage in financing by establishing a fund. However, such a fund can be characterized as a liability. Yet, if stocks are issued, a company can obtain a large amount of financing at once. Since this would not need to be repaid, a company that issues stocks would enjoy a considerable amount of economic freedom.

This allows an approach to management that is proactively focused on new business opportunities to be undertaken. Life insurance companies need to promote business in the newly emerging countries of Asia where population growth is significant rather than limit their operations to the domestic market. If stocks can be issued, these companies can accelerate their activities in this regard.

By establishing a holding company, the organization as a whole can be flexibly steered while placing subsidiaries within its purview. This framework is important since an M&A strategy can be deployed without having to establish a new company in a growth area.

If a company decided that it would establish a required company on its own, a significant amount of time would be incurred to put together a satisfying package of all the necessary elements. In contrast, harnessing an M&A approach will let you immediately obtain what you need, thereby enabling you to achieve a result that would be equivalent to the act of buying time.

In this way, companies are looking to become stock companies as a quick way to deal with the severe economic environment in which Japan is finding itself. Life insurance companies that are embarking on this path are tossing their hats into the ring one after another these days.

Part 3: Differences between stock companies and mutual companies

(1) Situation concerning American life insurance companies

In fact, the transformation of life insurance companies into stock companies can be proactively seen not just in Japan but also overseas. If you take a look at the United States, you will see that major life insurance companies Prudential and Met Life have already transformed themselves into stock companies and have had their stocks listed. While leveraging these changes, these companies have quickly expanded their operations through mergers and acquisitions.

There is no doubt that the transformation of these companies into stock companies can be seen as an effective means of prevailing over the competition for life insurance companies. On the other hand, however, there are also negative aspects to this approach that can give rise to catastrophic results if it is taken too far.

A global financial crisis was triggered by the Lehman Shock that occurred in September 2008. In the midst of this event, the way in which the transformation of life insurance companies into stock companies was seen also underwent significant changes. People began to look at not just the positive aspects but also the negative aspects of this transformation. This is because AIG, a major incorporated insurance company in the United States, incurred huge losses on its investments in financial instruments tied to subprime loans. The excessive pursuit of profit, the fundamental goal of stock companies, gave rise to catastrophic results.

Perhaps as a backlash to what happened, the momentum for reconsidering life insurance companies organized as mutual companies, some of which were largely unaffected by the financial crisis, gained steam. The philosophy of mutual companies lies in the spirit of providing mutual aid. The pursuit of profit is not seen as a foremost priority for such entities.

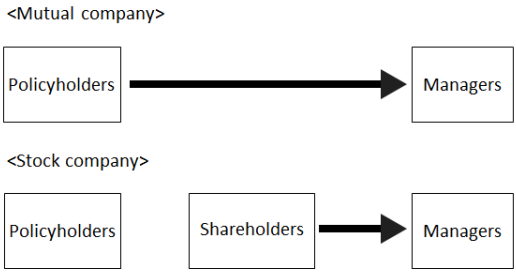
(2) Demonstrating through statistical analysis

In this way, the transformation of life insurance companies into stock companies is understood to have not just positive aspects but also negative ones. This is because the transformation of a company into a stock company encourages it to pursue the acquisition of returns (profits) to such an extent that risks are run as a repercussion of this pursuit.

Figure 1-2 sets forth these points by comparing stock companies with mutual

companies. With a mutual company, policyholders are clients and also exist to contribute to management through general meetings of policyholders.

Figure 1-2. Organizational forms of life insurance companies



For this reason, mutual companies possess qualities that generally prevent reckless acts of management of the sort that would force policyholders to run risks from being carried out. They are highly inclined to prioritize safety over profits.

In contrast, the desires of shareholders who seek to maximize profits are directly reflected in the approach to management at stock companies, such that there is a risk that risky conduct will be undertaken despite the possibility of failure.

Accordingly, it can be presumed that a life insurance company constituting a stock company would be more likely to engage in high-risk, high-return management activities than a mutual life insurance company.

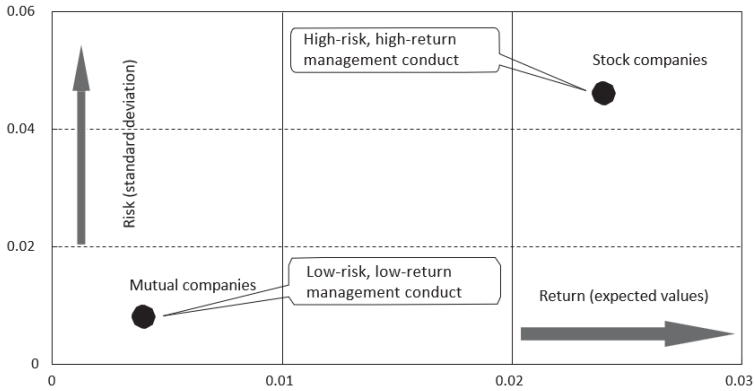
A paper demonstrating links between the organizational structure of life insurance companies and the assumption of risks from an academic standpoint was presented by Yanase, Asai, and Lai (2008).

For this paper, the authors sought to determine the expected ROE values (return) and standard deviation values (risk) for each type of organizational structure by looking at 20 major life insurance companies in Japan between 1976 and 1995. These 20 life insurance companies consisted of 16 mutual companies and 4 stock companies.

Figure 1-3 outlines the results of measurements taken in this study by organizational structure with the x-axis corresponding to return and the y-axis corresponding to risk. In looking at this figure, we see that incorporated life insurance companies constituting stock companies are clustered in the upper-right corner of the graph, while mutual life insurance companies are situated in

the opposite bottom-left corner of the graph.

Figure 1-3. Link between the organizational structure of life insurance companies and the assumption of risk



In other words, we see that life insurance companies constituting stock companies are more committed to a high-risk, high-return management approach than are mutual life insurance companies. The notion that there is a link between the organizational structure of life insurance companies and the assumption of risk was clearly demonstrated through simple descriptive statistics.

Of course, there are also some concerns over how these measurements were taken. Some people believed that the results had been determined by nothing more than the size of the entities in question. This is because life insurance companies constituting stock companies were overwhelmingly smaller than their mutual counterparts at the time, which meant that fluctuations in ROE values as an indicator of profitability tended to increase as a matter of course.

While this interpretation is certainly possible, we are going to assume that these measurement results demonstrate a link between the organizational structure of a company and the assumption of risk.

Part 4. Examples of failures on the part of life insurance companies constituting stock companies

(1) Collapse of Yamato Life Insurance

While we have to this point examined matters using a statistical approach, it

might be more persuasive to simply take up specific cases in which life insurance companies constituting stock companies engaged in risky conduct.

One specific example is the case of Yamato Life Insurance, which went bankrupt in October 2008. It was the eighth life insurance company to go under in the post-war era, with the first having been Nissan Life Insurance, which went bankrupt in April 1997.

Yamato Life Insurance was originally a mutual life insurance company. However, it merged with Azami Life Insurance, a stock company established to acquire Taisho Life Insurance, which went bankrupt in August 2000. In April 2002, the Yamato Life Insurance Company was established. At the time, it was a merged company that drew much attention as a life insurance company that had been transformed into a stock company.

Yamato Life Insurance was known for its willingness to make riskier investments than other life insurance companies. Securities accounted for a high percentage of its managed asset pool. The company held not just stocks but also stock investment trusts, real estate investment trusts, and other such instruments.

More than 30% of its pool of managed assets consisted of investments in derivatives, structured bonds, and other complex financial products. Yamato Life Insurance was indeed maintaining a high-risk, high-return investment stance.

The average assumed interest rate for insurance products was high at 3.35%. The company proactively engaged in management to reach this level. Of course, this was because the company's asset management stance was bolstered when the running of the company was steered in such a way that fear over risks was lost.

The existence of certain managers supports this argument. The president of the company, who reigned supreme among top executives, was not someone with a background forged in the life insurance sector but rather someone who had formerly belonged to a major securities firm, unconventionally.

The corporate climate and the attitude towards the running of operations differ completely between the insurance industry and the securities industry. Since someone with a background in the securities industry nevertheless took up the top post in the company in June 2005, a policy of engaging in risky operations came to be adopted at the time.

The result of these moves became clearly manifested in the global financial crisis that was triggered by the Lehman Shock. Yamato Life Insurance was

directly affected by this crisis and collapsed due to rapidly spreading losses on securities held by the company.

(2) Burden assumption according to organizational structure

With the bankruptcy of Yamato Life Insurance, the biggest losers were, as expected, policyholders. This is because the policy reserve was cut back to the maximum allowable 10%, the new assumed interest rate was lowered to 1 percentage point, and insurance payouts and benefits were substantially reduced. Since this was the second bankruptcy for policyholders with the former Taisho Life Insurance Company, this meant that they were forced to undergo a write-down twice.

At the same time, shareholders only had to suffer from a write-off of their shares since they had only assumed a limited liability. Thus, the inducement to seek extensive profits in an all-or-nothing gamble remains with shareholders. Likewise, executives who carry out actions in line with the wishes of such shareholders need only resign upon failure.

For a life insurance company constituting a stock company structured in a way that such risky conduct is induced, only policyholders are ultimately forced to take big hits. In contrast, each policyholder of a mutual life insurance company can directly and indirectly influence to some degree the way the company is run. This means that there is some room for putting the brakes on risky conduct.

Accordingly, the differences in terms of organizational structure as between being a stock company and being a mutual company are an important issue for life insurance companies in that these differences are tied to the extent to which risks are assumed.

(3) Ideas to avoid becoming trapped

While there are positive aspects behind the transformation of life insurance companies into stock companies in that such a transformation promotes the proactive running of these companies, there is also the negative aspect of forcing policyholders to suffer substantially in a worst-case scenario brought about by the excessive pursuit of profits.

Nevertheless, it would be wrong to assume that mutual companies are an organizational structure that provides a greater degree of assured safety. Not only have mutual life insurance companies become bankrupt as well, but it

would be difficult for these companies to retain their current position so long as they fail to transition to new ways of doing business in this era of a shrinking population.

As expected, stock companies may potentially be dealing with onerous problems, but they are nevertheless appealing in ways that mutual companies are not. To ensure that the transformation of a life insurance company into a stock company does not fall into a trap, a framework to ensure that governance functions work just as properly as they do with general companies and to keep a constant check on the running of the company is absolutely imperative. I believe that the presence of such a framework will prevent a company from rushing headlong into efforts to run it in an unreasonable manner.

Chapter 2: <2011>
Seeking measures to revitalize the life insurance industry

Part 1: Announcing financial results for the fiscal year that ended in March 2011

(1) Impact of the earthquake disaster

The financial results for major life insurance companies for the fiscal year that ended in March 2011 were announced. The Great East Japan Earthquake, which struck on March 11 of the same year, caused unexpected damage to the management of life insurance companies.

This is because the costs of settling insurance claims resulting from the earthquake reached approximately 190 billion yen, and because life insurance companies with large holdings of shares in TEPCO (Tokyo Electric Power Co., Inc.) ended up incurring huge losses.

While negative spreads, which had been a source of concern for a long time, appeared to have finally been halved, this state of improvement was negated when the earthquake struck.

Figure 2-1 summarizes such typical management benchmarks for major life insurance companies. In looking first at insurance premiums and other earnings, we see that this benchmark grew for some life insurance companies and remained stagnant for others.

It appears that the cause of this polarization can be found in differences among sales channels. Life insurance companies whose sales are rising not only engage in traditional sales through their sales agents but also proactively utilize a different sales channel in bank tellers.

On the other hand, many life insurance companies reported lower basic profits on a year-on-year basis. This is because they were directly affected by unexpected losses, as you might have imagined from examining the various earthquake-related charges that were assumed.

A special factor in terms of the sudden drop in stock prices caused by the earthquake disaster also had quite an impact. Due to this impact, there were many life insurance companies whose bottom line – as seen in their after-tax profit – decreased.

Attention concerning the financial results this year was directed at matters relating to the earthquake damage as well as at announcements of a solvency

margin (SM; a measure of a company's reserve capacity to pay insurance money) ratio that was based on a new standard. Of course, the SM ratio as based on the existing standard was also announced at the same time.

Calculated based on a strict standard, the SM ratio as based on a new standard did not represent anything more than a reference value. As it was slated to be completely adopted beginning in the fiscal year ending in March 2012, however, attention was drawn to the extent of any discrepancy between it and the value obtained based on the existing standard.

Figure 2-1. Financial results for major life insurance companies for the fiscal year that ended in March 2011

		Insurance premiums and other earnings		Basic profit		Earthquake-disaster-related burden	After-tax profit		Solvency margin ratio	
			Rate of increase or decrease		Rate of increase or decrease			Rate of increase or decrease	New standard	Existing standard
Domestic	Nippon	48,964	1.6	5,163	2.2	426	2,317	▲8.0	529.1	966.2
	Meiji Yasuda	39,446	20.2	3,105	6.5	295	1,397	▲2.6	663.6	1,156.8
	Dai-ichi	33,082	▲10.6	2,735	▲27.6	305	191	▲65.6	547.7	983.9
	Sumitomo	30,030	▲2.0	2,652	▲31.4	273	1,103	1.6	636.5	1,002.2
	T&D	14,742	▲22.3	1,077	▲17.8	170	238	▲1.7	—	—
	Daido	7,171	▲16.7	621	6.0	118	160	▲20.8	720.6	1,237.2
	Taiyo	7,179	0.6	504	▲1.0	49	125	▲13.4	670.8	1,229.7
	Fukoku	12,108	31.6	690	▲4.0	57	415	58.9	668.4	1,088.3
	Sony	7,780	9.9	547	▲14.4	59	402	▲12.8	1,720.0	2,900.1
	Mitsui	6,572	2.6	129	▲72.9	34	137	199.0	423.0	704.8
	Asahi	5,318	4.3	207	▲17.0	50	440	31.5	361.2	602.6
Foreign-affiliated	Prudential	15,990	10.6	1,355	▲7.5	67	646	▲28.8	656.8	1,120.0
	Aflac	13,707	11.3	1,658	5.0	16	137	▲66.5	512.2	919.3
	Alico	12,941	▲1.8	1,135	▲5.8	37-54	691	42.6	868.0	1,462.5
	Axa	6,338	▲9.6	434	▲19.9	106	914	74.8	608.4	1,042.1

Note: Units: hundred million yen, %; ▲ denotes a negative value.

Upon comparing the two values, a significant gap became apparent and highlighted just how strict the method of calculation based on the new standard was. Nevertheless, every single major life insurance company managed to exceed the 200% threshold as dictated by the Financial Services Agency, as an indicator of improved management.

(2) Recognized role of insurance

At magnitude 9.0, the Great East Japan Earthquake was the largest earthquake to strike Japan in recorded history. No doubt, there were some who probably felt anxious about whether life insurance companies could continue to

run given the unexpected and sudden increase in the amount of insurance money being paid out as a result of this disaster.

Yet, compared with the more than 2,300 billion yen in insurance money paid out for earthquake-disaster-related reasons in the non-life insurance sector, the amount paid out by life insurance companies was rather small. Thus, it is clear that the earthquake disaster did not substantially affect the operations of life insurance companies.

Actually, if we look at the after-tax profit figures outlined earlier, we see that not a single major life insurance company ultimately slipped into the red. Although it is a fact that the earthquake disaster caused a certain amount of damage to life insurance companies, the damage done was to an extent that could be easily absorbed.

Whether we speak of life insurance or non-life insurance, insurance companies set aside reserves to cover any and all conceivable risks. Thus, they are able to pay out insurance money as promised.

If anything, this year's earthquake disaster can be regarded as an event for which a positive aspect in terms of the ability of insurance companies to fulfill their role as providers of protection overshadowed a negative aspect in terms of the sense that life insurance companies were treading in dangerous waters.

Nevertheless, a long-term assessment of the life insurance industry in Japan does not give one enough reason to feel so secure about the future. This is because there is no sense at all that the momentum of the past will carry forward.

While each life insurance company is formulating its own strategy, their efforts are not proving to be very effective. I would like to explore ways that insurance companies can proceed to break through the obstructions that are in their way.

Part 2: Life insurance companies constituting stock companies fighting against heavy odds

(1) Slumping prices of stocks of life insurance companies

What should be apparent to anyone examining the financial statements of life insurance companies is that the life insurance industry in Japan is long past its growth phase and has entered its mature phase. Although insurance premiums and other earnings have increased slightly over the previous year, you can sense utterly no momentum of the sort that might remind you of past periods of growth.

As long as the rate of childbirth declines and the population continues to age, there are probably going to be people who are resigned to the fate that the life insurance industry is apparently facing. However, this state of obstruction cannot be so easily accepted if you are to consider the evolution of the Japanese life insurance industry as well as the future of this country.

The transformation of life insurance companies into stock companies is a possible solution to which many people have been turning their attention. As long as a life insurance company remains a mutual company, it will be difficult for it to smoothly secure financing and pursue mergers and acquisitions (M&A).

These issues can be easily overcome for a stock company. In particular, the advantages of transforming into a stock company can definitely be harnessed when implementing an M&A strategy by which a company seeks to target an overseas insurance market.

Since the domestic life insurance business has peaked, growth is difficult to achieve without focusing on overseas operations. Recognizing this state of affairs, it was the second-ranked Dai-ichi Life Insurance Company that managed to both transform into a stock company and become a publicly-listed company in April 2010.

If we look only at the first year since these changes were made, however, it is clear that the M&A strategy did not go as well as the company had hoped and that the results thus far fell short of investors' expectations.

Actually, the financial results for this fiscal year also revealed some gloom in terms of insurance premiums and other earnings, since the company's second-place standing in the industry, which had long been maintained, was yielded to the Meiji Yasuda Life Insurance Company. Dai-ichi Life Insurance Company fell to third place for the first time in six decades.

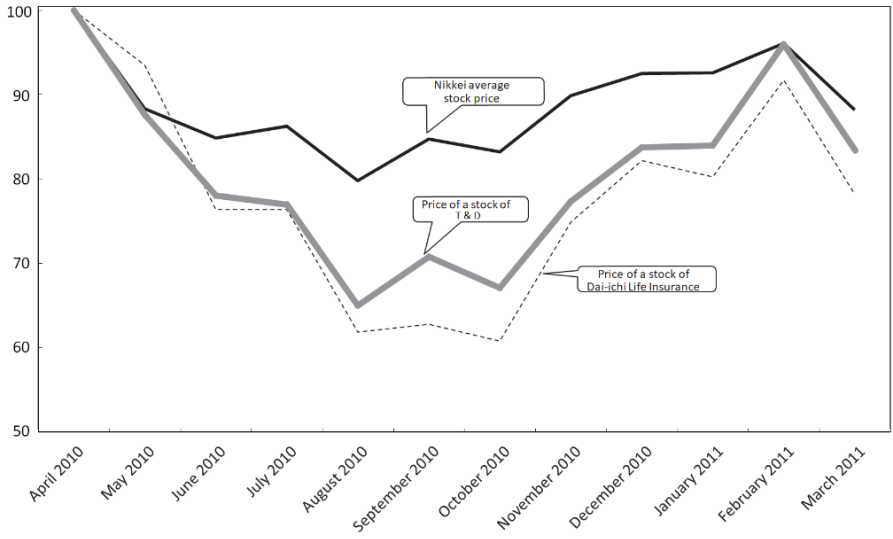
If a solid growth strategy had been properly formulated, then we would have seen not just insurance premiums and other earnings but also stock prices definitely rise. However, the vagueness of the strategy set forth by the company caused the company to suffer from an inability to deploy its actions as it had intended.

In tracing the changes in the company's stock prices over a period of a year, we see that the Dai-ichi Life Insurance Company listed its stocks on April 1, 2010, and that the price of a stock of the company hit its peak of 168,800 yen a day later on April 2, after which it continued to sink. Between August and November, the stock price eventually went below 100,000 yen. It subsequently

recovered somewhat but continued to flounder thereafter.

Figure 2-2 shows changes in the price of a stock of the Dai-ichi Life Insurance Company and compares it with the Nikkei average as well as with the price of a stock of T&D Holdings, which had already transformed into a stock company and listed its stocks.

Figure 2-2. The Nikkei average and changes in the prices of the stocks of 2 life insurance companies with April 2010 set as the base point in time and the base equaling 100



The stock price for each was set to an index value of 100 as of April 2010. Subsequent percentage changes extending to March 2011 were depicted on a monthly basis. If the graph dips above 100, then it means that the stock price exceeded the stock price as of April. If it dips below 100, then it means that the stock price was less than the stock price as of April.

As is clear from perusing this figure, the price of a stock of the Dai-ichi Life Insurance Company changed more or less in tandem with the Nikkei average. The same can be said of the price of a stock of T&D.

As the Nikkei average began to trend downwards in the first half of the fiscal year, the prices of the stocks of the two life insurance companies in question likewise decreased. These figures began to trend up in the second half of the

fiscal year on their way back to their original levels.

What is more, the prices of stocks of both life insurance companies declined by a greater degree than the Nikkei average. This is also a point of some concern.

Those who wholeheartedly supported the transformation of these companies into stock companies may have expected the prices of the stocks of life insurance companies to continue to rise independently of changes in the Nikkei average. Unfortunately, such an expectation proved to be unwarranted in light of the results that were obtained over the course of the past year.

(2) Managing the assumption of risks in a way that backfired

While life insurance companies whose basic profit has shrunk as a feature of their financial results are notable, we can discern a polarization of the industry in that some life insurance companies are seeing an increase in their profits while others are seeing their profits go down.

While basic profits on the whole declined due to the impact of the earthquake disaster, polarization is even more starkly revealed if we eliminate this special factor. This can also be seen in the financial results for the period from April to December 2010, which predated the earthquake.

Polarization is the result of having differences in sales strategies reflected in earnings. Some life insurance companies whose profits increased focused their efforts on traditional whole-life insurance products but most life insurance companies that sustained a loss were proactively engaged in the selling of annuity insurance.

Annuity insurance is divided into two types: fixed annuities and variable annuities; this categorization depends on whether the insurance plan in question guarantees a fixed rate of return or not. While a fixed annuity guarantees a rate of return, variable annuities do not. Therefore, an insurance company offering a fixed annuity plan bears asset-management risks associated with that annuity plan, while any such risk is borne by the policyholder for a variable annuity plan.

Even with variable annuities, however, life insurance companies themselves sustained asset-management losses due to falling stock prices, since principal-guaranteed variable annuity plans were proactively sold. This is because life insurance companies, whose basic profits were declining even as their insurance premiums and other earnings were increasing, managed to increase sales of this type of annuity insurance through bank tellers.

While it is true that a life insurance company will sustain a loss if it suffers a

failure in terms of managing a principal-guaranteed product, it will conversely earn a profit if it succeeds. In this sense, this sort of insurance product is one for which returns are sought even as risks are assumed.

For a life insurance company whose basic profit as reported in its financial statements has gone substantially down, the sale of principal-guaranteed variable annuity plans can be said to have placed a millstone around its neck in complete opposition to initial expectations. As can be understood by the drop in the Nikkei average, life insurance companies that relied on this type of insurance product unfortunately sustained losses on the stock investment.

Many life insurance companies whose basic profit declined substantially had focused their attention on principal-guaranteed variable annuities. Representative of this type of life insurance company were listed stock companies consisting of the Dai-ichi Life Insurance Company and T&D.

As an unlisted company that had transformed into a stock company before the Dai-ichi Life Insurance Company did, Mitsui Life Insurance, too, sustained losses on principal-guaranteed variable annuities, which caused its basic profit to decline by quite a bit.

While it may be too hasty to judge based on an examination of just three companies, it appears that profit-oriented growth strategies implemented by stock companies yielded results that betrayed expectations.

This is because the biggest mission of a stock company is to generate maximum profits for shareholders, which necessitates an approach to management that entails the assumption of risks.

In contrast, the Nippon Life Insurance Company and Fukoku Mutual Life Insurance Company, major entities that are committed to remaining mutual companies, are the mirror opposites of the aforementioned three life insurance companies constituting stock companies. They do not offer principal-guaranteed variable annuity plans.

In looking at this situation, we may yet see a pessimistic way of looking at the transformation of life insurance companies into stock companies make a comeback in sharp contrast to how this trend was regarded the previous year. However, this is the result of observations after just a single year. We must not forget to engage in discussions on the structure of organizations from a longer-term perspective.

Part 3: The advantages and disadvantages of solvency margin ratio measures

(1) Impact of reinforcing capital controls

The reconsideration of asset management can also be seen as a feature of the financial results for life insurance companies this year. Since capital controls were set to be tightened beginning in the fiscal year ending in March 2012, life insurance companies were already carrying out related measures.

As touched on earlier, the solvency margin (SM) ratio is a unique indicator used by insurance companies to indicate the soundness of their financial affairs. For the financial results for this fiscal year, an SM ratio was presented on the basis of current standards as well as on the basis of new standards one year ahead of their adoption.

This indicator consists of a denominator reflecting various types of risks and a numerator equal to substantive equity capital. A ratio of 200% or more denotes sound operations.

If the ratio dips below this figure, the Financial Services Agency, as the regulatory authority, will ask the insurance company to submit a management-amelioration plan. However, the most recent solvency margin ratios for the Chiyoda Life Insurance Company and Kyoei Life Insurance Company, which went bankrupt one after another in October 2000, and the Tokyo Life Insurance Company, which went under in March 2001, had exceeded 200%.

More recently, the solvency margin ratio for the Yamato Life Insurance Company, which went bankrupt upon becoming directly affected by the Lehman Shock in October 2008, likewise exceeded 200%.

Under these circumstances, it is rather difficult to gain the trust of policyholders. For this reason, the method by which risks are calculated was required to become stricter.

In this connection, life insurance companies have been expanding their capital holdings by accumulating retained earnings and funds or issuing perpetual subordinated bonds in order to strengthen their financial underpinnings and satisfy the new standards.

Life insurance companies have also undertaken a broad review of their investment portfolio. This is because the risk of holding domestic stocks is set to a higher level than before under the new method by which the SM ratio is to be calculated. For this reason, stocks will tend to account for a lower percentage

of total assets.

While an investigative commission to draft strict standards had already been set up by the regulatory authority five years earlier, major life insurance companies have approximately halved their shareholdings compared with that time. It is clear that life insurance companies have been steadily making moves and selling stocks in anticipation of the new standards.

Instead, life insurance companies are increasing their holdings of bonds issued by the government as well as other entities as they sell off stocks. It is difficult for banks and other financial institutions to find favorable borrowers. In this connection, life insurance companies are purchasing large amounts of government-issued bonds through a process of elimination, even though this option may not be that appealing as an investment asset.

In addition to this reason, however, life insurance companies are acquiring government bonds due in large part to the method by which the SM ratio is calculated.

(2) Potential risks of capital controls

In this way, life insurance companies are selling off stocks to accommodate the strengthening of capital controls. It is true that this may be regarded as an effective means of preventing the SM ratio from dropping. If you think about it rationally, however, this approach can be characterized as risky and problematic in terms of giving rise to pro-cyclicality.

Let us say that a life insurance company proactively sold off high-risk stocks while keeping the SM ratio in mind. The stock price would drop, thereby negatively affecting the prices of other stocks and worsening the economic climate itself.

This will in turn cause stock prices to further drop and worsen the financial soundness of the life insurance company, thereby launching another round in which held stocks are sold off. This negative spiral is unfavorable towards both the life insurance company itself and the Japanese economy.

On the other hand, it may be possible to prevent the SM ratio from declining by shifting funds freed up by selling off held stocks into bonds issued by the government and other entities. However, this approach too is risky in certain ways.

While government bonds are better than stocks in terms of how risks are calculated, they are simply not an ideal target of investment from the standpoint

of investment earnings. If you continue to hold low-yield bonds, there is the risk that negative spreads will once again increase.

The amount outstanding of Japanese government bonds has increased substantially while their rating has declined. A sharp fall in the value of government bonds could occur as long as there is no clear prospect of a reduction in the fiscal deficit.

Even if such a crisis situation does not come to pass, the prices of government bonds will inevitably decline. When that happens, life insurance companies that have large holdings of government bonds will sustain a huge hit to their financial strength in accordance with current value accounting.

On this basis then, actions taken to sell off stocks and purchase government bonds in response to efforts to strengthen capital controls cannot always be described as actions taken to avoid risks.

Part 4: The expected revitalization of life insurance companies

Today's life insurance industry does not exude the sort of vigor we have seen in the past in terms of the selling of insurance products and by other measures. Asset management results are also not taking much of a turn for the better. In addition, the expansion of overseas operations is taking a lot of time to carry out. The transformation of companies into stock companies is not generating benefits as quickly as initially anticipated.

The dwindling birthrate and aging population are weighing heavily on the Japanese economy. As long as conventional business models are followed, we cannot hope to see growth in the life insurance industry. New tools or elements will need to be discovered.

(1) Selling pure endowment insurance

For example, what can we say about selling pure endowment insurance? In Japan, term insurance to deal with the risk of death as well as whole life insurance and endowment insurance, both of which include a savings function, are primarily offered.

These are all examples of life insurance that provides death protection. However, the current state of the Japanese life insurance market is such that this market more or less lacks any pure endowment insurance options.

If this were an age in which the demographics were weighted more towards

younger cohorts, then traditional life insurance products for which protection is emphasized might very well have been fine. However, societal age distribution is changing dramatically, which means that it is rather difficult to promote such products at a time in which the elderly account for an increasingly bigger slice of the overall population.

People these days seek life insurance products that are designed to eliminate longevity risks more than death risks. Pure endowment insurance that pays out insurance money in the event that you remain alive after a certain period of time is believed to be needed for the Japanese economy, given the concerns over the declining birthrate and aging of society.

Above all, someone who feels insecure about what he or she will be receiving from his or her public pension plan will find that pure endowment insurance is more attractive. Where the payment amount is reduced or the age at which benefits begin to be paid out is raised, there will be no stability in people's lives unless there is some means of offsetting the shortfall.

In light of the foregoing as well, life insurance companies may want to seriously consider stepping into a new domain that involves the selling of pure endowment insurance policies.

(2) Establishing a secondary market

Another proposal for revitalizing the industry consists of the establishment of a secondary market for life insurance products. In the West, a market for reselling insurance already exists and is known as the life settlement market.

In the case of Japan, while there is a market for the issuance of insurance products, there is no secondary market for the buying and selling of existing insurance products. You may have concluded a contract for a life insurance product when you were young. Your needs, however, might fade with the passage of years. Since there is no resale market that would allow you to unload your contract, you will have no choice but to cancel your policy and be reimbursed with a small amount of money.

If you could use a life settlement market, you might be able to have your policy purchased by an investor for a price that is higher than the cash surrender value of your policy. The investor will gain a stable rate of return that is higher than the yield on stocks and bonds and that is unlikely to be affected much by fluctuations in the economy.

This market is appealing for both policyholders and investors. Positive

benefits in terms of sales can be expected by the life insurance industry as a whole if liquidity features are introduced.

You may be inclined to agree that a new approach is worth trying if you were to take notice of these advantages.

Chapter 3: <2012>
Revising the solvency margin ratio and stock investment actions taken by life insurance companies

Part 1: Announcing financial results for the fiscal year that ended in March 2012

(1) Insurance premiums and other earnings and basic profits

The financial results for major life insurance companies for the fiscal year that ended in March 2012 were announced. These financial results were positive, most notably for increased earnings and profits, which were welcomed by management at life insurance companies.

Figure 3-1 outlines the three generally-accepted management benchmarks for major life insurance companies. These benchmarks are the growth, profitability, and soundness indicators.

Figure 3-1. Financial results for major life insurance companies for the fiscal year that ended in March 2012

		Insurance premiums and other earnings		Basic profit		Solvency margin ratio	
			Rate of increase or decrease		Rate of increase or decrease		FY ended March 2011
Domestic	Nippon (mutual)	53,682	9.6	5,443	5.4	567.0	529.1
	Meiji Yasuda (mutual)	51,840	31.4	3,709	19.5	749.6	663.6
	Dai-ichi	34,046	2.9	3,199	17.0	575.9	547.7
	Sumitomo (mutual)	25,943	▲13.6	3,318	25.1	708.6	636.5
	T&D	16,912	14.7	1,449	34.5	-	-
	Daido	7,202	0.4	824	32.6	851.9	720.6
	Taiyo	9,034	25.8	575	14.2	747.3	670.8
	Fukoku (mutual)	9,509	▲21.5	731	5.9	741.1	668.4
	Sony	8,161	5.9	716	27.3	1,980.4	1,720.0
	Mitsui	5,826	▲11.3	300	131.5	486.7	425.8
	Asahi (mutual)	5,056	4.9	285	37.9	426.6	361.2
Foreign-affiliated	Prudential	18,016	12.7	1,188	▲12.3	720.6	702.8
	Aflac	17,535	27.9	2,028	22.3	609.6	512.2
	MetLife Alico	15,721	21.5	1,535	35.3	847.2	868.0
	Axa	6,677	5.3	656	51.1	599.5	608.4

Notes: Units: hundred million yen, %; ▲ denotes a negative value; (mutual) = mutual company. The solvency margin ratio for the fiscal year that ended in March 2011 is based on the new standard.

If we look at the growth indicator as constituted by insurance premiums and

other earnings, we see that rankings within the industry were changing, albeit slightly, compared with those of previous years. Illustrative of this change is the smaller gap between first-place Nippon Life Insurance and second-place Meiji Yasuda Life Insurance.

While each company reported higher earnings, it appears that the increased demand for insurance in the wake of the Great East Japan Earthquake had some impact on this result. Indeed, it was reported that more insurance policies were signed in the Tohoku region.

More pertinent, however, is the fact that the rate of growth in sales of single-payment whole life insurance plans for which interest rates were more favorable than those for other financial instruments and for which the premium can be paid in a lump sum appears to have driven the changes seen in figures for insurance premiums and other earnings. Interest on the part of people has definitely shifted from protection-type insurance products to savings-type insurance products.

Thus, life insurance companies enjoying a high rate of growth in insurance premiums and other earnings largely benefited from the brisk selling of single-payment whole life insurance plans through bank tellers. In contrast, struggling life insurance companies were affected by their efforts to keep sales of such products in check out of a concern over negative spread risks.

If we then look at basic profits as an indicator of profitability that corresponds to the profitability of the main operations of these companies, we see that profits increased for all companies but one. This is tied to various special factors. Contributing to the increase in profits at these companies was not just unrealized gains on rising stock prices but also return gains that were generated, since the amount of insurance money paid out due to the Great East Japan Earthquake was less than the expected amount.

In addition, the investment environment also improved somewhat, resulting in increased income gains in the form of interest from held bonds and dividend earnings from stocks. This suggests a pathway to resolving the problem of negative spreads, which had been encumbering the life insurance industry.

Many life insurance companies actually managed to lessen their negative spread, and some even succeeded in attaining a positive spread. Nippon Life Insurance had already solved their negative spread issues and has been enjoying two consecutive terms in which a positive spread was attained. Meiji Yasuda Life Insurance eliminated their negative spread issues for the first time in twenty years.

(2) Adopting the new SM ratio

If we next turn our attention to the solvency margin (SM) ratio, a typical indicator of soundness associated with life insurance companies, we see that all of these life insurance companies satisfied the minimum standard of 200% by a considerable margin. For this reason, it can be deemed that these companies were fully capable of paying insurance money in terms of how they were managed.

Beginning this fiscal year, all life insurance companies were subject to a newly-revised SM ratio requirement. Values calculated in accordance with this stricter benchmark were announced in the financial results a year earlier for no more than reference purposes. Since this value was applied beginning this fiscal year as the target of early remedial measures, it constituted an indicator of interest for concerned parties in the insurance business.

From the results, we see that each company definitely managed to reach beyond the threshold value required of it. In addition, ratios also increased as compared with ratios calculated a year earlier based on the new standard. Accordingly, generally favorable results were also achieved for the soundness indicator.

Compared with the older method by which it was calculated, the new SM ratio was revised to ensure that the more a company holds stocks, the greater this value falls, given the increase in price-fluctuation risks. Therefore, newspapers and other media outlets occasionally report that life insurance companies sell stocks in advance as a measure for dealing with the SM ratio.

If we examine the ratio of stocks to total assets held by life insurance companies throughout the industry, we see that life insurance companies collectively halved their stockholdings since fiscal year 2005, right before discussions on fortifying regulations began.

However, since the amount of stocks held as referred to here is expressed in terms of the current market value, the amount would have gone down even without a single stock being sold if the Nikkei average had declined. Thus, it does not necessarily mean that stocks were being relinquished by life insurance companies as a measure for dealing with the SM ratio.

Alternatively, if you were to purely regard stocks from an investment standpoint, it would be natural to see stocks account for a lower percentage of an investment portfolio whenever the stock market falters. If anything, that ought to be considered the rational course of action to be taken.

In this connection, I would like to examine below whether life insurance

companies had truly been selling stocks as an effective means of dealing with the SM ratio. I believe that this is a theme that is relevant for determining not only the financial strength of life insurance companies but also, in broader terms, the comprehensive capabilities of their management.

Part 2: The solvency margin ratio, an indicator in which people are taking a growing interest

(1) Background behind the revision of the solvency margin ratio by the Financial Services Agency

People probably began to have a serious interest in the financial strength of life insurance companies when the Nissan Life Insurance Company became the first life insurance company in the post-war era to go bankrupt in April 1997. Like other companies operating in the economic sphere, life insurance companies too will go bankrupt if their financial condition takes a turn for the worse.

Those who were cognizant of this fact came to focus on the soundness of life insurance companies. Introduced seemingly to accommodate such people was the concept of the SM ratio.

Even for ordinary people, the SM ratio is an exceedingly easy-to-use benchmark. This is because it allows even those who lack expertise in this field to immediately deem a given life insurance company to be reliable if this value is at least 200%.

The problem, however, is that the SM ratio as reported in the wake of the most recent settlement of accounts for the Chiyoda Life Insurance Company and Kyoei Life Insurance Company, which went bankrupt in October 2000, and the Tokyo Life Insurance Company, which went under in March 2001, had exceeded the threshold standard of 200%.

Under these circumstances, the significance of having an SM ratio at all was lost. In an effort to raise the reliability of the SM ratio, the Financial Services Agency formulated various proposals for revision.

A written report entitled Regarding Solvency Margin Ratio Calculation Standards, which was released by the Financial Services Agency on April 3, 2007, set out to make considerable revisions.

Points subject to revision were set forth across a broad range of topics. Broadly speaking, however, a revision of the SM ratio from two standpoints was

indicated. The first focused on raising the risk coefficient as a short-term measure. The other focused on carrying out evaluations on an economic value basis as a medium-term measure.

The transition to an economic value basis with a focus on net assets necessitated an investigation that would take some time while international trends were observed. For this reason, specific reform measures were hammered out with a view to raising the risk coefficient in the short term.

On February 7, 2008, the following year, Outline of the Revision of the Solvency Margin Ratio (Draft) was released by the Financial Services Agency. A sweeping short-term proposal for a reexamination of the SM ratio was specifically laid out.

Items applicable to domestic stocks and other risky assets were identified in this outline. In addition, changes to the method by which the price fluctuation risk, which is equivalent to the risk of a loss of principal caused by fluctuations in asset prices, is calculated were also summarized.

According to the older calculation method, the risk coefficient was equal to the difference between the minimum rate of return (hurdle rate) covering 90% of events in accordance with the probability distribution graph and the zero-profit rate (principal). This was changed to the difference between the minimum rate of return covering 95% of events and the principal. This change enabled the price fluctuation risk to be broadly estimated.

However, the Yamato Life Insurance Company, a medium-sized life insurance company, suddenly went under on October 10, 2008. In response, it became necessary to partially revise the draft outline. This was because the most recent SM ratio for the Yamato Life Insurance Company was 555%, which clearly exceeded the threshold standard of 200%.

The Financial Services Agency released the Revised Outline for Revising the Solvency Margin Ratio (Draft) on August 28, 2009, taking the lesson found in the bankruptcy of the Yamato Life Insurance Company to heart. In the revised outline, the method by which the SM ratio is to be calculated was made even stricter.

To illustrate, an unrealized loss on securities, as an item tied to stock investments, lowers the core solvency margin. With this lowering of the core solvency margin treated as a new constraint, a framework for lowering the SM ratio was introduced. Nevertheless, the approach to estimating price fluctuation risks remained unchanged. The level at which the minimum rate of return is to

be considered reliable, which had been previously increased from 90%, remained at 95%.

In this way, short-term measures for revising the SM ratio were announced twice, one after another. As mentioned earlier, the revised SM ratio was calculated as a reference indicator for financial results for the fiscal year that ended in March 2011. It was made clear that it would be applied from this fiscal year as a basis for determining remedial measures at an early stage.

If a life insurance company whose SM ratio came in below 200% were to emerge, it would be required to submit a management-amelioration plan to the Financial Services Agency.

(2) Handling price fluctuation risks

To prevent this from happening, a life insurance company needs to implement effective SM measures by the deadline. What suddenly drew considerable interest in connection with this matter was the handling of price fluctuation risks that are present whenever domestic stocks are held.

Major Japanese life insurance companies hold stocks for pure investment purposes to fulfill their role as institutional investors and as a means of deepening their ties with affiliated companies. In other words, they hold shares for strategic-holding-stock purposes.

When a life insurance company holds a large volume of stocks, however, the SM ratio will go down substantially if the new calculation method is used. The worst-case scenario in which the 200% threshold standard for triggering an administrative intervention is not met must be absolutely avoided.

Even if the threshold standard is sufficiently exceeded, a significant drop in the SM ratio could cause policyholders and other stakeholders to become concerned.

To dispel such concerns, a life insurance company will have to sell off held stocks and lower its price fluctuation risks. While indicating specific numbers, newspapers had been reporting that life insurance companies had been taking measures to deal with the SM ratio by selling off domestic stocks ever since the notion that the method of calculating the SM ratio should be revised began to be discussed.

Yet, we should pay attention to the fact that data on stocks held as presented by newspapers consisted of figures announced by companies when they released their financial statements. Such data had been expressed in terms of the current

market value.

If it is asserted that life insurance companies are selling off stocks as an SM measure, then any assessment should be made based not on their current market value but on their book value.

This is because, as mentioned earlier, the amount of held stocks with the current market value approach will go down if stock prices themselves decline, even if stocks are not sold off.

Under these circumstances, it is not possible to determine that stocks have been sold off. Indeed, you cannot definitively say that SM measures are being implemented by a company. As long as calculations are not based on the book value of stocks, you will be unable to accurately assess stock investment actions being undertaken by a life insurance company.

In this connection, let us try to accurately trace pertinent changes by estimating the book values of held stocks based on data provided in past financial statements. I believe that this will allow us to clarify whether stocks were actually being sold off as an SM measure as had been reported by mass media outlets.

Part 3: Purpose of investments in stocks by life insurance companies

(1) The selling of stocks as an ambiguous SM measure

When you examine stock-investment actions carried out by life insurance companies, you will typically look up net assets as announced in fiscal year-end financial statements and the shareholding ratio as based on the current market value of stocks. Alternatively, you might seek to determine the amount by which the current market value of stocks has increased or decreased over the previous year.

To properly examine stock-investment actions as they truly are, however, you must calculate using the amount of stocks held as expressed in terms of their book value. Indeed, it is when the amount of stocks held in terms of their book value continuously decreases that SM measures implemented by way of selling off stocks are finally demonstrated. In this connection, you should deduct any unrealized losses or gains from the current value of stocks in order to determine the book value of these stocks.

Figure 3-2 shows financial data relating to life insurance companies based on aggregate values for nine major life insurance companies in Japan (Nippon, Dai-

ichi, Meiji Yasuda, Sumitomo, Mitsui, Asahi, Taiyo, Daido, and Fukoku). The surveyed period is a six-year period extending from fiscal year 2005, which was right before studies conducted by the Financial Services Agency commenced, to fiscal year 2010.

Figure 3-2. Financial data for 9 major life insurance companies in Japan

(1) Financial data <1>	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Total assets	165,011,629	168,795,965	160,349,911	152,133,136	157,630,549	161,222,002
Current market value of stocks	29,839,573	31,179,444	23,057,779	15,182,637	18,153,136	15,599,174
Year-on-year rate of change in the current market value of stocks	39.1	4.5	▲26.0	▲34.2	19.6	▲14.1
Shareholding ratio	18.1	18.5	14.4	10.0	11.5	9.7

(2) Financial data <2>	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Unrealized loss or gain on stocks	13, 699, 576	14,728,206	6,879,112	542,293	3,493,758	2,399,644
Book value of stocks (estimated)	16, 139, 997	16,451,238	16,178,667	14,640,344	14,659,378	13,199,530
Year-on-year rate of change in the book value of stocks	5.1	1.9	▲1.7	▲9.5	0.1	▲10.0

(3) Financial data <3>	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
SM ratio	1,037.4	1,145.4	1,014.0	832.1	964.9	996.9
Year-on-year rate of change in the SM ratio	194.9	108.0	▲131.4	▲181.9	132.8	31.9
Funds	2,420,780	2,630,780	2,680,780	2,725,780	2,840,780	2,810,980
Year-on-year rate of change in funds	8.5	8.7	1.9	1.7	4.2	▲1.0

Note 1: Each data set consists of aggregate values for nine life insurance companies (Nippon, Dai-ichi, Meiji Yasuda, Sumitomo, Mitsui, Asahi, Taiyo, Daido, and Fukoku). However, the SM ratio values are simple average values for these nine life insurance companies.

Note 2: Units: million yen, %; ▲ denotes a negative value.

If we look at the shareholding ratio as calculated based on the use of current market values, we see that it became halved in a period of six years. This was widely interpreted by newspapers as the result of the selling off of stocks by life insurance companies.

However, the year-on-year rate of change in the current market value of stocks was not negative in every single year. From this, we can conclude that life insurance companies did not all undertake to sell off their stocks. (See Financial data <1> in Figure 3-2.)

Thus, there is a sense that reporting on the selling off of stocks by life insurance companies had been exaggerated. Since this alone, however, is insufficient, let us further analyze matters, estimate the book value of stocks held by life insurance companies based on unrealized gains or losses, and attempt to determine the rate of year-on-year changes in this figure. This should allow us

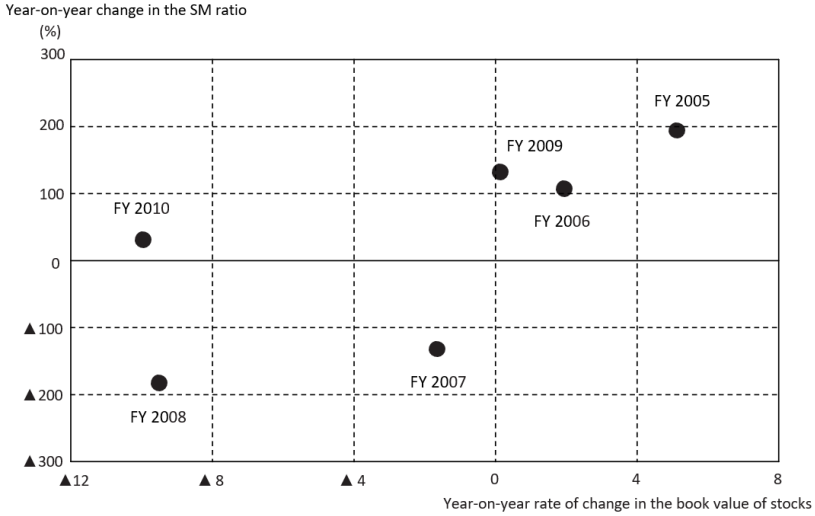
to ascertain actual investment actions taken with respect to stocks by life insurance companies.

In examining the results of this process, we see that, as expected, positive and negative periods were mixed together as was the case with the current market value of stocks. Moreover, we see that the magnitude of fluctuations in the book value of stocks was much smaller. (See Figure 3-2. Financial data <2>.)

If life insurance companies were endeavoring to sell off stocks in order to keep price fluctuation risks in check, then it would not be strange at all to see the year-on-year rate of change in the book value of stocks stay negative each year and numerical values even increasing in magnitude. Yet, the results did not reveal that such a phenomenon was occurring.

Even if a different approach had been adopted, no picture of stocks as an SM measure can be found. Figure 3-3 was put together for this purpose. This figure shows the correlation between the year-on-year changes in the SM ratio and year-on-year rate of change in the book value of stocks for the period from fiscal year 2005 to fiscal year 2010.

Figure 3-3. Correlation between the book value of stocks and the SM ratio



While there are only six data points, an overall look at this figure appears to show that there was more or less a positive correlation between the two variables. This relationship runs counter to investment actions taken with respect to stocks

as an SM measure.

This is because, if we regard stocks as a means of mitigating price fluctuation risks, then investment actions taken with respect to stocks can only be said to have taken financial soundness into account when a negative correlation between the two variables is depicted.

(2) Augmenting funds

In what way then had life insurance companies been dealing with the revision to the SM ratio? They had been attempting to resolve this matter by way of a highly conventional approach by which funds are augmented. As can be confirmed through data, funds were almost certainly being increased with each passing fiscal year. (See Figure 3-2. Financial data <3>.)

Of course, increasing funds will allow not just price fluctuation risks but also various other risks affecting life insurance companies to be absorbed. In this way, life insurance companies appeared to be focused on soundness measures from not just a short-term standpoint but also a medium-term standpoint.

As mentioned earlier, a written report issued by the Financial Services Agency contained recommendations in two stages: short-term initiatives and medium-term initiatives. In this context, dealing with rising price fluctuation risks corresponds to initiatives with a view to carrying out short-term revisions.

In contrast, a medium-term initiative is an action that takes into account an international trend consisting of the current market valuation of insurance liabilities. If we engage in the current market valuation of not just assets but liabilities as well, then interest rate-based fluctuations in net assets, as the difference between the two, will increase. In a worst-case scenario, a company could go deep enough into negative territory that it would effectively become bankrupt.

To resolve this issue, companies must aspire to develop an asset liability management (ALM) approach, which entails making adjustments to the maturity dates of assets and liabilities. For this purpose, life insurance companies are proactively purchasing ultra-long-term government bonds matched up with the maturity dates of liabilities.

However, government bonds with maturity dates that can be matched up with the ultra-long-term liabilities that are unique to life insurance companies do not exist. If they do happen to exist, they are of an insufficient amount. It is impossible to perfectly adjust the maturity dates of assets and liabilities.

In this connection, a method of expanding net assets by having external funds injected by way of the augmentation of funds was being adopted. Through this approach, attempts were being made to not just revise the SM ratio but also develop a system capable of absorbing various risks to which life insurance companies are exposed.

Part 4: Holding stocks for pure investment purposes

In looking back, we see that life insurance companies in the past regarded stocks as a long-term strategic holding stock. In other words, they continued to hold shares in other companies as a means of establishing links to insurance policies.

These days, however, the adoption of current value accounting means that losses will be incurred if stocks drop in value. Thus, companies tend to keep from engaging in actions by which shares are needlessly held and will seek to sell off shares while obtaining the understanding of other companies, unless there is a reasonable chance that stock prices will rise.

In other words, stocks represent a pure target of investment for modern life insurance companies. Stocks are expected to yield high profit rates. Accordingly, holdings of stocks will be proactively increased if it is believed that stock prices are set to rise.

However, the Japanese economy had been rather unable to extricate itself from its prolonged state of stagnancy. For this reason, profit rates were declining and domestic stocks had been losing their sheen. That life insurance companies did not desire to increase their holdings of domestic stocks appears to be more attributable to management decisions taken from a pure investment standpoint than to SM measures.

A life insurance company that is also an institutional investor must efficiently manage funds entrusted to it by policyholders to ensure that as much profit as possible can be generated. While such investment profits will be returned to policyholders as a share of the profits (dividends), a portion of such profits will be treated as retained earnings to raise the SM ratio itself.

In today's investment environment, it is difficult to place much weight on stocks. If a favorable investment environment capable of instilling expectations of high earnings can someday soon be restored, investments in stocks will surely contribute to not just profitability but also to soundness.

Right now, the negative aspects of stocks are emphasized, and stocks tend to be regarded as a factor behind the lowering of the SM ratio due to price fluctuation risks. However, if the investment environment turns around for the better, a different way of looking at these matters will become widespread among persons and parties tied to life insurance companies. When that time comes, the weight assigned to stocks will no doubt be greater than it is today.

Chapter 4: <2013 (i)>
Life insurance companies' strategy of extending asset-side durations

Part 1: Announcing financial results for the fiscal year that ended in March 2013

(1) Major life insurance companies enjoy rising profits

The financial results for major life insurance companies for the fiscal year that ended in March 2013 were announced. Abenomics, a set of economic policies promoted by the Abe administration, appeared to have provided a tailwind for life insurance companies.

Along with a change of government, a cheaper yen and an ascendant stock market bolstered the financial results of life insurance companies. Figure 4-1 outlines the key management benchmarks of life insurance companies.

Figure 4-1. Financial results for major life insurance companies for the fiscal year that ended in March 2013

		Insurance premiums and other earnings		Basic profit		Net profit		Positive or negative spread		Solvency margin ratio	
			Rate of increase or decrease		Rate of increase or decrease		Rate of increase or decrease		Previous fiscal year		Previous fiscal year
Domestic	Nippon	53,428	▲0.5	5,465	0.4	2,106	▲5.0	317	316	696.4	567.0
	Meiji Yasuda	36,593	▲29.4	3,945	6.4	2,355	36.9	425	192	930.3	749.6
	Dai-ichi	36,468	3.0	3,476	8.6	324	59.2	▲584	▲907	702.4	575.9
	Sumitomo	31,842	20.4	4,207	27.9	1,078	▲0.1	▲505	▲668	843.9	708.6
	T&D	19,409	14.8	1,824	25.9	637	138.1	18	▲202	943.9	810.6
	Sony	9,258	13.5	800	11.7	424	35.0	21	▲15	2,281.8	1,980.4
	Fukoku	8,622	▲9.3	819	12.0	502	77.0	22	▲48	994.6	741.1
	Mitsui	5,782	▲0.8	529	76.4	88	▲40.9	▲530	▲561	601.3	486.7
	Asahi	4,603	▲9.0	262	▲8.0	127	80.0	▲803	▲837	495.8	426.6
Foreign-affiliated	Prudential	25,337	40.6	1,490	25.4						
	American Family	19,958	13.8	1,623	▲20.0						
	MetLife Alico	14,970	▲4.8	423	▲72.4						
	Axa	6,706	0.4	661	0.8						

Note 1: Units: hundred million yen, %; ▲ denotes a negative value.
Note 2: Rate of increase or decrease is the percentage change over the preceding fiscal year (%).
Note 3: The SM ratio is the solvency margin ratio (%).

If we first look at insurance premiums and other earnings, we see that there

was a division between life insurance companies that were growing and those that were floundering. This is because structural issues in Japan in the form of a declining birthrate and aging society were having an impact. Companies would continue to have a tough time selling conventional protection-type products.

The indicator that we need to focus on with these financial results is profitability. Basic profit, an indicator of profitability that corresponds to the profitability of the main operations of these companies, grew for many life insurance companies. High rates of growth in terms of net profit were also seen.

For some of these companies, basic profit on the whole rose as interest income received from foreign bonds increased due to a cheaper yen and as valuation losses on securities shrank significantly due to rising stock prices. It can be said that rapid changes in the investment environment truly helped to increase profits accruing to life insurance companies.

In addition, higher investment earnings were causing negative spreads, a long-time concern in this industry, to head towards shrinkage in the future. Indeed, more and more life insurance companies were reporting a positive spread whereby investment yields exceed assumed interest rates.

The SM ratio (solvency margin ratio), a benchmark of soundness, also started to pick up again thanks to higher unrealized gains from stocks and bonds.

None of the major life insurance companies that were surveyed reported an SM ratio in decline. For each of these companies, the SM ratio grew and exceeded the 200% threshold standard of soundness.

(2) Large volumes of government bonds held by life insurance companies

A cheaper yen and rising stock prices combined to give rise to more favorable financial results as described above. However, there was no guarantee that the blessings of economic policies would continue to be granted on a permanent basis. There was always the chance that the investment environment would shift from providing a tailwind to throwing up a headwind.

Life insurance companies in those days held large volumes of government bonds, which were wielded for investment purposes. While high investment yields had been temporarily obtained from foreign currencies and stocks, these companies could not feel secure as long as earnings generated by government bonds did not rise.

However, government bond yields had been floundering over an extended period of time, thereby limiting investment earnings by life insurance companies.

Nevertheless, government bond holdings continued to increase, since attractive investment alternatives remained unavailable.

Against this backdrop, the Bank of Japan introduced quantitative and qualitative easing measures of a wholly different nature in April 2013. Consequently, the prices of government bonds underwent repeated cycles of erratic fluctuations. Just when you thought that yields had dropped to a significantly low point, they would climb in very short order.

Will those in charge of investments at life insurance companies continue to purchase government bonds in large volumes? Perhaps they might turn to foreign bonds as an alternative investment target. It is to this possibility that market watchers were directing their attention.

Investment earnings are undeniably important for the management of life insurance companies. Since government bonds accounted for a significant percentage of invested funds, their existence was of considerable relevance.

For life insurance companies, however, government bonds were not held simply for the purpose of obtaining earnings. They also served to help manage risks. This has the effect of stabilizing management itself. Given the long-term nature of insurance policies, the stabilization of management is, if anything, more important.

I would like to explore the effective use of government bonds, which account for a significant amount of investment activities undertaken by life insurance companies, as a means of managing risks.

Part 2: Shifting from cost to current market value

(1) A past moment of truth for life insurance companies and the measure taken in response

When we take a look at the financial results for this fiscal year, we see that while there was some concern regarding insurance premiums and other earnings, the results as announced were more or less acceptable. Yet, remaining in our memory is the fact that Japanese life insurance companies were visited by an unparalleled crisis between the latter half of the 1990s and the beginning of 2001.

While the elements of this crisis were thought to be entirely unconnected to concerns over management up to that point in time, the collapse of the bubble economy sparked not just concerns over stymied growth in the number of new policies but also the serious issue of negative spreads caused by a long-term drop

in interest rates.

Is there a way to avoid the risk of negative spreads in the changing investment environment? Of course, there is. It is called asset liability management (ALM).

This is a means of suppressing the occurrence of a negative spread as much as possible by shrinking the gap between asset-side and liability-side durations (maturity terms).

In this connection, I would like to explore possible solutions to the issue of negative spreads affecting life insurance companies, which is of interest to many people. In other words, let us examine whether Japanese life insurance companies are properly implementing ALM as a means of avoiding negative spreads while heeding the lessons of the crisis that hit life insurance companies beginning in the latter half of the 1990s.

As an approach to be taken, the durations of negotiable securities and loans receivables held by major life insurance companies will be measured each fiscal year. For any life insurance company, liability-side durations are generally greater than asset-side durations. Therefore, if the durations of typical held assets are found to be increasing with each passing fiscal year, then measures for reducing the risk of negative spreads can be deemed to have been implemented.

In fact, the purpose here is to measure and ascertain changes in asset-side durations. Before proceeding, allow me to explain the concept of the economic value basis, which is closely tied to ALM analysis.

(2) Economic value-based valuations

The solvency regime imposed on life insurance companies by the regulatory authorities was reinforced in response to the crisis affecting life insurance companies. In Japan, solvency margin rules were introduced based in part on the U.S.-drafted risk-based capital (RBC) requirements for the settlement of accounts in fiscal year 1996.

Various revisions were thereafter made. For the settlement of accounts in fiscal year 2011, revisions known as “short-term measures” with a focus on revising the risk coefficient were implemented. Revisions known as “medium-term measures” based on the concept of the economic value basis are being studied for the future.

While asset-side current market valuation has already been adopted, liabilities remain valued at acquisition cost. Accordingly, the shift to an economic value basis will notably and invariably direct our attention to changes

in liability-side valuations.

Currently, assumptions pertaining to the policy reserve that accounts for the bulk of liabilities are locked in, which means that the assumed interest rate that is set at the time a policy is entered into is fixed into the future. For this reason, an additional policy reserve needed in order to pay insurance money and benefits in the future must be set aside where interest rates lower than the assumed interest rate are expected to persist.

As long as the acquisition cost of a liability applies, however, this necessity will not be expressly conveyed, and the policy reserve will continue to be insufficient. While funds covering the negative spread amount ought to be accumulated, this matter can be ignored as far as the accounting of it goes.

Therefore, you might have an insurance company suddenly go bankrupt as a result of being stymied after a certain period of time when faced with the need to pay insurance money and benefits.

Liability-side current market value accounting is an attempt to address this issue. By applying a lock-free approach, the assumed interest rate can change each time valuations are undertaken. The policy reserve will automatically vary, such that it will be augmented when interest rates decline.

Since this approach allows anyone to verify the amount of policy reserve needed for the future, a management crisis can be detected in advance.

Part 3: Relationship between net assets and interest rates

(1) Interest-rate-based fluctuations in assets and liabilities

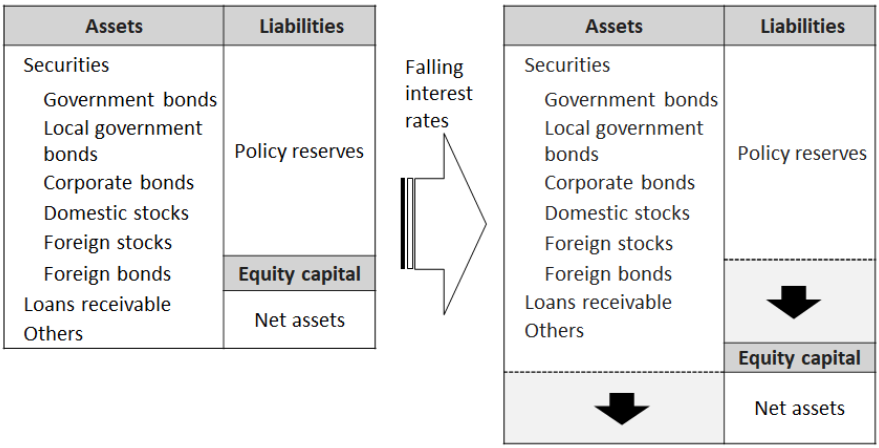
Allow me to reference the balance sheets of life insurance companies to shed light on what I have just mentioned. Figure 4-2 outlines changes in assets and liabilities based on current market value accounting in the event that interest rates fall.

First, let us look at what this figure is saying on the asset side of the table. For a life insurance company, assets might consist primarily of securities comprising government bonds, local government bonds, corporate bonds, domestic stocks, foreign stocks, and foreign bonds. In addition, a life insurance company will hold loans receivable and various other assets. If interest rates fall, the economic value of held assets will increase.

Likewise, the economic value of the liability-side policy reserve will increase if interest rates fall. Under the current accounting system, the policy reserve does

not change if interest rates fall. Under a system of accounting that is completely based on current market values, funds required to pay future insurance money and benefits will be reflected in the accounting, which means that the policy reserve as a liability will increase.

Figure 4-2. Impact of falling interest rates on the assets and liabilities of insurance companies



What needs to be focused on here is the net assets, which is equivalent to equity capital. This is because the amount of net assets is an indicator of the solvency of the life insurance company. Once it falls into negative territory, the company is effectively bankrupt.

Life insurance companies in Japan came to face a crisis situation because life insurance companies whose net assets as calculated on a current market value basis were negative emerged one after another.

(2) Current market value of liabilities

Under the current system of accounting, the liability-side policy reserve is stated on a book value basis. For this reason, any state of excessive liabilities would not be realized until after bankruptcy is declared. In fact, however, net assets would already have fallen into a negative state of excessive liabilities in line with a lowering of interest rates.

The policy reserve as stated on a current market value basis will in fact increase when interest rates decline. When the equity capital is depleted, the

company will ultimately end up bankrupt. At the same time, however, assets will also increase as interest rates decline.

Therefore, net assets, equaling the difference between assets and liabilities, is not unilaterally determined as a function of changes in the liability-side policy reserve. Asset-side changes also need to be taken into account as part of this process.

In this figure, declining interest rates are shown to increase both assets and liabilities simultaneously; indeed, you can see how declining interest rates affect net assets. In this case, both assets and liabilities appear to increase by the same amount, such that net assets, which are equal to the difference between assets and liabilities, remain more or less unchanged.

However, it is not necessarily always the case that both assets and liabilities will change by the same extent. The bankruptcy of life insurance companies occurred because liabilities increased to a greater extent than assets as interest rates declined, which is a situation that should be immediately familiar to anyone who lived through the crisis that affected life insurance companies.

These differences in how assets and liabilities fluctuate can be attributed to differences in their respective durations. In this connection, allow me to conceptually set forth the effect that interest rates have on net assets through assets and liabilities by referring to the notion of what is known as the duration gap.

(3) Impact of the duration gap

Whether we speak of assets or liabilities, interest-rate-based changes in economic value depend on their respective durations. Moreover, the greater the value of the asset or liability in question, the greater the change and vice-versa.

Thus, fluctuations in net assets are affected by the duration gap, which corresponds to the difference in duration between assets and liabilities. The greater this value, the greater the fluctuation in net assets.

On the other hand, if the durations of assets and liabilities are matched, then net assets will not be affected by interest rates whatsoever. ALM by life insurance companies is in fact a strategy by which the duration gap is to be brought as close to zero as possible.

Since a life insurance company will typically offer many long-term policies, the full terms of liabilities will be greater than the durations of assets. For this reason, the most effective means of abating interest rate fluctuations is a strategy

by which asset-side durations are prolonged. Specifically, this entails extending the full terms of securities, loans receivable, and other assets held as assets by life insurance companies.

Other effective means include a strategy by which liability-side durations are shortened and a strategy by which the capital-to-asset ratio is increased. However, these have a drawback in that time is required for their implementation. In contrast, the strategy by which asset-side durations are prolonged can be attained by changing the financial assets that are held by the company.

It can be presumed that if Japanese life insurance companies had been attempting to overcome the negative spreads that had been the cause of their crisis, then the strategy by which asset-side durations are prolonged would have been implemented.

In this connection, I would like to ascertain what the asset-side durations were for life insurance companies and determine whether this approach was actually attempted.

Part 4: Trends in asset-side durations

(1) Changes in composition by type of asset

If we look at the assets of life insurance companies, we see that their management changes with the times. During periods of advanced economic growth, loans receivable accounted for a significant proportion of assets, while securities accounted for a proportion of assets that was not especially high. These days, however, the situation with respect to assets is the complete opposite.

Figure 4-3 outlines percentage changes in composition by type of asset for all surveyed life insurance companies since fiscal year 2000. In looking at this figure, we see that securities accounted for an overwhelmingly large percentage of assets throughout the years in question. On the other hand, the percentage of assets accounted for by loans receivable continued to decline and presently sits at just above 10%.

In addition, stocks accounted for a significantly different percentage of assets this fiscal year than they did in the past. Stocks used to be an attractive investment target, which explains why there was a time when stocks accounted for nearly 30% of a company's total assets. As with loans receivable, the percentage of total assets accounted for by stocks declined into single-digit territory.

Figure 4-3. Changes in composition by type of asset for all surveyed life insurance companies (%)

		FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Securities		57.6	60.2	61.4	65.3	68.8	71.9	73.7	72.6	71.6	75.3	76.3
	Government bonds	16.6	17.8	19.4	19.3	21.9	21.3	22.1	23.2	26.4	27.8	30.5
	Local government bonds	3.9	3.9	4.1	3.4	3.1	2.7	2.5	2.5	2.6	2.7	2.5
	Corporate bonds	9.3	9.7	10.7	10.2	9.5	8.7	8.7	9.1	9.4	9.0	8.6
	Stocks	15.4	13.4	9.6	11.6	11.5	14.7	14.7	11.2	7.6	8.6	7.2
	Foreign securities	11.4	14.3	16.1	18.3	19.1	18.8	18.8	19.4	19.1	19.5	20.1
	Other securities	1.0	1.1	1.5	2.5	3.7	5.7	6.9	7.2	6.5	7.9	7.3
Loans receivable		26.1	25.5	24.7	22.6	20.0	17.5	15.9	16.0	16.0	14.1	13.1
Other assets		16.3	14.3	13.9	12.1	11.2	10.6	10.4	11.4	12.4	10.6	10.6

Note 1: “Other assets” includes cash and deposits, call loans, monetary trusts, and tangible fixed assets.
Note 2: Source: Overview of the Life Insurance Business, Life Insurance Association of Japan

Not much changed for local government bonds and corporate bonds. If anything, the percentages of total assets accounted for by local government bonds and corporate bonds appeared to have gone down, albeit by just a little. In a completely contrastive manner, government bonds continued to increase as a percentage of total assets. By this fiscal year, they came to account for the biggest slice of investment assets held by insurance companies.

Accordingly, we can see that securities accounted for a rising percentage of total assets largely on the back of this trend in government bonds. For life insurance companies at that time, government bonds were a major target of investment. It can be said that characteristics of held government bonds were directly reflected in the nature of investments.

(2) How to measure duration

The investment stance adopted by life insurance companies had shifted to actions by which large volumes of government bonds were retained to a greater extent than loans receivable and stocks. Furthermore, greater weight was being placed on holding longer-term government bonds with each passing fiscal year.

Examples of government bonds include government bonds with a maturity term of 10 years or less upon issuance, for which the face value is paid to the holder at maturity, and long-term government bonds with a maturity term greater than 10 years. In other words, these consist of government bonds with a maturity

term of 20, 30, or 40 years. Life insurance companies were increasing the weight they were placing on such ultra-long-term government bonds.

Given that the percentage of held total assets accounted for by government bonds was rising and that these government bonds increasingly had ultra-long terms of maturity, it was expected that asset-side durations for life insurance companies would rise on their own.

In this connection, I attempted to measure the durations of government bonds held by life insurance companies. At the same time, I also tried to measure the durations of corporate bonds, local government bonds, and loans receivable.

With reference made to Journal of Life Insurance Management (2009), written by Katsunori Shinko, for the method of calculation to be applied, I focused on balances by remaining period as reported in an annual report, which is published by each life insurance company each fiscal year, and determined durations through the use of these figures.

Specifically speaking, I proceeded as follows. First, I specified the number of years in advance according to the extent of the remaining period.

For example, 0.5 years was specified for assets whose remaining period is 1 year or less, 2 years was specified for assets whose remaining period is more than 1 year and up to 3 years, 8.5 years was specified for assets whose remaining period is more than 8 years and up to 10 years, and 15 years was specified for assets whose remaining period is more than 10 years.

Next, I assigned weights to these figures based on the percentages of held assets accounted for by the corresponding assets and arrived at estimates of duration.

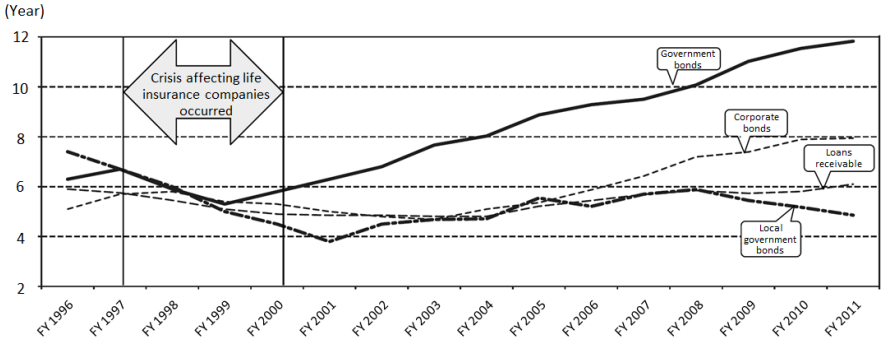
(3) Prolongation strategy being pursued

I obtained estimated durations for each type of negotiable assets held for 4 major companies (Nippon Life Insurance, Meiji Yasuda Life Insurance, Dai-ichi Life Insurance, and Sumitomo Life Insurance) based on this approach and plotted the results in Figure 4-4.

In looking at this figure, we can see that the durations of local government bonds had recently been declining, while those of government bonds, corporate bonds, and loans receivable had more or less been steadily rising.

Above all, the durations of government bonds, which accounted for the biggest proportion of total assets, were remarkably higher than those of other assets.

Figure 4-4. Changes in duration by type of assets held by 4 major life insurance companies (years)



Notable here is the fact that the duration of each type of asset between fiscal year 1997, when the crisis affecting life insurance companies first struck, and fiscal year 2000, which I have identified as the turning point, was trending upwards. This was particularly true for government bonds. The durations of government bonds definitely rose since the time life insurance companies first came to be mired in a crisis situation.

This shows that insurance companies, stung by difficult bankruptcies caused by the issue of negative spreads, had been implementing an ALM strategy designed to narrow the duration gap.

Part 5: Other ALM strategies

In this way, asset-side durations had been steadily rising as major life insurance companies responded to the crisis that affected life insurance companies. By proactively purchasing ultra-long-term government bonds, they had been closing the duration gap.

Thus, the reduction in net assets brought about by declining interest rates was smaller than it was in the past. Obviously, this should mean that fewer companies would go under in a manner attributable to negative spreads as we had seen happen in the past.

While we have to date focused only on asset-side durations in carrying out an ALM strategy, other options include a strategy by which liability-side durations are shortened and a strategy by which the capital-to-asset ratio is

increased.

It is thought that modern life insurance companies moderate fluctuations in net assets by skillfully combining these three types of strategies. Therefore, it cannot be asserted that only asset-side durations are keeping net asset fluctuations in check, as long as recent developments pertaining to liability-side durations and the capital-to-asset ratio are not pursued.

These developments will need to be subjected to precise analysis as a future research topic to be explored.

Chapter 5: <2013 (ii)>
Changing breakdown of the life insurance industry by type of operation

Part 1: The life insurance industry in transition

(1) The age of kanji-named life insurance companies

When we trace the history of the life insurance industry in Japan, we see that changes occurred in the latter half of the 1990s, corresponding to the point in time when the old order gave way to a new one.

Throughout the long post-war period, traditional kanji-named life insurance companies, which were emblematic of the industry, collectively accounted for an overwhelmingly large slice of the market. Broken down by size, seven of these companies were major life insurance companies, ten were mid-sized life insurance companies, and three were small life insurance companies.

Namely, the seven major life insurance companies consisted of Nippon, Dai-ichi, Sumitomo, Meiji, Asahi, Mitsui, and Yasuda. The ten mid-sized life insurance companies consisted of Taiyo, Chiyoda, Toho, Kyoei, Daihyaku, Fukoku, Daido, Nihon Dantai, Tokyo, and Nissan. The three small life insurance companies consisted of Heiwa, Yamato, and Taisho.

Of course, foreign-affiliated life insurance companies had already entered the Japanese market, but they were not regarded yet as real competitors given their low market share. For this reason, these twenty kanji-named life insurance companies primarily functioned as industry leaders. The large life insurance companies in particular enjoyed a huge presence. Some were famous for steadily increasing the number of insurance policies under their belts while being tied to affiliated groups that were distinctively Japanese and that were capable of wielding influence over the Japanese economy.

Since competition among life insurance companies had been suppressed as much as possible in accordance with the convoy system of regulations as enacted back then by the Ministry of Finance, fluctuations in company rankings were eliminated alongside the removal of price competition.

Indeed, an era focused on maintaining industrial order lasted for many years. The establishment of a rock-solid insurance system meant that the Japanese life insurance industry could be expected to steadily grow. This intended effect was impressively attained.

(2) Developments subsequent to the collapse of the bubble economy

This industrial order came to be slightly disturbed during the era of the bubble economy that arose in the latter half of the 1980s. As stock and land prices rose rapidly, single-payment endowment insurance plans and bank-sponsored individual annuity plans, which represented typical savings-type insurance products, sold like crazy.

This is because their appeal as financial products was enhanced when high assumed interest rates were set. Mid-sized life insurance companies in particular were aggressively engaged in selling these products as they sought to improve their relative rankings in the industry.

Consequently, the industrial order that had been reliably kept in place to date had been disturbed, such that we saw the rankings of mid-sized life insurance companies change vis-à-vis one another. Such changes, however, were slight. No such changes affected large life insurance companies.

Full-scale developments amounting to a reorganization of the life insurance industry first began to be observed upon the collapse of the bubble economy. Large negative spreads generated by life insurance products with high assumed interest rates became onerous. In no time at all, management crises manifested themselves, largely at mid-sized life insurance companies.

The crisis affecting life insurance companies came to a head. Starting with the bankruptcy of Nissan Life Insurance in April 1997, one life insurance company after another faded away into obscurity. A critical situation descended on the industry as seven life insurance companies would become bankrupt in a span of just four years. In October 2008, even Yamato Life Insurance met its end.

Amid this sequence of bankruptcies involving life insurance companies, foreign-affiliated life insurance companies arrived on the scene to purchase these failed firms in succession. With this, power relationships among life insurance companies came to be forged in ways that could never have previously been imagined.

(3) Breakthroughs made by foreign-affiliated life insurance companies and the life insurance affiliates of nonlife insurers

The structural construct by which kanji-named life insurance companies enjoyed an overwhelmingly dominant presence gradually weakened. Entering the market to fill the void caused by this weakening, foreign-affiliated life

insurance companies absorbed mid-sized life insurance companies to expand rapidly.

Figure 5-1 presents the rankings of life insurance companies in terms of premiums and other earnings for fiscal years 1997 and 2012, as determined by looking at all life insurance companies belonging to the Life Insurance Association of Japan.

This figure shows the changes that affected the life insurance industry since the fiscal year in which the first bankruptcy occurred. In fiscal year 1997, the top 13 companies were all kanji-named life insurance companies. Below them, we see the first-ever appearance of a foreign-affiliated life insurance company in such a list.

In contrast, if we look at the section corresponding to fiscal year 2012, we see changes in that multiple foreign-affiliated life insurance companies were now interspersed among kanji-named life insurance companies. While four large kanji-named life insurance companies were ranked at the top of the list, a number of foreign-affiliated life insurance companies ranked right behind them. Kanji-named life insurance companies other than the four large kanji-named life insurance companies ranked behind the aforementioned cluster of foreign-affiliated life insurance companies.

Moreover, life insurance companies that can be grouped together with foreign-affiliated life insurance companies as katakana-named life insurance companies, like Sony and Orix, were also making steady gains on kanji-named life insurance companies.

In looking at these industrial rankings in this way, we see that the momentum enjoyed by kanji-named life insurance companies, whose profile used to be overwhelmingly dominant, was weakening. Above all, the profile of foreign-affiliated life insurance companies that grew in the wake of the crisis affecting life insurance companies was quite substantial.

At the same time, the life insurance affiliates of nonlife insurers belonging to the MS & AD, Tokyo Marine Nichido, and NKSJ groups could no longer be ignored. As parent companies consisting of nonlife insurance companies had coalesced into three groups, subsidiaries consisting of life insurance companies concurrently merged in line with these developments to rapidly expand in terms of scale.

Figure 5-1. Rankings of life insurance companies in terms of premiums and other earnings -comparing fiscal year 1997 with fiscal year 2012-

Order	Category	Life insurance company	FY 1997
1	Kanji	Nippon	6,275,565
2	Kanji	Dai-ichi	4,012,537
3	Kanji	Sumitomo	3,419,029
4	Kanji	Meiji	2,747,219
5	Kanji	Mitsui	1,767,449
6	Kanji	Asahi	1,712,324
7	Kanji	Yasuda	1,703,512
8	Kanji	Taiyo	1,328,894
9	Kanji	Daido	1,168,436
10	Kanji	Fukoku	797,644
11	Kanji	Chiyoda	780,292
12	Kanji	Kyoei	747,536
13	Kanji	Nihon Dantai	662,471
14	Katakana	American Family	591,809
15	Kanji	Toho	521,133
16	Kanji	Daihyaku	447,006
17	Katakana	Sony	277,706
18	Katakana	Alico Japan	256,735
19	Kanji	Tokyo	210,472
20	Katakana	Orix	118,855
21	Katakana	Prudential	117,617
22	Katakana	ING	96,398
23	Katakana	INA Himawari	91,168
24	Kanji	Heiwa	78,563
25	Nonlife	Tokio Marine Anshin	75,466
26	Katakana	Saison	73,907
27	Kanji	Yamato	58,423
28	Kanji	Taisho	47,731
29	Nonlife	Mitsui Marine Mirai	26,214
30	Nonlife	Sumitomo Marine Yu-Yu	26,210
31	Katakana	Orico	26,047
32	Katakana	Nicos	25,772
33	Nonlife	Nichido	13,408
34	Nonlife	Dowa	9,321
35	Nonlife	Dai-Tokyo Shiawase	9,197
36	Nonlife	Fuji	8,360
37	Nonlife	Chiyoda Kasai Ebisu	7,737
38	Nonlife	Nippon Fire Partner	7,315
39	Nonlife	Koa Fire Magokoro	6,956
40	Katakana	Axa	6,784
41	Nonlife	Kyoei Kasai Shinrai	6,354
42	Katakana	Zurich	855
43	Katakana	Scandia	812

Order	Category	Life insurance company	FY 2012
1	Other	Japan Post	6,481,772
2	Kanji	Nippon	5,342,857
3	Kanji	Meiji Yasuda	3,659,351
4	Kanji	Dai-ichi	3,472,882
5	Kanji	Sumitomo	3,184,252
6	Katakana	Prudential	2,533,792
7	Katakana	American Family	1,995,885
8	Kanji	T&D	1,939,640
9	Katakana	Met Life Alico	1,497,002
10	Katakana	Sony	925,874
11	Nonlife	MS & AD	878,869
12	Kanji	Fukoku	862,224
13	Katakana	Axa	672,566
14	Kanji	Mitsui	578,201
15	Nonlife	Tokyo Marine Nichido	576,232
16	Katakana	Manulife	532,968
17	Kanji	Asahi	460,383
18	Nonlife	NKSJ	374,523
19	Katakana	ING	301,264
20	Katakana	Mass Mutual	259,530
21	Katakana	Orix	131,445
22	Katakana	Hartford	125,585
23	Katakana	AIG Fuji	80,987
24	Katakana	Sony Life Aegon	51,182
25	Katakana	Cardiff	34,569
26	Other	Rakuten	26,638
27	Katakana	PCA	13,312
28	Katakana	Zurich	10,030
29	Katakana	Credit Agricole	7,062
30	Other	Life Net	5,915
31	Other	Midori	5,003
32	Katakana	Allianz	152

In this connection, allow me to explore the life insurance affiliates of nonlife insurers below.

Part 2: Attributes of the life insurance affiliates of nonlife insurers

(1) Three mega-nonlife insurers and their life insurance subsidiaries

Eleven life insurance affiliates of nonlife insurers began operations in October 1996. This was made possible by the promulgation of the New Insurance Business Act in June of the preceding year, which made it henceforth possible for life and nonlife insurers to enter into each other's area of business by way of the establishment of subsidiaries for this purpose.

Insurance administration as based on the convoy system of regulations, which had long been maintained in Japan during the postwar era, transformed in line with the maturation of the country's economy through necessity. It finally came to be that it would have to become liberalized and deregulated.

This course of events came to be promoted by the New Insurance Business Act, which represented a comprehensive set of revisions to the statute it replaced as a way to overhaul a system that had been in place for more than half a century. At the time, insurance talks between Japanese and American officials were also intricately intertwined. The Big Bang deregulation of Japan's financial markets as put forth by Prime Minister Ryutaro Hashimoto also served to jumpstart the insurance market in a major way.

Progress made in terms of liberalization and deregulation was especially rapid in the nonlife insurance sector. As specific measures, the obligation to utilize rates as determined by the relevant rating organization was repealed and risk sub-divided automotive insurance policies came to be allowed.

Restrictions on cancer and healthcare insurance plans that had been imposed on the life insurance subsidiaries of nonlife insurers as a measure to mitigate the dramatic impact of complicated reforms discussed by and between Japanese and American officials were also lifted.

Nonlife insurers managed to nimbly respond to such changes in the management environment in which the insurance industry was operating by repeatedly undergoing consolidations and mergers. This resulted in the emergence of three mega-nonlife insurers: MS & AD, Tokyo Marine HD, and NKSJ. These three major nonlife insurance groups grabbed hefty slices of the market for themselves through net premiums.

Amid these developments, subordinated life insurance subsidiaries, too,

underwent consolidations and mergers to march in step with what their parent companies were doing. The life insurance subsidiaries of the three mega-nonlife insurers also expanded in scale as did their parent companies.

Even in looking at rankings of all life insurance companies in terms of insurance premiums and other earnings, you will see that the life insurance affiliates of nonlife insurers improved over where they were when they were founded in a manner beyond comparison.

(2) Sales channels through agencies

The life insurance affiliates of nonlife insurers did in fact expand in terms of management scale in accordance with the rapid reorganization of their parent companies. Accordingly, this development might be similar to that of foreign-affiliated life insurance companies from the standpoint of consolidations and mergers.

However, we need to focus on the sales channels used by the life insurance affiliates of nonlife insurers. Generally speaking, life insurance products are frequently sold primarily by female sales staff members. In contrast, the life insurance affiliates of nonlife insurers typically harness the agency network in place for the primary nonlife insurance operations of their parent companies.

With sales channels maintained through agencies, nonlife insurance products as well as life insurance products are handled while the nonlife insurer's client base is utilized. Indeed, this is a state of actions carried out on an integrated basis by life insurance companies and nonlife insurers. These independent sales channels help to increase the amount of new policies.

In the life insurance industry, questions about the efficiency of sales channels have been posed for a long time. This is because there are ongoing concerns over high turnover, a problem manifested in the high rates of hiring and resignation of female sales staff members.

It appears that the life insurance affiliates of nonlife insurers that utilize agency networks have overcome this problem. Agencies typically use the process of selling nonlife insurance products as a springboard to selling life insurance products. This is because the selling of nonlife insurance products would be negatively affected if salespersons quit with regularity.

To prevent this from happening, the fostering of long-term relationships with clients is an essential requirement. The fulfillment of this requirement forges ties of trust between the company and the client and leads to an increase in sales.

The breakthrough achieved by the life insurance affiliates of nonlife insurers is believed to be attributable to not just the expansion of scale through consolidations and mergers but also to the appeal of sales channels of this type.

(3) Attributes of products offered by nonlife insurers

The difficulty of selling insurance products has long been recognized by many in the industry. This is because insurance products, in contrast to general goods, are intangible. The selling of life insurance products in particular is hard.

In the case of a nonlife insurance product providing coverage to protect an automobile or a house, anyone can recognize what the potential risks are to a certain degree. However, the same cannot be said for life insurance products, which means that the various risks pertaining to one's life must be carefully laid out when selling such products.

Selling through sales staff members can be described as an approach designed to overcome this problem. To have a client recognize such risks himself or herself, however, requires the expending of much time and cost.

Thus, a sales staff person tends very highly to become completely absorbed in sales to an excessive degree. This often gives rise to worst-case outcomes by causing clients to develop an aversion to and desire to stand clear of such products.

On the other hand, the life insurance affiliates of nonlife insurers do not engage in such an extreme approach to sales, since they are steeped in the attributes of nonlife insurers. This is because clients who recognize risks and understand the need for nonlife insurance products often visit agencies on their own.

This pattern is also reflected in the selling of life insurance products, such that the sort of relentless approach to sales seen in sales staff persons is kept in check. Evidence suggests that, if anything, the approach taken by the life insurance affiliates of nonlife insurers gives rise to a favorable impression on the part of clients.

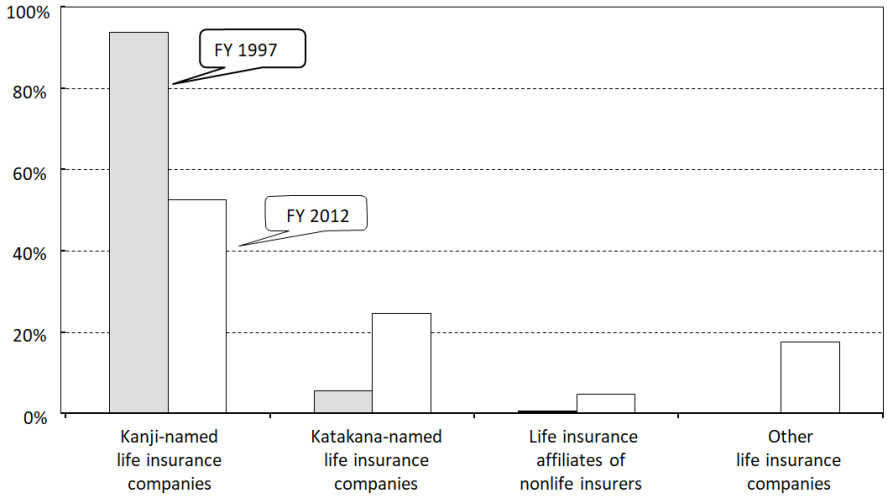
Part 3: From price competition to the reorganization of life insurance companies

As explained earlier, the Japanese life insurance industry was such that kanji-named life insurance companies enjoyed dominant clout within the context of the convoy system. Power relationships, however, began to change in the second

half of the 1990s, as foreign-affiliated life insurance companies and the life insurance affiliates of nonlife insurers started to exert their presence in the market.

In order to specifically verify this change, Figure 5-2 presents changes in market share in terms of insurance premiums and other earnings by type of life insurance operation in accordance with the same data for fiscal years 1997 and 2012 as used earlier. All surveyed life insurance companies have been divided into four categories: kanji-named life insurance companies, katakana-named life insurance companies, the life insurance affiliates of nonlife insurers, and other life insurance companies.

Figure 5-2. Market share in terms of insurance premiums and other earnings by type of life insurance operation
-comparing fiscal year 1997 with fiscal year 2012-



In taking a look at this figure, we see that while kanji-named life insurance companies had accounted for more than 90% of the market in the past, this share was lowered to fifty-something percent by 2012. On the other hand, katakana-named life insurance companies, which consisted of foreign-affiliated life insurance companies and others, gained in market share from five-odd percent to 25% over the same time period.

In addition, we see that the life insurance affiliates of nonlife insurers, who

had not even gained 1% of the market, managed to lay claim to nearly 5% of the market. Other life insurance companies, too, grew to corner almost 20% of the market thanks to the privatization of Japan Post Insurance.

Seen in this light, the overwhelming dominance previously enjoyed by kanji-named life insurance companies appeared to be weakening. Extrapolating from what we are seeing here, it was conceivable that foreign-affiliated life insurance companies and others could have continued to siphon off market share from kanji-named life insurance companies.

Representative of kanji-named life insurance companies, big (major) life insurance companies shifted their offensive focus in recent years to efforts to reduce the prices of their flagship offerings, perhaps due in part to rising concerns over the criticality of the situation they faced. It was expected that the move to lower insurance premiums would be co-opted by other life insurance companies, thereby giving rise to all-out price competition within the industry.

If this did in fact become reality, it would no doubt have eventually caused the life insurance industry to undergo further reorganization, at which time the breakdown of market share by type of life insurance operation might have ended up looking very different from how it came to be constituted at that time.

Chapter 6: <2014>
Unprecedented easing measures of the Bank of Japan and asset-management actions undertaken by life insurance companies

Part 1: Announcing financial results for the fiscal year that ended in March 2014

(1) Financial results corresponding to lower revenues and higher profits

The financial results for major life insurance companies for the fiscal year that ended in March 2014 were announced. Insurance premiums and other earnings, which had been rising in recent years, declined for the first time in half a decade.

This is because sales of whole life insurance plans, individual annuity insurance plans, and other savings-type insurance products, which had been growing under a state of deflation in the economy, floundered. A reduction in assumed interest rates carried out in April 2013 caused the appeal of such plans as savings-type products to wane and the flow of funds to be diverted to investment trusts and other types of financial instruments.

Figure 6-1 outlines key data on financial results and reveals that insurance premiums and other earnings declined for many life insurance companies. While the slump in savings-type products had a substantial impact on this result, sales of medical insurance and other examples of insurance coming under the category of third-sector insurance grew, albeit not by enough to support overall growth.

A positive takeaway from these financial results this year is the fact that basic profits, an indicator of the profitability of the primary operations of these companies, appeared to be trending upwards. This was attributable to the increase in the number of life insurance companies that had managed to overcome the problem of negative spreads and transition to positive spreads.

Thanks to considerable improvements in the investment environment made possible by rising stock prices and a cheaper yen, investment yields finally came to exceed assumed interest rates corresponding to yields promised to policyholders.

In terms of aggregate numbers for key life insurance companies, this was the first time that negative spreads had been eliminated since investment results were announced for the fiscal year that ended in March 2001. Consequently,

some life insurance companies started to increase dividends to policyholders.

Figure 6-1. Financial results for major life insurance companies for the fiscal year that ended in March 2014

		Insurance premiums and other earnings		Basic profit		Positive or negative spread	
			Rate of increase or decrease		Rate of increase or decrease		Previous fiscal year
Domestic	Nippon	48,255	▲9.7	5,924	8.4	1,147	317
	Dai-ichi	43,532	19.4	4,284	23.2	323	▲584
	Meiji Yasuda	36,162	▲1.2	4,604	16.7	1,193	425
	Sumitomo	25,228	▲20.8	3,939	▲6.4	▲157	▲507
	T&D	16,097	▲17.1	2,102	15.2	333	18
	Sony	9,609	3.8	723	▲9.6	84	21
	Fukoku	7,070	▲18.0	901	10.0	140	22
	Mitsui	5,449	▲5.8	516	▲2.5	▲486	▲530
	Asahi	4,114	▲10.6	269	2.7	▲711	▲803
Foreign-affiliated	Prudential	20,307	▲19.0	1,261	▲15.4	Positive spread	▲93
	Aflac	16,757	▲16.0	3,252	100.4	257	126
	MetLife Alico	16,547	10.5	10	▲97.6	Positive spread	317
	Axa	5,519	▲17.7	857	29.7	380	▲584

Notes: Unit: hundred million yen. Rate of increase or decrease is the percentage change over the preceding fiscal year (%); ▲ denotes a negative value.

(2) Investment stance of life insurance companies

In this way, the financial results for this fiscal year show that, even as insurance premiums and other earnings – which are, taken as a whole, equivalent to sales – flounder, basic profit was rising thanks to the elimination of negative spreads.

Ironically, this was because the appeal of investment trusts and other competing financial instruments was bolstered further even as life insurance companies themselves attained better investment results as made possible by a significantly improved investment environment.

Conventional life insurance products emphasizing the provision of death protection were stagnating against the backdrop of a declining birthrate and aging society. If we look at the total amount of individual insurance policies in force as a management indicator reflecting this reality, we can see a downward trend emerging over an extended period of time.

As expected, as long as sales of savings-type products did not grow, insurance premiums and other earnings were unlikely to expand. For this reason, their appeal in an investment sense must be enhanced to a greater extent than

other financial instruments.

For an insurance company, efficient asset management is a condition not just for overcoming the problem of negative spreads but also for growth.

Thus, if we regard the mission of life insurance companies in terms of the proper enforcement of insurance policies over many years, there is a sense that these companies cannot simply engage in proactive asset management activities.

In this context, recent unprecedented easing measures enacted by the Bank of Japan had the potential of affecting the management of assets by life insurance companies. It seems that the central bank hoped that there would be a shift in the way life insurance companies engage in investment activities.

In this connection, allow me to explore the investment stance taken by life insurance companies in light of policy changes that were being implemented by the Bank of Japan.

Part 2: Unprecedented easing measures enacted by the Bank of Japan

(1) Portfolio-rebalancing effect

In April 2013, the Bank of Japan hammered out a set of bold easing measures that was both quantitatively and qualitatively unprecedented under the direction of Haruhiko Kuroda, who was the new governor of the Bank of Japan at the time. These measures fostered great expectations that extrication from a deflationary economy as promoted through Abenomics might be achieved.

One policy issue of importance for Japan concerned our ability to overcome deflation and shift to an economy characterized by sustainable growth. The Bank of Japan's new unprecedented qualitative and quantitative easing measures were helping to realize its policy goals.

To enable the Japanese economy to dramatically grow, funds needed to be proactively shifted from savings to investments. In hopes of accelerating this shift, the Bank of Japan wished to see a portfolio-rebalancing effect applied to financial institutions and institutional investors.

Specifically, financial easing measures had been implemented by purchasing large amounts of government bonds from private banks. Private banks shifted investment funds freed up by lowering their holdings of government bonds to loans receivable and other risky assets. Consequently, funds flowed from savings to investments.

In contrast, money in the possession of life insurance companies was

expected to be invested in foreign bonds. This was because long-term interest rates would rapidly decline due to the Bank of Japan's easing measures, which would in turn make it impossible to secure sufficient investment earnings by holding onto government bonds.

If life insurance companies sold large amounts of government bonds to the Bank of Japan and diverted the large amounts of funds freed up as a result of this process into investments in foreign bonds, foreign currency markets would be affected.

This would facilitate a shift from yen appreciation to yen depreciation to allow an economic environment that is favorable to iconic Japanese export industries to be cultivated.

The inducements to invest in foreign bonds as provided by the Bank of Japan not only enabled life insurance companies to attain higher yields but also gave the Japanese economy a chance to extricate itself from a state of deflation.

Accordingly, it was hoped that the unprecedented easing measures as enacted by the Bank of Japan would encourage not just private banks engaged in lending activities but also life insurance companies acting as institutional investors to shift from safe asset investment options primarily consisting of government bonds to riskier asset investment options.

(2) Characteristics of money in the possession of life insurance companies

In the past, there was once a period of time in which Japanese life insurance companies were referred to overseas as the seiho (life insurance companies). This was during the bubble economy of the second half of the 1980s. This term emerged as these companies garnered much attention in global financial capital markets due to their penchant for aggressively purchasing foreign bonds.

Although higher yields were sought, currency exchange risks unfortunately surfaced and large losses were ultimately incurred. In light of the bitter experiences of the past, life insurance companies would likely be forced to be wary of policy shifts of the sort we saw then on the part of the Bank of Japan.

In this connection, let us examine asset management actions carried out by life insurance companies based on relevant data by focusing on what happened before and after the unprecedented easing measures were implemented by the Bank of Japan.

Figure 6-2 summarizes the balance of government bonds and foreign securities held by all life insurance companies between the end of June 2012 and

the end of December 2013, as determined based on materials issued by the Life Insurance Association of Japan.

Figure 6-2. Changes in investment assets for all surveyed life insurance companies

(1) Before the implementation of unprecedented easing measures by the Bank of Japan

	End of June 2012	End of September 2012	End of December 2012	End of March 2013
Government bonds	142,541,181 (106.0)	145,071,062 (105.5)	146,198,005 (104.9)	148,769,242 (105.3)
Foreign securities	47,209,552 (102.7)	48,412,448 (110.4)	53,441,259 (121.2)	55,986,474 (119.2)

(2) After the implementation of unprecedented easing measures by the Bank of Japan

	End of June 2013	End of September 2013	End of December 2013
Government bonds	149,196,720 (104.7)	149,519,895 (103.1)	149,934,854 (102.6)
Foreign securities	56,808,156 (120.3)	57,191,344 (118.1)	61,347,810 (114.8)

Note 1: The upper figure in each square is the amount (million yen); the lower figure is the year-on-year change expressed as a percentage.
Note 2: Source: Life Insurance Association of Japan

Taking April 2013, the month in which the Bank of Japan's unprecedented easing measures were announced, as the boundary between before and after, I compared changes in holdings of government bonds and foreign securities before and after this point in time.

First, the balance of government bonds held by life insurance companies was hardly affected by the Bank of Japan's announcement, as it is shown to have grown at more or less a fixed rate. If the portfolio-rebalancing effect had been functioning as intended, then we should have expected to see this balance continuously decrease through the selling off of government bonds.

Since the balance of government bonds nevertheless continued to increase, it means that a result that had not been intended by the Bank of Japan occurred.

In contrast, it may be possible to construe the changes in foreign securities as having occurred in accordance with the Bank of Japan's expectations. This is because the balance of foreign securities held by life insurance companies increased after the Bank of Japan's announcement.

However, life insurance companies had been proactively purchasing foreign securities since before the central bank's announcement was made. It is not necessarily true that these companies increased their holdings of foreign securities by taking advantage of the Bank of Japan's policy shift.

It had been reported that private-sector banks moved to lend funds freed up

when the Bank of Japan started its large-scale purchasing of government bonds. Indeed, it can be said that this situation was unfolding as scripted by the Bank of Japan.

Yet, there was no real sense that there had been sufficiently significant changes affecting the management of assets by life insurance companies.

While holdings of foreign securities were definitely on the rise, asset management practices by life insurance companies remained very much focused on purchasing reliably safe government bonds.

Indeed, the increase in the stock of these companies' portfolios accounted for by ultra-long-term government bonds was causing the average full-term duration to rise.

At the end of the day, the tendency on the part of life insurance companies to seek to avoid risks by holding large amounts of government bonds despite whatever drastic changes in policy were implemented by the government or the Bank of Japan was strong. This was believed to be an inherent characteristic of money in the possession of life insurance companies.

Since the core of a life insurance company's operations involves the provision of protection, risk avoidance is a natural action to be taken by such an enterprise. This is because funds must be properly managed to ensure that there is no delay in the payment of insurance money in the future.

For this purpose, a company will consider asset management to avoid risks as much as possible. Moreover, since coverage must be reliably provided over the long term, asset-side durations must correspond to liability-side durations.

At the same time, it is also a fact that many policyholders wish to see their insurance providers engage in the proactive management of assets in hopes of receiving high amounts of dividend. In this connection, I will seek to ascertain whether a risk-avoidance investment stance is a trend that can only be seen among Japanese life insurance companies.

If a careful investment stance as typified by large holdings of government bonds is a fundamental trait associated with life insurance companies, then the portfolio-rebalancing effect that was anticipated by the Bank of Japan can be construed to have been an impossible notion from the beginning insofar as life insurance companies are concerned.

To clarify this matter, I would like to explore the nature of asset management with reference made to the life insurance industry in the United States, the biggest market for insurance in the world.

Part 3: Current state of life insurance companies in the United States

(1) Key data by organization type

Allow me to provide an overview of the industry while referring to Figure 6-3, which outlines the current state of life insurance companies in the United States as based on data provided by the 2013 ACLI (American Council of Life Insurers) Life Insurers Fact Book.

First, it should be noted that there were 868 life insurance companies in the United States, a number which was far greater than the 43 life insurance companies operating in Japan. While there were around 2,300 life insurance companies that were active in the United States in the second half of the 1980s, this number had been continuously declining since that time. This is because companies repeatedly undergo restructuring due to tough regulations that have been put in place in response to the bankruptcies of life insurance companies.

Figure 6-3. Key data by type of organizational structure with respect to life insurance companies in the United States (2012)

Organizational structure	Stock companies	Mutual companies	Cooperatives	Total
(1) Number of companies	660	120	88	868
(2) Financial data				
Amount of insurance policies in force	13,742,216	5,094,851	483,849	19,320,916
Amount of new business	2,039,778	764,144	53,023	2,856,945
Total assets	4,412,993	1,217,035	147,392	5,777,420
Payments	422,724	101,781	9,665	534,170
Insurance premiums and other earnings	514,542	128,832	12,414	655,788

Note 1: Unit used for financial data: million dollars

Note 2: ACLI (American Council of Life Insurers) Life Insurers Fact Book (2013); same for Figures 6-4 and 6-5.

In breaking down the data by organizational structure, we see that life insurance companies constituting stock companies accounted for quite a bigger percentage of the industry than life insurance companies constituting mutual companies did, not just in terms of company numbers but also in terms of the amount of insurance policies in force and other pieces of financial data.

Figure 6-4 outlines the state of asset management by life insurance companies in the United States. In this figure, a division is made between general accounts corresponding to life insurance products promising coverage amounts or benefit amounts and separate investment accounts for which life insurance products that fluctuate in terms of the balance sheet depending on investment

results are handled.

Figure 6-4. Asset management by account as engaged in by life insurance companies in the United States (2012)

	General accounts		Separate investment accounts		Total	
		Percentage		Percentage		Percentage
Bonds	2,636,436	71.1	299,269	14.5	2,935,705	50.8
Stocks	82,391	2.2	1,642,868	79.4	1,725,259	29.9
Mortgages	345,602	9.3	8,452	0.4	354,053	6.1
Real estate	21,725	0.6	8,834	0.4	30,559	0.5
Policyholder loans	130,348	3.5	367	0.0	130,715	2.3
Others	491,137	13.3	109,992	5.3	601,129	10.4
Total	3,707,639	100.0	2,069,782	100.0	5,777,420	100.0

Note: Units: million dollars and %.

With general accounts, investments are primarily made in bonds, since stable interest earnings must be secured over the long term. In contrast, stocks are the main focus of investments with separate investment accounts, since the goal is to obtain higher earnings while assuming risks.

Since life insurance companies constituting stock companies accounted for quite a bigger percentage of the industry than life insurance companies constituting mutual companies did, not just in terms of company numbers but also in terms of total assets, there may be some who feel a bit perplexed to see an investment system focusing on bonds dominating the mainstay general accounts column.

This is due to the fact that since a stock company engages in actions for the primary goal of maximizing profits for shareholders, it would normally be assumed that such a company would carry out high-risk investments not just with separate investment accounts but also with general accounts.

However, actions are actually carried out with a focus on bonds in accordance with an investment approach that emphasizes safety. We should then determine the duration corresponding to the average full term of held bonds.

(2) Holding bonds as a means of managing risks

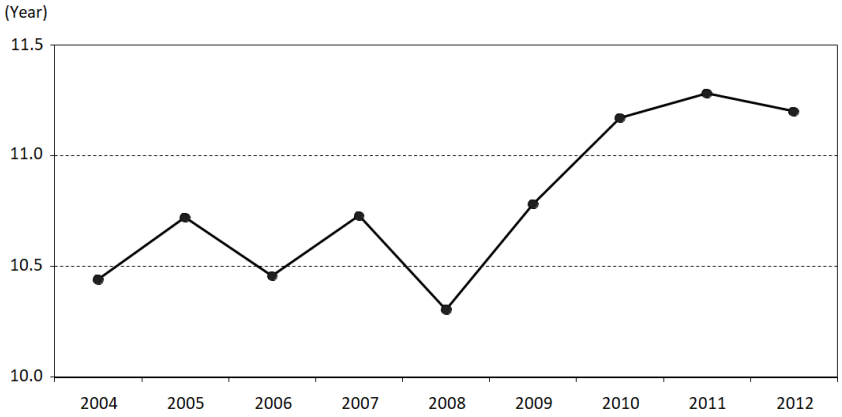
For a life insurance company, the duration of held assets must be long term to match that of liabilities. This will enable the company to be sufficiently capable of making future payments.

This role is notably filled by bonds, which account for a significant percentage of held assets. In this connection, let me examine the durations of

bonds held by American life insurance companies.

For Figure 6-5, the estimated values of durations were computed based on held bonds for the period between 2004 and 2012. Changes in these values are depicted in this figure.

Figure 6-5. Changes in the durations of bonds held by life insurance companies in the United States (general accounts)



In looking at this figure, we see that bond durations had been rising since 2008. From this, we can conclude that the number of remaining years for bonds held by American life insurance companies was rising.

This is because asset liability management (ALM), by which asset-side durations are matched with liability-side durations, was being undertaken. It is clear that a system for absorbing unforeseen interest rate fluctuation risks was being steadily put into place.

What we should focus our attention on, however, are the contents of held bonds. If we look at bond types under general accounts in 2012 in terms of percentage of total assets, we see that U.S. government bonds, foreign government bonds, corporate bonds, and securitized instruments accounted for 8.5%, 2.1%, 47.5%, and 13.1% of total assets, respectively.

Bonds held by Japanese life insurance companies typically consist of government bonds. In contrast, government bonds do not account for as big a percentage of held bonds in the United States. There, bonds consist primarily of investment-grade corporate bonds. This indicates that companies might be

attempting to secure stable sources of interest earnings but are nevertheless seeking higher earnings that can be obtained from government bonds.

In any case, this does not change the fact that companies were extending durations with a focus on highly safe corporate bonds while emphasizing a stance of commitment to asset liability management.

Part 4: The form of life insurance companies in the future

(1) Asset management oriented towards the avoidance of risks

As can be seen from examining approaches to asset management in the life insurance industry in Japan and the United States, companies are inclined to avoid risks in both countries.

While Japanese life insurance companies place a greater weight on government bonds and American life insurance companies place a greater weight on corporate bonds, there is no difference in the sense that the approach to investment is one that emphasizes safety. Indeed, investment durations are getting longer in both countries.

While I have thus far pointed out similarities with Japanese life insurance companies while examining American life insurance companies, the same things can be said of life insurance companies in Europe.

For example, a look at the composition of assets belonging to key life insurance companies in such countries as the United Kingdom, Germany, and France reveals that bonds are held with a focus on low-risk offerings while higher-risk assets account for quite a small percentage of total assets.

When all is said and done, long-term asset management for the avoidance of risks by Japanese life insurance companies is a common feature found in the life insurance industry of each of the world's leading industrialized nations. Underpinning this is the strong influence exerted by global solvency controls on insurance companies.

These controls encourage life insurance companies to compute the quantities of different risks for which insurance companies provide coverage based on proprietary formulas and secure sufficient capital to accommodate such risks.

If a company is to be in accordance with formulas for computing asset management risks incorporated into this process, then it must excessively increase capital if risky assets are added. To avoid this problem, the company will increase the weight it places on reliably safe bonds.

The ultimate objective of the quantitative easing measures put forth by Governor Kuroda of the Bank of Japan was to direct the flow of capital from savings to investments. Indeed, the success of Abenomics hinges on the approach taken by private-sector companies in making capital investments.

For this purpose, funds must be directed towards risky investment targets, such as loans and stocks, primarily by private-sector banks and institutional investors.

However, if you are familiar with the nature of money in the possession of life insurance companies, then you should be able to easily deduce that the approach taken by life insurance companies to the management of assets cannot be changed without difficulty regardless of any bold change in policy made by the Bank of Japan.

(2) Default risks associated with government bonds

Life insurance companies must reliably provide protection to clients, which goes to the core of their operations. Since the reinforcement of solvency controls has become a global trend in recent years, a conservative investment stance for the avoidance of risks on the part of these companies is unlikely to change anytime soon.

Nevertheless, funds will need to be diverted from savings to investments in order to enable the Japanese economy to fully extricate itself from its deflationary state and become converted into an economy based on sustainable growth. To this end, if life insurance companies could also examine matters from a longer-term point of view, then they should ideally engage in asset-management practices for which a certain degree of risks would be assumed.

Compared to the lowest point in the past when the problem of negative spreads had arisen, the financial strength of life insurance companies has increased substantially. Even so, it is clear that no rock-solid system facilitating the proactive assumption of risks is in place.

When you think about the future of life insurance companies, however, it is hoped that they will at some point shift towards seeking to secure high levels of investment earnings. It is conceivable that, by that time, life insurance companies will also be enjoying a big enough profile to spur on the diversion of funds from savings to investments.

At present, life insurance companies have huge holdings of ultra-long-term government bonds, which are regarded as reliably safe investment targets.

Against this backdrop, the national debt has continued to balloon. As of the end of September 2013, it had exceeded 1,000 trillion yen, which means that if the national debt were apportioned equally to everyone in the country, every man, woman, and child in the country could be said to owe approximately 7.94 million yen.

The direction in which the national debt is going is such that the situation can be likened to a runaway train. As the prospect of ever repaying the debt in whole continues to disappear, the time may yet come when people will feel insecure about the investment stance being taken by life insurance companies, whereby massive amounts of government bonds continue to be held.

While life insurance companies hold large amounts of government bonds out of a desire for safety, these bonds can be regarded as dangerous in light of the default risk associated with government bonds. If this perception were to take hold, then changes in investment policy would no doubt be in the process of being implemented.

Chapter 7: <2015>
Interpreting insurance solicitation rules as learned from reading textbooks on the economy

Part 1: Announcing financial results for the fiscal year that ended in March 2015

(1) Favorable financial results and investment earnings

The financial results for major life insurance companies for the fiscal year that ended in March 2015 were announced. Numerous life insurance companies posted positive results, setting new all-time records in terms of earnings.

Equivalent to sales, insurance premiums and other earnings had by and large increased over the previous fiscal year. In addition, basic profits, an indicator of the profitability of the primary operations of these companies, and bottom-line net profits were both trending upwards.

Improvements in investment earnings can be regarded as a significant factor behind these favorable financial results. This is because, with Abenomics helping to keep the yen down and elevate stock prices, yen-denominated interest income from foreign bonds and dividends from stocks held by life insurance companies increased.

Consequently, some life insurance companies managed to exceed conventional expectations by significant margins and increase positive spreads, while others were able to finally liberate themselves from the problem of negative spreads, whereby investment returns fell short of returns promised to policyholders.

Increasing profits were leading to higher dividends made to policyholders. In complete contrast to the time when these companies were stuck trying to address the problem of negative spreads, a greater willingness to return profits to policyholders had emerged.

It appears that this shift from negative spreads to positive spreads had been having a huge impact on the management of life insurance companies. It is clear that this favorable turnaround in the investment environment was benefiting policyholders through an increase in the amounts of dividends being made.

Figure 7-1 outlines insurance premiums and other earnings, basic profits, and negative/positive spreads by dividing the financial results for 13 major life insurance companies into those for domestic life insurance companies and those

for foreign-affiliated life insurance companies.

These values reveal that the situation for many life insurance companies was improving. While higher numbers for insurance premiums and other earnings are notable, it is also clear to see that higher basic profits were a function of developments concerning negative and positive spreads.

Basic profits increased as positive spreads rose or negative spreads shrank. The fact that asset management results dictated how financial results would be obtained by life insurance companies is highly evident.

Figure 7-1. Financial results for major life insurance companies for the fiscal year that ended in March 2015

		Insurance premiums and other earnings		Basic profit		Positive or negative spread	
			Rate of increase or decrease		Rate of increase or decrease		Previous fiscal year
Domestic	Dai-ichi	54,327	24.8	4,720	5.8	743	323
	Nippon	53,371	10.6	6,790	14.6	1,906	1,147
	Meiji Yasuda	34,084	▲5.7	5,063	10.0	1,686	1,193
	Sumitomo	25,971	2.9	4,050	2.8	81	▲157
	T&D	19,580	21.6	1,827	▲13.1	345	333
	Sony	9,140	▲4.9	765	5.7	130	84
	Fukoku	7,964	12.6	959	6.4	236	140
	Mitsui	5,451	0.0	590	14.3	▲462	▲486
	Asahi	4,059	▲1.3	276	2.4	▲649	▲711
Foreign-affiliated	Prudential	21,157	4.2	1,683	33.5	Positive spread (amount is not disclosed)	
	MetLife	17,476	5.6	696	68 times	Positive spread (amount is not disclosed)	
	Aflac	15,316	▲8.6	4,529	39.3	437	257
	Axa	5,489	▲0.5	617	▲28.0	282	380

Notes: Units: hundred million yen, %. Rate of increase or decrease is the percentage change over the preceding fiscal year. ▲ denotes a negative value.

(2) Effect of being number one

Garnering attention with respect to the announcement of financial results this time was the change in the top of the leaderboard in terms of insurance premiums and other earnings. This marked the first time in the postwar era when Nippon Life Insurance ceded the top spot to Dai-ichi Life Insurance for an entire fiscal year.

It appears that the Dai-ichi Frontier Life Insurance Company, a subsidiary of the Dai-ichi Life Insurance Company offering savings-type insurance products for sale through bank tellers, propped up the numbers for insurance premiums and other earnings. The rate by which premiums and other earnings grew for this

company was 50%.

However, the company did not manage to pass Nippon Life Insurance in terms of basic profit. These two companies remained apart when it came to profit. The fact that these two companies switched places at the top of the rankings in terms of sales was nevertheless a remarkable development in the life insurance industry.

For the life insurance industry, the so-called number-one effect is highly influential. Not only is the trust placed in the company elevated but the potential for growth is also fortified. Thus, the possibility that a leading company might fall from the top of the leaderboard also grows smaller.

By proactively selling highly-popular new insurance products, Nippon Life Insurance sought to recover its industry-leading status. However, the competition between Dai-ichi Life Insurance and Nippon Life Insurance was also linked to debates surrounding the form of management to be adopted by life insurance companies.

This is because the traditional loyalty of the market towards mutual companies may be weakening as a result of mutual company Nippon Life Insurance being overtaken by Dai-ichi Life Insurance, a company that had transformed itself into a stock company.

In any case, changes in insurance premiums and other earnings are, for the life insurance industry, an important management indicator to which attention is always paid. In this connection, let us focus on trends concerning the selling of insurance below.

In recent years, activities being carried out by independent agencies have garnered notice. Allow me to explain while also maintaining a focus on this development.

Part 2. Economic background behind insurance-solicitation rules

(1) Establishing basic rules

In June 2013, a working group of the Financial System Council released a report entitled Modalities for New Insurance Products/Services and Solicitation Rules. In response, the Act for Partial Revision of the Insurance Business Act was enacted in May 2014.

While insurance products and services also incorporate highly interesting

contents, I will limit the scope of my explanation to the solicitation rules applicable to insurance.

Regulations governing insurance solicitation originally were composed of the Act on the Control of Insurance Solicitation, which was enacted in 1948, and the Act on the Revision, etc., of Related Acts for the Financial System Reform, which was adopted in 1998.

At the same time, sales channels became notably diversified in the context of sales. Independent agencies, including brick-and-mortar offices visited by clients, came to assume greater prominence alongside bancassurance and websites and other non-face-to-face means of engaging in sales.

The insurance solicitation system that had traditionally been anchored by full-time staff members belonging to insurance companies appeared to be undergoing a sea change.

In the aforementioned report, which became the basis for amending the law governing the industry, the "establishment of basic rules for insurance solicitation" and the "regulations applicable to insurance solicitors" are outlined for the accommodation of environmental changes.

(2) Obligations and regulations

Basic rules governing insurance solicitation cover two obligations: the obligation to ascertain the client's intent and the obligation to provide information to the client.

In soliciting insurance products, you must first ascertain the client's intent and verify that the insurance product in question meets the client's needs before concluding an agreement. For this purpose, information needs to be provided to the client. This allows the client to deepen his or her understanding of insurance products.

A system designed to provide an opportunity to check whether a recommended insurance product matches the client's own needs with the use of a written confirmation of intent had already been put into place. Apparently, however, this system was not sufficiently effective.

In addition, the provision of product information to clients used to lack balance in comparison with other financial instruments. Savings accounts and other products exist as easy-to-understand financial instruments. For these types of financial instruments, the provision of information is mandated. In contrast, no provision mandating the proactive provision of information had been set forth

in the Insurance Business Act prior to its amendment.

The basic rules governing insurance solicitation have been summarized in accordance with these points. However, as long as the insurance solicitor standing between an insurance company and a client does not appropriately engage in his or her duties, the proclamation of these two obligations represents nothing more than a desire on the part of policymakers.

In this connection, an obligation to develop systems was put forth as a regulation to be applied to insurance solicitors. While an obligation to develop systems had long been imposed on insurance companies, insurance solicitors had not been subject to this obligation.

In this context, independent agencies and other examples of large-scale sales channels emerged to mark significant changes to the environment in which insurance operations were undertaken. Consequently, it came to be mandated that not only insurance companies but insurance solicitors as well would be required to develop systems to appropriately engage in operations and duties.

This allowed the competent authorities to shift from a system for indirectly supervising insurance solicitors through insurance companies to a system by which direct supervision was made possible.

However, the system of supervision varied in accordance with the scale and characteristics of operations and duties undertaken by insurance solicitors. It was not necessarily the case that a universal set of regulations applied to all insurance solicitors.

For example, it was possible to limit supervision to the indirect supervision of the sales staff members of an insurance company provided that an appropriate training system was being run.

(3) Promoting financial education

In this way, the report in question explicitly outlined regulations applicable to insurance solicitors after indicating the obligation to ascertain the intent of each client and the obligation to provide information to each client as basic rules for insurance solicitation. The contents of this report were in fact reflected in the amendments made to the Insurance Business Act.

While the imposition of regulations on insurance solicitors constituted the establishment of a new framework, these changes felt like nothing more than the fortification of the basic rules governing insurance solicitation through codification mandating what had been a conventional approach to the matters in

question.

An insurance solicitor should, at all times, ascertain the intent of a client and provide appropriate insurance products while providing information to the client. This stance should apply equally whether you are talking about the past or the future.

Notwithstanding this point, why was the Insurance Business Act partially amended? As mentioned earlier, it was likely done in part to ensure consistency with other statutes.

Specifically, the amendments were likely based on efforts to achieve consistency with the Banking Act and the Financial Instruments and Exchange Act.

An industry-regulating statute is to be amended not in anticipation of developments in reality but when it no longer conforms to actual conditions. If one accepts that this view is correct, then one gets the sense that the heightened competitiveness of insurance products in comparison with general financial instruments over time constituted the backdrop to the given amendments that were made to the Insurance Business Act.

The report summary sought to further urge the insurance industry and other concerned parties to engage in financial education initiatives. This was because a certain degree of knowledge concerning financial matters is required to have a client enroll in an insurance plan that matches his or her needs.

No matter how much an insurance solicitor carefully explains the features of an insurance product that is appropriate for a client, such actions will not lead to enrollment as long as the client himself or herself does not possess financial knowledge. The spread of financial education will help promote the growth of insurance.

In the next part, I will introduce mechanisms for determining insurance products based on normal economics textbooks that constitute a basis for working out ways to provide financial education. I believe that this will enable the report to be understood in greater depth.

Part 3: Insurance solicitation rules as decoded in economic textbooks

(1) Providing protection-type insurance products

In our lives, we are confronted with all sorts of risks. In order to lead an economically fulfilling life, you will need to recognize these risks. You must

also strive to secure a stable life for your future.

A protection-type insurance product is designed to eliminate existing risks, while a savings-type insurance product is designed to stabilize the client's future life.

If we were to harness tools of analysis as used in economics textbooks, we can depict these roles as fulfilled by insurance products as shown in Figures 7-2 (1) and (2). These figures indicate rational mechanisms for determining income to the satisfaction of people not just in the present but in the future as well.

First, let us examine Figure 7-2 (1). This figure presents a state in which current income (Y_0) is exposed to risks. In the unfortunate event that a risk materializes, income (Y_1) would be the outcome.

From utility curve UU, which shows the level of satisfaction generated from different levels of income, we see the level of utility (U_0) corresponding to the point in time at which income equals income (Y_0) and the level of utility (U_1) corresponding to the point in time at which income equals income (Y_1).

The current state corresponds to point A. The state when a risk materializes is shown as corresponding to point B. The expected value of utility arising from 2 types of income according to the probability that a risk will materialize is utility (U_2) from point C. This is referred to as expected utility.

The income that is equivalent to satisfaction is income (Y_2) from point D. This represents a risk-free level of income that is capable of properly covering a state of exposure to realistic risks.

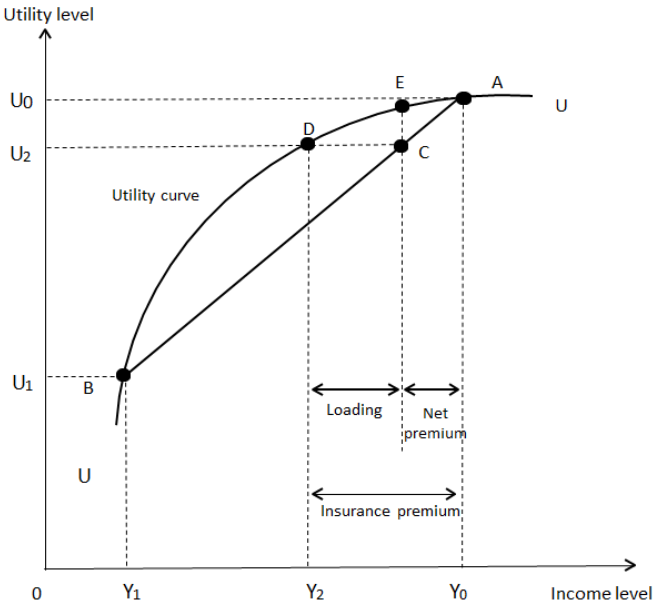
In this context, a protection-type insurance product functions effectively, since any shortfall in income suffered in the event that a risk materializes will be fully offset. By paying a pure premium, utility is raised to a determined level at point E.

However, the insurance premium consists of a net premium and loading equivalent to the service fee imposed on an insurance contract (policy). Thus, a client must pay an amount equivalent to the difference between income (Y_0) and income (Y_2) as the maximum insurance premium that can be selected.

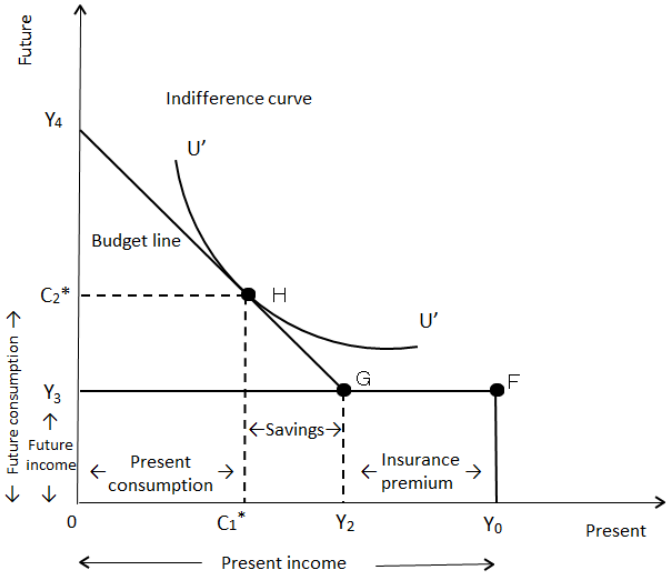
The probability that a given risk will materialize is a subjective probability as assumed by the individual in question. Some people are risk-averse while others are risk-tolerant. Trends in protection-type insurance products are a function of differences in the degree to which a given risk is avoided.

Figure 7-2. Mechanism for determining an insurance product

(1) Determining a protection-type insurance product



(2) Determining a savings-type insurance product



Accordingly, an insurance solicitor needs to surmise the extent to which a client wishes to avoid risks while accepting the client's intent. Alternatively, if the client is completely unaware of the risks involved, an insurance solicitor will also need to explain these risks while providing information.

This should cause the client to become more inclined to purchase a protection-type insurance product in order to raise his or her own level of expected utility. This is what is supposed to happen when the basic rules of insurance solicitation are properly followed.

It should be noted that insurance products are not the only means by which risks can be eliminated. By accumulating funds, risks can be covered. Of course, this is not to say that one can be fully relieved of all risks.

That said, general financial instruments can also be described in terms of competing with protection-type insurance products, since they function to some degree as a means of covering existing risks.

(2) Providing savings-type insurance products

We cannot live while thinking only about our current financial state. We must also give serious thought to our own future. On this note, Figure 7-2 (2) depicts an individual's present and future income situations.

Point F in this figure lies at the intersection of present income (Y_0) and future income (Y_3). However, since the individual is enrolled in a protection-type insurance plan to eliminate existing risks, the effective income at present is income (Y_2), which equals present income (Y_0) less the insurance premium. Thus, point G captures the individual's true financial state.

People tend to set aside a portion of their present income as savings for the future. In this figure, a budget line combining present and future incomes is shown as a straight line extending in an upper-left direction from point G.

The combination of present and future incomes generating maximum satisfaction on this line is point H, which is where this line comes into contact with indifference curve U'U'. This curve depicts income combinations for which satisfaction is at a constant level.

While there exists an infinite number of indifference curves, the maximum combination that is budget-feasible is at point H, where the indifference curve comes into contact with the budget line. In this case, present consumption is C_1* and future consumption is C_2*.

Thus, present income (Y_2) less present consumption (C_1*) is committed to

the future as savings to facilitate future consumption (C_2*).

Savings are what enables the fulfilment of an important role in determining the apportionment of present and future incomes. Various financial instruments are the means by which such savings are carried out. Examples include a bank deposit or savings account and investment trusts and stocks offered by securities firms.

Of course, savings-type insurance products offered by insurance companies are also a typical example of a savings vehicle. For instance, an individual annuity insurance plan is the most easy-to-understand savings vehicle that one can find. The same can be said of endowment insurance plans and whole life insurance plans.

The degree of time preference by an individual towards the present on the one hand and the future on the other determines the magnitude of savings. Some people prefer to consume in the present more than in the future while others prefer the opposite. This is shown by the slope of the indifference curve.

Accordingly, where a savings-type insurance product is being sold, the insurance solicitor needs to know the time preference of the client and tie it to whatever contract is concluded, after explaining the insurance product that is consistent with the client's preference. It goes without saying that this applies equally well to any typical financial instrument constituting an alternative to a savings-type insurance product.

Part 4: Discussions concerning commissions

The report in question also discusses the appropriateness of the disclosure of commissions. In this context, doubts arose as to whether independent agencies recommended, from among multiple options, products with high commissions to their clients.

This is because independent agencies used to receive little in the way of instructions as issued by insurance companies compared to insurance solicitors belonging exclusively to a single company. However, this problem would disappear if an appropriate system were to be developed. For this reason, the report did not seek the disclosure of commissions.

The job of an insurance solicitor begins with the ascertainment of risks affecting a client and the provision of precise advice to allow the client to achieve financial stability into the future. This was learned from economics textbooks.

A commission can also be thought of as consideration for services rendered by an insurance solicitor. If there is no ascertainment of risks affecting a client and no effort undertaken to lay out a plan for the future, then massive losses may eventually be incurred. The advice provided by an insurance solicitor is meant to impart value greater than the commission to the client.

At the same time, the advice provided by an insurance solicitor may well be unnecessary if a client is sufficiently knowledgeable about risks and future planning. In such a case, the commission should be lowered.

Such a description could very well be applied directly to non-face-to-face sales through online channels. The appeal of Internet sales can be found in cheaper insurance premiums. This is because there is no need to receive advice when seeking a policy via the Internet.

If a commission is expressly disclosed, the amount could be construed as an advisory signal made to the client. Would it not make interactions with insurance solicitors easier to understand for clients?

It is said that amendments to the Insurance Business Act were made to achieve consistency with other industries. In terms of economic rationale, it is believed that these amendments were made since insurance products are constituted in such a way that they effectively compete as alternatives to general financial instruments.

Meanwhile, commissions are disclosed for investment trusts. The competitive relationship between investment trusts and insurance products sold through bank tellers is further intensifying. A system in which commissions are not disclosed for only insurance products is a confusing one for clients purchasing financial instruments.

In the life insurance industry, discussions were held concerning the disclosure of the three surplus factors (profit or loss attributed to differences in risks, profit or loss attributed to differences in interest rates, and profit or loss attributed to differences in expenses). The industry declined to disclose the three surplus factors on the grounds that they were equivalent to a disclosure of costs. However, these are announced at the time financial results are disclosed pretty much as a matter of course by many major life insurance companies these days.

In light of these aspects of the past, you may conclude that solicitation commissions might someday come to be disclosed.

Chapter 8: <2016 (i)>
The Bank of Japan's negative interest rate policy and the management of life insurance companies

Part 1: Announcing financial results for the fiscal year that ended in March 2016

The financial results for major life insurance companies for the fiscal year that ended in March 2016 were announced. Figure 8-1 summarizes these financial results for 12 major life insurance companies and Japan Post Insurance. Let us examine insurance premiums and other earnings, a figure that is equivalent to sales, and basic profits, a figure that is equivalent to operating income.

Figure 8-1. Financial results for major life insurance companies for the fiscal year that ended in March 2016

		Insurance premiums and other earnings		Basic profit	
			Year-on-year change		Year-on-year change
Domestic	Nippon	62,620	16.6	7,076	3.9
	Dai-ichi	55,860	2.8	5,351	13.4
	Meiji Yasuda	33,578	▼1.5	4,599	▲9.2
	Sumitomo	30,448	17.3	3,017	▲25.5
	T&D	15,745	▲19.6	1,530	▲16.2
	Sony	10,280	12.5	430	▲43.8
	Fukoku	7,888	▲1.0	948	▲1.2
	Asahi	4,014	▲1.1	259	▲6.2
Foreign-affiliated	Prudential	22,289	5.4	1,708	1.5
	MetLife	16,313	▲6.7	383	▲45.0
	Aflac	15,333	0.1	2,602	▲42.6
	Axa	6,044	10.1	419	▲32.1
Japan Post		54,138	▲9.1	4,642	▲9.9

Note: Units: hundred million yen, %. ▲ denotes a negative value.

For the first time in two years, Nippon Life Insurance topped the industry leaderboard in terms of insurance premiums and other earnings. This was attributable in part to the positive performance of foreign currency-denominated whole life insurance plans as sold through bank tellers under conditions of ultra-

low interest rates and to the effect of the acquisition of Mitsui Life Insurance, a company with which a business merger was concluded in December 2015.

Likewise, Dai-ichi Life Insurance also benefited from the positive performance of foreign currency-denominated products as sold through bank tellers and saw its insurance premiums and other earnings grow thanks in part to the influence of U.S.-based Protective, which it purchased in February 2015. The company nevertheless failed to retain its hold on first place.

While jostling for ranking position, both Nippon Life Insurance and Dai-ichi Life Insurance reported favorable increases in earnings and profit but, generally speaking, there were more companies in the industry that suffered from lower earnings than companies that posted higher earnings. Similarly, more life insurance companies incurred a loss rather than a profit in terms of basic profit.

This was because yields from government bonds, which play a central role in the midst of an ultra-low interest rate environment, were decreasing. Thus, insurance premiums on single-payment insurance plans came to be increased and sales of plans came to be discontinued one after another, thereby holding back performance results.

While proactive engagements in investments and loans and foreign bond investments through which high interest earnings can be obtained are conceivable, there is a limit to the schemes that can be conceived for investment capabilities. As the currency market wavered with the rising of the yen and weakening of the dollar, some life insurance companies notably sustained losses while their interest incomes from foreign bonds decreased.

As long as the ultra-low interest rate investment environment did not change, life insurance companies would continue to be buttressed by increasingly harsh winds. Surprisingly, however, the Bank of Japan decided to shift its focus from an ultra-low interest rate policy to an even more aggressive negative interest rate policy. Savings-type products would likely undergo further price hikes and decisions made by companies to refrain from selling these products. It appeared as if life insurance companies would become even tougher to run than ever before.

Below, I shall specifically explore, from an accounting perspective, the question of how life insurance companies would seek to absorb this latest shock while focusing on the Bank of Japan's negative interest rate policy. I would also like to touch on long-term solutions in accordance with my findings.

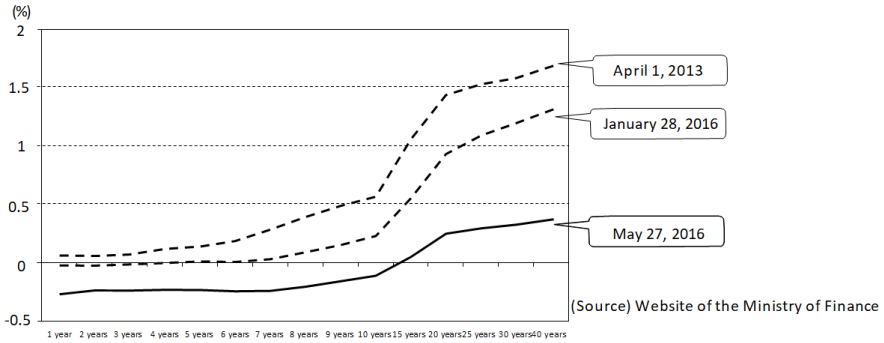
Part 2: Introducing a negative interest rate policy

(1) Background behind the Bank of Japan's unprecedented easing measures

Since April 2013, Governor Haruhiko Kuroda of the Bank of Japan had been implementing unprecedent easing measures and lowering interest rates by purchasing large amounts of government bonds. In October 2014, he expanded the scale of government bond acquisitions to reinforce the central bank's monetary easing stance.

Despite these moves, the rate of inflation did not reach the initial policy goal of 2%. In this connection, the Bank of Japan finally embarked on the introduction of a negative interest rate policy on January 29, 2016.

Figure 8-2. Yield curves for government bonds



This meant that a lending bank would instead have to pay interest out of a portion of its current account balance with the Bank of Japan.

Figure 8-2 depicts different yield curves for government bonds: a yield curve three years before the Bank of Japan's unprecedented easing measures went into effect (April 1, 2013), a yield curve just prior to the adoption of the negative interest rate policy (January 28, 2016), and a yield curve as of the end of May 2016 (May 27, 2016).

As can be understood by taking a look at this figure, interest rates in general shifted downwards as a result of the central bank's large-scale acquisitions of government bonds. The introduction of a negative interest rate policy had an especially profound impact. Not only did the yield curve shift downwards but

the portion of the curve corresponding to 10-year long-term government bond yields dipped below zero.

While the Bank of Japan was hoping to see a positive impact on consumption and investments resulting from a lowering of real interest rates, the reality unfortunately is that we remained unable to extricate ourselves from a state of deflation and thereby attain the original objective behind this measure. Instead, the side effects from the negative interest rate policy were putting a strain on the running of financial institutions.

(2) Side effects affecting financial institutions

Faced with difficulties in further lowering deposit interest rates, banks lowered interest rates on loans. Consequently, profit margins shrank. If such a state persists, the management of banks would become more volatile and their ability to serve as financial mediators could become compromised.

A flagship product of securities firms, money management funds (MMF) had also become directly affected by negative interest rates. With stable yields no longer possible to secure, companies were finally forced to discontinue investment activities and sales.

Likewise, life insurance companies were being exposed to a harsh investment environment. It had become difficult to secure yields promised to policyholders thanks to negative interest rates. Above all, reductions in long-term interest rates were having quite an impact given the nature of life insurance products.

While the Bank of Japan's unprecedented easing measures had already caused companies to stop selling single-payment endowment insurance plans and single-payment fixed-amount annuity insurance plans, it had also become difficult for companies to engage in the selling of single-payment whole life insurance plans. For this reason, life insurance companies that were choosing to partially suspend sales or substantially raise insurance premiums had also emerged.

Single-payment whole life insurance plans were popular as an instrument highly geared towards savings for those seeking a way to invest their retirement allowance money. This was because you could obtain relatively higher yields than you could with fixed-term deposits offered by banks dealing with ultra-low interest rates. However, personal investment targets were regarded as being likely change to some extent in the future.

Part 3: The management of life insurance companies in terms of basic profit

(1) Income calculation mechanism used by life insurance companies

Life insurance companies responded to the Bank of Japan's ultra-low interest rate policy by suspending sales of flagship life insurance products and raising insurance premiums. It is believed that these actions were squeezing the business operations of these companies.

Insofar as the financial results for this year reveal, however, the situation had not become as serious as you might have thought. These results could not be described as favorable but neither were they all that bad. Some major life insurance companies had even announced increased dividends in successive fiscal periods.

While this situation might have appeared to be full of inconsistencies, it is easy to understand if the way in which income was calculated at life insurance companies is known. Countermeasures that might be taken by life insurance companies when negative interest rates are maintained can also be anticipated to some degree.

In this connection, I will begin by describing the mechanism by which life insurance companies calculate income with reference made to Figure 8-3. I will then explore the impact that the Bank of Japan's ultra-low interest rate policy will have on the management of life insurance companies.

Figure 8-3. Income calculation process at life insurance companies

(1) Ordinary profit			[1]＋[2]＋[3]
	[1] Basic profit		(i) + (ii) + (iii)
		(i) Profit attributed to differences in risks	
		(ii) Profit attributed to differences in expenses	
		(iii) Profit attributed to differences in interest rates	
	[2] Capital profit or loss		
	[3] Non-recurring profit or loss		
(2) Extraordinary profits or losses			
(3) Corporate taxes and other taxes and dues			
(4) Unappropriated surplus for the current term			(1) + (2) – (3)

A primary variable used by life insurance companies when calculating income is basic profit, which is equivalent to the sum of the three surplus factors (profit attributed to differences in risks, profit attributed to differences in

expenses, and profit attributed to differences in interest rates). Basic profit is an indicator of the profitability of the primary operations of these companies. A detailed explanation of the three surplus factors is as follows.

Profit attributed to differences in risks is the difference between the payment amount as required based on the expected risk materialization rate (expected mortality) and the actually materialized payment amount. Profit attributed to differences in expenses is the difference between the business expenses as required based on the expected rate of expenses and the actual business expenses. Profit attributed to differences in interest rates is the difference between investment earnings as calculated based on assumed interest rates and the actual investment earnings.

Basic profit plus the capital profit or loss from securities and any non-recurring profit or loss equals ordinary profit. By adding extraordinary profits or losses and deducting corporate taxes, you are ultimately left with an unappropriated surplus for the current term. Part of this is distributed to policyholders as dividends.

As expected, basic profit is what effectively determines how much surplus funds a company has. If the amount of basic profit is high, then surplus funds will also increase as will dividends to policyholders. For this reason, if a life insurance company is to be assessed in terms of its management, then changes in the three surplus factors comprising basic profit will no doubt be watched closely.

(2) Immediate impact and specific countermeasures

Life insurance companies for which basic profit declined over the preceding fiscal year thanks in part to the impact of lower interest rates were a generally notable aspect of the financial results for this year. This is because such results are attributable to stagnancy in terms of interest gains.

The fact that companies were nevertheless earning sufficient basic profits did not appear to be changing. To illustrate, the sum of the basic profits earned by the four big life insurance companies in the industry (Nippon, Dai-ichi, Meiji Yasuda, and Sumitomo) exceeded two trillion yen, a high level indeed.

However, if the ultra-low interest rate investment environment remained in effect over the long-term, it would become increasingly difficult to secure profit attributed to differences in interest rates. This is because government bonds accounted for a significantly high percentage of assets held by life insurance

companies, which means that interest earnings obtainable from such assets would become more and more stagnant over time.

Figure 8-4 outlines changes in investment assets for all life insurance companies. Holdings of securities accounted for an overwhelmingly large percentage of investment assets. Moreover, Figure 8-5 reveals that government bonds constituted a typical asset type within the category of securities. The durations (full terms) of held government bonds were extended in accordance with the characteristic of products offered by life insurance companies.

Figure 8-4. Changes in investment assets for all life insurance companies

	Cash and deposits	Call loans	Monetary trusts	Securities	Loans receivable	Tangible fixed assets	Others	Total assets
FY 2010	36,097	14,139	18,458	1,708,079	293,296	66,831	102,141	2,239,044
	(1.6)	(0.6)	(0.8)	(76.3)	(13.1)	(3.0)	(4.6)	(100.0)
FY 2011	22,905	19,115	17,716	1,829,732	282,448	65,153	95,569	2,332,641
	(1.0)	(0.8)	(0.8)	(78.4)	(12.1)	(2.8)	(4.1)	(100.0)
FY 2012	28,507	25,634	18,031	2,056,866	275,530	63,740	77,046	2,545,357
	(1.1)	(1.0)	(0.7)	(80.8)	(10.8)	(2.5)	(3.0)	(100.0)
FY 2013	27,532	24,396	18,775	2,156,527	270,786	62,306	74,614	2,634,939
	(1.0)	(0.9)	(0.7)	(81.8)	(10.3)	(2.4)	(2.8)	(100.0)
FY 2014	34,020	32,275	18,976	2,331,523	268,329	61,977	76,330	2,823,432
	(1.2)	(1.1)	(0.7)	(82.6)	(9.5)	(2.2)	(2.7)	(100.0)

Note 1: Amount of total assets for all life insurance companies; exclusive of Japan Post Insurance.
Note 2: Units: hundred million yen; %. Parentheses denote composition ratios expressed as percentage figures. Source: Life Insurance Trends (2015), Life Insurance Association of Japan.

Accordingly, even if the adoption of the Bank of Japan's negative interest rate policy were to rapidly cause yield curves to shift downwards, it would not have an impact on the investment earnings of life insurance companies in the short run. This is because nothing more would happen than the replacement of a small percentage of government bonds each fiscal year. However, if a state of ultra-low interest rates were to persist over a prolonged period of time, a serious problem would emerge due to reductions in interest earnings.

While a certain amount of profit attributed to differences in interest rates was secured as reflected in the financial results for this fiscal year, it is not possible to believe that such a result could be maintained in the future with assurance. As countermeasures, companies discontinued sales of single-payment whole-life insurance plans or raised insurance premiums in line with changes in assumed interest rates. What other options might they have been able to entertain?

Figure 8-5. Changes in securities for all life insurance companies

	Government bonds	local government bonds	Corporate bonds	Stocks	Foreign securities	Others	Total
FY 2010	682,957 (40.0)	56,606 (3.3)	191,930 (11.2)	162,149 (9.5)	450,147 (26.4)	164,288 (9.6)	1,708,079 (100.0)
FY 2011	813,135 (44.4)	53,851 (2.9)	191,154 (10.4)	147,434 (8.1)	463,081 (25.3)	161,074 (8.8)	1,829,732 (100.0)
FY 2012	922,966 (44.9)	52,361 (2.5)	186,713 (9.1)	167,246 (8.1)	550,842 (26.8)	176,735 (8.6)	2,056,866 (100.0)
FY 2013	972,928 (45.1)	48,351 (2.2)	184,540 (8.6)	180,289 (8.4)	602,114 (27.9)	168,303 (7.8)	2,156,527 (100.0)
FY 2014	1,006,752 (43.2)	43,127 (1.8)	182,028 (7.8)	226,969 (9.7)	712,990 (30.6)	159,654 (6.8)	2,331,523 (100.0)

Note 1: Amount of securities for all life insurance companies; exclusive of Japan Post Insurance.
Note 2: Units: hundred million yen; %. Parentheses denote composition ratios expressed as percentage figures. Source: Life Insurance Trends (2015), Life Insurance Association of Japan.

One was the proactive shifting of investments from safe assets consisting of government bonds to risky assets consisting of foreign securities and other such vehicles. This would increase interest and dividend earnings and cause profit attributed to differences in interest rates to increase. Life insurance companies were actually increasing their investments in foreign securities.

This can also help promote a rise in stock prices and a weakening of the yen as desired by the Bank of Japan. In light of the characteristics of products offered by life insurance companies, however, there would appear to be limits to an approach to asset management that entails a full-scale assumption of risks.

Another option might have been, given the severity of the investment environment, a conversion of existing high assumed interest rate life insurance products into low assumed interest rate life insurance products. However, talks would have needed to proceed after policyholders came to a sufficient understanding of the complex structure of life insurance products. For this reason, there was also a sense that there is was limit to the extent to which life insurance products can be converted.

Of course, a more conventional approach would have been to thoroughly promote life insurance products that were sufficiently adaptive to even a difficult investment environment. Specifically, such life insurance products feature characteristics that emphasize protection over savings.

With this approach, there would not have been much of a burden placed on the management of life insurance companies. However, companies cannot afford

to disregard savings characteristics if they hope to offer life insurance products that can be of assistance to clients in their retirement years as society continues to age.

Part 4: New developments for life insurance companies

(1) Shockwaves emanating from the negative interest rate policy

The Bank of Japan's negative interest rate policy further worsened the earnings of banks, both city (commercial) banks and local regional banks. The situation was especially serious for local regional banks since many of them served local economies that had been battered due to a shrinking population base.

In recent years, local regional banks had been actively engaged in repeated mergers and consolidations with one another in hopes of mitigating, in however small a way, the harshness of the asset management environment in which they were operating.

An expansion of scale does not just stabilize the management base. It also helps to suppress the shrinking of profit margins. Various other advantages are also generated. For these reasons, major local regional banks are at the vanguard of efforts to broaden the geographical scope of markets.

To ensure that banks mired in a harsh asset management environment can reliably accrue earnings, they must shift their focus from a traditional stock-based approach to business through the provision of loans to a fee-based approach to business by which they will seek to obtain commissions.

This would enable companies to offset losses even with the adoption of a negative interest rate policy. I believe that these banks will take actions with a view to obtaining commissions in the future.

It is in this context that banks were becoming interested in commissions that can be earned through the selling of insurance. While sales of products through bank tellers had been positive for some time then, it was expected that this sales channel would become further fortified.

If commissions are high, then surely banks would place even more emphasis on the selling of insurance. This could result in greater moves to sell unnecessary insurance plans with misdirected vigor.

This sort of concern can be fully traced to the non-disclosure of commissions for the selling of products. Greater transparency ought to ease misgivings on the part of policyholders. Thus, shockwaves from the Bank of Japan's negative

interest rate policy ranged from a strengthening of banks' fee businesses to the disclosure of commissions for the selling of insurance.

Consequently, it appeared that commissions for the selling of variable annuity plans and foreign currency-denominated insurance plans through bank tellers would be disclosed beginning in the fall of this year as is the case for investment trusts.

(2) Cost-consciousness of policyholders

If this course of developments strengthened, then there will be, in the case of life insurance companies, a greater focus on profit attributed to differences in expenses, which is a component of basic profit. If commissions for the selling of products are unnecessarily high, then profit attributed to differences in expenses will decrease by this extent. Since a portion of profit attributed to differences in expenses is distributed as dividends, policyholders likely wish to see commissions for the selling of products lowered as much as possible.

In addition, the cost consciousness of policyholders is not limited to just commissions for the selling of products. It is also directed at the structure of the three surplus factors for life insurance companies. In the first place, there is room to spare with respect to profit attributed to differences in expenses because the expected rate of expenses is set at a high level. If this were to be decreased, then additional premiums themselves would be lowered.

Contributing to basic profit the most is profit attributed to differences in risks. If we break down the three surplus factors for fiscal year 2014 in terms of the cumulative totals for the top four life insurance companies, we see that profit attributed to differences in risks accounted for 68%, while profit attributed to differences in expenses and profit attributed to differences in interest rates accounted for 10% and 22%, respectively.

That profit attributed to differences in risk is both extensive and greater than it is even for overseas life insurance companies is due to the fact that the expected risk materialization rate is set at a conservatively high level. If this were lowered, then net insurance premiums too would be reduced. This would also make it clearer why dividends are generated for life insurance products that are highly geared towards the provision of protection.

Life insurance companies were being squeezed when it came to asset management thanks to the adoption of a negative interest rate policy by the Bank of Japan. Concerns over the possibility that negative spreads may arise, as actual

investment yields fall short of expected yields, could not be dispelled. However, basic profit could still be positive in the event that negative spreads arise as a result of profit attributed to a difference in interest rates descending into negative territory, as long as this situation is offset by profit attributed to a difference in risks and profit attributed to a difference in expenses.

Seen in this light, there was a sense that there was an overall margin of safety when it came to the management of life insurance companies, since basic profit had essentially been designed to stay in the black. Nevertheless, if policyholders expressed greater interest in the three surplus factors for life insurance companies in response to discussions on the disclosure of commissions for the selling of products, it was thought that pressure to lower insurance premiums would increase.

(3) Pursuing greater scales of operation through mergers and acquisitions

How would life insurance companies respond if faced with such a situation? An effective countermeasure is the expansion of scale through a strategy of mergers and acquisitions, as can be seen in recent years with local regional banks. By pursuing economies of scale, it would first be possible to lower the expected rate of expenses.

As the scale in terms of financing increases, higher yields that are stable thanks to efficient asset management could be obtained. This could help curb any lowering of assumed interest rates.

If the number of policyholders increases, the law of large numbers would facilitate the accurate ascertainment of the risk materialization rate. For this reason, there would be less of a need to set the assumed risk materialization rate at a conservatively high level.

A strategy of mergers and acquisitions does not only stabilize the management of life insurance companies operating in a harsh earnings environment. It also allows the demands of policyholders to be accommodated through improvements to the three surplus factors.

While it was unknown how much longer the Bank of Japan's negative interest rate policy would remain in effect, it was possible that we might begin to see huge waves of change in the form of the restructuring of life insurance companies through repeated processes of mergers and acquisitions if this strategy stayed in place over an extended period of time.

Analysts frequently invoke the law of three. While this law is non-scientific

and cannot be academically proven, it is a law that says that an industry will ultimately end up with three companies as competition within the industry intensifies.

The city banking sector and nonlife insurance industry appear to conform to the law of three. Will the life insurance industry also come to align with this law in response to the Bank of Japan's negative interest rate policy? It is an interesting question to ponder.

Chapter 9: <2016 (ii)>
Domestic and overseas acquisition strategy as carried out by major life insurance companies

Part 1: The transforming domestic life insurance market

(1) Active acquisition strategy undertaken by major life insurance companies

Recent developments in the life insurance industry have been quite dynamic. This is was in the proactive efforts to make a foray into overseas markets on the part of four major life insurance companies. Figure 9-1 outlines the overseas expansion of these companies on a country-by-country basis.

Figure 9-1. Strategy of overseas acquisitions on the part of major life insurance companies

	Dai-ichi	Nippon	Meiji Yasuda	Sumitomo
U.S.	Protective (2015)	Nippon Life Insurance Company of America (1991)	Pacific Guardian (1976), StanCorp (announced in 2015)	Symmetra (announced in 2015)
Poland			TU Europa Warta (2012)	
China		Great Wall Changsheng (2009)	PKU Founder Life (2010)	
India	Star Union Dai-ichi (2009)	Reliance (2011)		
Indonesia	Panin Dai-ichi Life (2013)	Sequis Life (2014)	Avrist (2012)	BNI Life (2014)
Vietnam	Dai-ichi Life Vietnam (2007)			Bao Viet (2013)
Thailand	Ocean Life (2008)		Thai Life (2013)	
Australia	TAL (2008)			

Overseas life insurance companies, especially those in Asian countries – China, India, Indonesia, Vietnam, and Thailand – were purchased. The emphasis appeared to be shifting from emerging countries in Asia to the United States, a developed nation.

Companies were also expanding in terms of scope as characterized by the acquisition of U.S.-based Protective by Dai-ichi Life Insurance (580 billion yen), the acquisition of the U.S.-based StanCorp Financial Group by Meiji Yasuda Life Insurance (525 billion yen), and the acquisition of U.S.-based Symmetra Financial by Sumitomo Life Insurance (465 billion yen).

While it could be hoped that the untapped Asian market would grow at high rates, this market was also beset by numerous issues, such as restrictions on foreign investments. Substantial amounts of time would be incurred to generate a profit flow. In addition, the small size of the market gave rise to the risk that an unexpected event would have a suddenly destabilizing impact.

Comparatively speaking, the U.S. market was bigger, such that a sense of stability was imparted. It was fairly straightforward to directly cultivate higher sales and profits by operating in this market. For this reason, companies were also proactively expanding into the U.S. market rather than staying exclusively bound to the Asian market.

Acquisitions by major life insurance companies encompassed not just overseas targets but domestic ones as well. As the biggest player in the industry, Nippon Life Insurance acquired major life insurance company Mitsui Life Insurance and transformed it into a subsidiary. The company was purchased for a real amount in the upper end of the 200-billion-yen range.

Domestic life insurance companies are undergoing large-scale restructuring for the first time since 2004. In that year, Meiji Life Insurance and Yasuda Life Insurance merged to create Meiji Yasuda Life Insurance. It was also then that T&D Holdings emerged. Despite the passage of many years since that time, it appeared as if major life insurance companies were finally beginning to make their moves.

(2) Circumstances surrounding life insurance companies

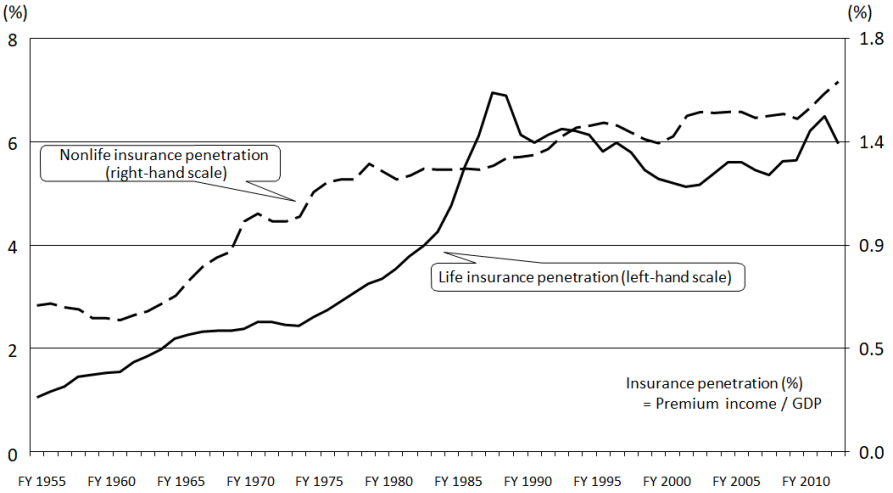
The maturation of the domestic market constituted an underlying factor explaining why major life insurance companies were then vigorously seeking to make purchases in Japan and overseas. Compared to the global insurance market, the life insurance market in Japan was growing at a relatively low rate. Proactive acquisitions were being carried out in order to overcome this difficult domestic state.

Figure 9-2 depicts changes in insurance penetration collectively for all life and nonlife insurance companies. The graph shows the percentage of the gross

domestic product (GDP) that was accounted for by premium income on an industry basis. Two lines are shown; the solid one denotes life insurance penetration.

This figure outlines developments extending from the era of high economic growth during the postwar years to today. After the bubble economy collapsed in the 1990s, you can see how growth appeared to be stalled. Furthermore, life insurance penetration in Japan was higher than it was in a number of developed countries, namely the United States, Canada, the United Kingdom, France, and Germany.

Figure 9-2. Changes in life and nonlife insurance penetration



The fact that the insurance market in Japan is not growing can be traced to the facts that our population is shrinking, the birthrate is declining, and our society is aging. If younger cohorts could continue to bolster their numbers, then economic activities would be stimulated accordingly. Income levels would also go up, and demand for life insurance products would naturally rise.

However, developments today are going in the opposite direction. There are utterly no signs of a potential increase in the population. If this means that the Japanese economy will be rendered incapable of being as dynamic as it once was and that we cannot expect life insurance penetration to increase, then there would be no choice for companies but to go off in a new direction whereby domestic and overseas life insurance companies are acquired.

Neither can we ignore changes in the asset management environment. As long-term interest rates decline, it is becoming harder and harder to generate sufficient investment yields. Ultra-long-term government bonds are central to asset-management practices carried out by life insurance companies. Their yields have declined to abnormally-low levels thanks to large-scale easing measures being implemented on an extended basis by the Bank of Japan.

If the decline in the birthrate and the aging of society are not stemmed, then the weights assigned to products being sold should simply be changed. Emphasis should be shifted from traditional protection-type life insurance products that primarily provide death protection to single-payment whole-life insurance plans and endowment insurance plans as well as to individual annuity plans and other types of savings-type life insurance products.

However, Japan's asset management environment has been harsher than expected, such that the risk that actual yields will fall short of yields promised to policyholders (assumed interest rates) has arisen. Thus, it will come to pass that the selling of savings-type life insurance products will be reexamined.

Part 2. Learning about insurance management from nonlife insurance companies

(1) Leading nonlife insurance companies

While nonlife insurance companies had, like their life insurance counterparts, been engaged repeatedly in domestic and overseas mergers and acquisitions, they started quite a bit earlier than life insurance companies did.

Major nonlife insurance companies quickly underwent consolidation in the wake of the liberalization of regulations governing nonlife insurance rates in 1998. City banks coalesced into three mega-banks through a process by which financial institutions merged and integrated with one another. In line with these developments, the nonlife insurance sector, too, bore witness to the birth of three mega-nonlife insurance companies.

Moreover, companies had also been busy in terms of overseas acquisitions. Recent examples include the acquisition of U.K.-based Canopius by Sompo Japan (as it was known at the time) (100 billion yen), the acquisition of U.S.-based HCC Insurance Holdings by Tokio Marine Holdings (940 billion yen), and the acquisition of U.K.-based Amlin by Mitsui Sumitomo Marine (642 billion yen).

Acquisitions were also getting bigger. Another characteristic of nonlife insurance companies was the shift we were seeing from a strategy focusing on Asia to one focusing on the West. For the three mega-nonlife insurance companies that are based in Japan, their overseas insurance divisions have underpinned growth in premium income and are also contributing quite a bit to profits these days.

It is clear that nonlife insurance companies embarked on the acquisition of domestic and overseas companies before life insurance companies did as the population began shrinking, and the domestic market started to peak as a result. What then is the specific situation with regard to the penetration of nonlife insurance?

Figure 9-2 shows changes in the penetration of nonlife insurance relative to changes in the penetration of life insurance. This figure reveals that the penetration of nonlife insurance remained on an upward path in contrast to the penetration of life insurance.

In contrast to the situation with respect to life insurance, values for the penetration of nonlife insurance are relatively lower than they are for major countries in the West. This suggests that the domestic market still has room to grow.

Nevertheless, it is conceivable that the keen sense of danger with respect to the management of companies is what caused rapid actions to be taken from an early stage.

Promoting this was the approach to management called enterprise risk management (ERM). In this connection, I would like to discuss ERM management, which is often put forth as a framework for the management of nonlife insurance companies, while seeking to apply it to the management of life insurance companies.

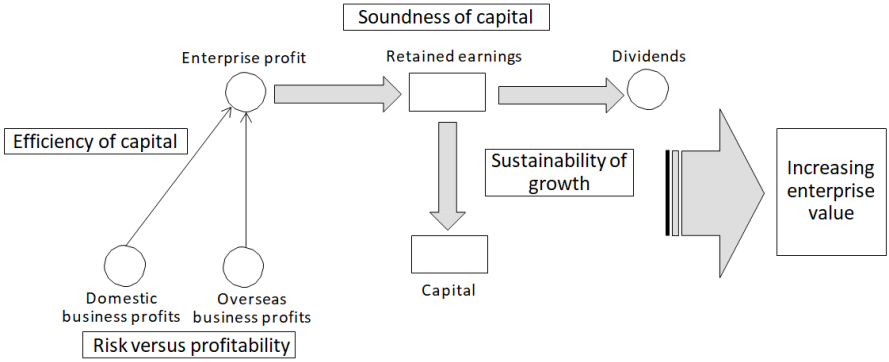
I believe that this will allow the current form of the life insurance industry to be reworked and also its future form to be predicted. While ERM is sometimes regarded in terms of the management of company-wide risks, I will be referring to this term in its literal sense (enterprise risk management).

(2) ERM framework

Insurance companies, whether they are life insurance companies or nonlife insurance companies, obtain returns (earnings) in return for taking on risks (bearing risks). Figure 9-3 provides a full picture of ERM for insurance

companies seeking to maximize enterprise value while appropriately controlling risks and returns.

Figure 9-3. Framework of ERM at an insurance company



Today's insurance companies are proactively engaged not just in domestic operations but also in overseas operations. In light of this reality, the breakdown of domestic and overseas operations must be investigated from a risk-versus-profitability perspective.

In the course of comparing profits from domestic operations and profits from overseas operations, the optimal ratio of these operations should be determined while taking different risks materializing through each of these operations into account.

Insurance companies repeatedly engage in the acquisition of domestic and overseas companies in hopes of improving returns in line with risks by altering the ratio of their domestic and overseas operations. If it is determined that there is room for improving domestic operations, a company will embark on domestic mergers and acquisitions. If overseas operations are relatively more attractive, then a company will direct its attention to mergers and acquisitions in foreign lands.

In this way, overall profit is expanded by raising the efficiency of capital. While this profit goes towards retained earnings, a part of it is distributed as dividends. While mutual life insurance companies distribute profit as part of their dividend scheme to policyholders (with policyholders regarded as members), life and nonlife insurance companies organized as stock companies

distribute profit both as part of their dividend scheme to policyholders and as dividends to shareholders.

When distributing profit, a company just cannot distribute it in full. To facilitate the smooth operations of an insurance company, equity capital of an amount sufficient to absorb all risks to management is required. For this reason, profit is not fully distributed. Instead, some of it is also diverted to capital.

The accumulation of capital is not undertaken from just a soundness standpoint in terms of the absorption of risks. It can also induce growth if capital is bolstered. This allows new profit to be generated and capital to be further increased, which in turn promotes the sustainability of growth.

By perpetuating such a virtuous cycle, all stakeholders, including policyholders and shareholders, should be satisfied. Thus, increasing enterprise value is the ultimate goal of any insurance company.

(3) Environmental changes underpinning ERM

Various risks arise as an insurance company expands its operations. ERM is a means of carrying out sound management practices while emphasizing the management of risks. A company will thereby grow through its ability to obtain appropriate profits in line with the risks to which it is exposed.

The development of a proper environment is required for the appropriate management of risks. This entails the involvement of international insurance accounting standards and insurance oversight regulations. Efforts are underway to develop a system for monitoring the soundness of insurance companies, one that is based primarily on the International Financial Reporting Standards (IFRS), the International Association of Insurance Supervisors (IAIS), and the EU Solvency II project.

Under this system, one is constantly focused on figuring out the extent to which net assets, equal to the difference between assets and liabilities on a current market valuation basis, exceeds the total amount of risks. Initiatives being undertaken by supervisory authorities in countries around the world also promote ERM on the part of insurance companies.

The increase in foreign stockholding ratios is also serving to encourage insurance companies to engage in ERM. For each of the three mega-nonlife insurance companies, the foreign stockholding ratio is high at around 40%. For major life insurance company Dai-ichi Life Insurance, this ratio is likewise at forty-something percent.

Compared to domestic shareholders, foreign shareholders are believed to be stricter when it comes to demands placed on insurance companies. They will likely require an approach to management that entails the further pursuit of capital efficiency. Due to its excessive riskiness, over-reaching management must pay attention to the soundness of capital.

As an approach to management that prioritizes the striking of a balance between risks and returns, ERM will probably garner more and more attention as foreign stockholding ratios rise.

Part 3: Outcomes of large-scale acquisitions

(1) Diversification

Japan continues to be beleaguered by typhoon damage every year. Nonlife insurance companies can also accommodate insurance payments for wind and flood damage through sales of fire insurance, automobile insurance, and other forms of insurance. In recent years, Japan has found itself in the direct path of more and more typhoons, albeit with a fluctuation in number from year to year, and the monetary amount of damage sustained is also growing larger.

Nonlife insurance companies are making a foray into overseas markets not just in order to expand earnings. Diversification effects to mitigate fluctuations affecting domestic operations are also expected. This will allow company-wide risks affecting nonlife insurance companies to be reduced.

In contrast to nonlife insurance companies, life insurance companies do not suffer as much in the way of fluctuations affecting domestic operations, but there are still expectations that making a foray into overseas markets will allow company-wide risks affecting life insurance companies to be eliminated through diversification.

In terms of scale, both life and nonlife insurance companies place an overwhelmingly greater weight on domestic operations. If more risk diversification is sought, then the acquisitions of overseas insurance companies is likely to continue.

(2) Competition over rankings

Major life insurance company Nippon Life Insurance had long maintained its firm hold on the top of the industry leaderboard in terms of both premium income and total assets. However, Dai-ichi Life Insurance managed to overtake,

in terms of premium income, Nippon Life Insurance, a company that was once referred to as Gulliver[1]. This happened as revealed in the financial results for fiscal year 2014.

This year, Nippon Life Insurance staged a comeback to reclaim the top spot from Dai-ichi Life Insurance in terms of premium income by purchasing Mitsui Life Insurance. The competition for ranking among life insurance companies was fierce indeed. Of course, the same can be said of nonlife insurance companies.

Among the three mega-nonlife insurance companies, Tokio Marine Holdings was ranked number one. However, the acquisition of U.K.-based Amlin by Mitsui Sumitomo Marine allowed MS & AD to come within striking distance of the current leader.

Mergers and acquisitions were undertaken by insurance companies in order to increase earnings and diversify risks. In addition, however, competition over rankings cannot be ignored as another factor behind these actions. Above all, the effect of being number one has a huge impact.

If you are an industry leader, you can enjoy advantages in terms of brand strength and other conditions. This status will elevate your earning power and ability to control risks for a positive spiral effect.

Domestic and overseas acquisitions by major life insurance companies and the three mega-nonlife insurance companies appeared to represent the manifestation of a long-term growth strategy being carried out while taking industry rankings into account.

The mutual company structure adopted by many major life insurance companies is disadvantageous in certain ways for carrying out mergers and acquisitions. Dai-ichi Life Insurance was able to rapidly expand in terms of scale by transforming itself into a stock company.

For a life insurance company seeking to expedite its management strategy, transformation into a stock company is an urgent matter to be properly pondered. It is believed that this will help to further promote the restructuring of life insurance companies.

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[1] Gulliver is a protagonist in *Gulliver's Travels*, a book written by Jonathan Swift. During his first voyage, Gulliver stumbles across a country inhabited by people who are only fifteen centimeters tall. In Japan, "Gulliver" has become a shorthand for a huge company that enjoys overwhelming power in a given industry.

Chapter 10: <2017>
Impact of a lowering of assumed interest rates on life insurance companies

Part 1: Announcing financial results for the fiscal year that ended in March 2017

(1) Spreading impact of the negative interest rate policy

The financial results for major life insurance companies for the fiscal year that ended in March 2017 were announced. The impact of the Bank of Japan's negative interest rate policy was vividly captured in financial results that were severe for the companies in question. Figure 10-1 summarizes these financial results for 13 key life insurance companies, consisting of major domestic life insurance companies and foreign-affiliated life insurance companies as well as Japan Post Insurance.

Figure 10-1. Financial results for major life insurance companies for the fiscal year that ended in March 2017

		Insurance premiums and other earnings		Basic profit	
			Year-on-year change		Year-on-year change
Domestic	Nippon	52,360	▲16.4	6,855	▲3.1
	Dai-ichi	44,687	▲20.0	5,584	2.7
	Sumitomo	34,588	13.6	3,330	7.8
	Meiji Yasuda	28,663	▲15.2	4,962	6.5
	T&D	15,052	▲4.4	1,599	4.5
	Sony	9,567	▲6.9	838	94.9
	Fukoku	6,487	▲17.8	915	▲3.5
	Asahi	3,837	▲4.4	220	▲14.9
Foreign-affiliated	MetLife	22,857	40.1	1,105	188.5
	Prudential	21,398	▲4.0	1,686	▲1.3
	Aflac	14,399	▲6.1	2,586	▲0.6
	Axa	6,191	2.4	357	▲14.8
Japan Post		50,418	▲6.9	3,900	▲16.0

Note: Units: hundred million yen, %. ▲ denotes a negative value.

On the whole, the reduction in insurance premiums and other earnings is remarkable. Earnings declined by over a trillion yen for Nippon Life Insurance and Dai-ichi Life Insurance. Ten out of the thirteen companies surveyed reported lower earnings than they did in the preceding fiscal year. Moreover, some life insurance companies notably posted double-digit drops in earnings. This can be

attributed to the restraints imposed on high assumed interest rate life insurance products, such as single-payment whole-life insurance plans, by a difficult investment environment.

An indicator of the profitability of the primary operations of these companies, basic profit also sustained heavy damage due to reductions in interest income and dividends caused by the introduction of the negative interest rate policy. Nevertheless, there were still some life insurance companies whose basic profit increased as contributions made by overseas life insurance companies that they had purchased helped offset declines in value brought about by the difficult investment environment. For this reason, there were fewer life insurance companies whose basic profit went down than life insurance companies reporting lower insurance premiums and other earnings.

In this way, the negative interest rate policy has had a negative impact on the life insurance market in terms of both sales and profit. This is because assumed interest rates embedded in life insurance products are linked to the core of the problem in question. Lower investment yields mean that it has become more difficult to exceed assumed interest rates. Consequently, companies are being forced to stop sales of life insurance products.

(2) Countermeasures for life insurance companies

Under these circumstances, the life insurance market will continue to shrink. Accordingly, assumed interest rates need to be lowered.

We have already seen assumed interest rates lowered for single-payment life insurance products. Beginning in April 2017, assumed interest rates were slated to go down for level-payment life insurance products as well. Since level payment life insurance products are considered a more typical type of life insurance product than single-payment life insurance products, the impact of this development will be quite significant.

The harmful effects on profit from declining investment yields resulting from these developments can be absorbed to a certain extent. It should be possible for the shrinkage in basic profit to be kept in check even without relying much on contributions made by overseas businesses.

Since any decline in assumed interest rates goes hand in hand with an increase in insurance premium rates, however, a considerable burden will be placed on those who are in charge of sales at these companies. A risk that insurance premiums and other earnings will decline further will emerge.

Ironically, any policy designed to secure profit will raise the likelihood that developments will shift in such a way that sales will be constrained.

At the same time, the management of assets by life insurance companies might also become affected. The Bank of Japan promoted measures to shift the weight from government bonds to foreign bonds in order to induce a weakening of the yen. If life insurance companies continue to hold large amounts of low interest rate government bonds, it will be difficult to exceed expected yields. In this connection, companies have been proactively purchasing higher yield foreign bonds.

However, the lowering of assumed interest rates could cause a reversion in the approach to asset management on the part of life insurance companies. This is because there would no longer be any need to continue to take risks in purchasing foreign bonds if a difference between assumed interest rates and investment yields could be secured. If this were to happen, the Bank of Japan's intended policy would become effectively overturned.

In this way, the lowering of assumed interest rates will affect the management of life insurance companies in various ways. In this chapter, I will examine these effects on asset management while exploring, in a theoretical sense, the mechanisms that have an impact on the demand for insurance products.

Part 2: The Bank of Japan and the market for life insurance

(1) The Bank of Japan's ultra-low interest rate policy

As I mentioned several times in a number of previous chapters of this book, the Bank of Japan announced financial easing measures that were unprecedented in both a quantitative and qualitative sense in April 2013. The central bank aimed to achieve a 2% annual inflation rate in two years by implementing proactive financial easing measures, such as by purchasing government bonds at a 50-trillion-yen-a-year pace.

The central bank sought to extricate the Japanese economy from a long-term state of deflation. However, satisfactory results were not forthcoming with ease. In October 2014, the amount of government bonds to be purchased yearly was raised to 80 trillion yen.

The set of financial easing measures in question caused the level of interest rates on government bonds to remain low. However, evidence that these measures were helping to raise expectations of inflation was sorely lacking and

economic activities continued to flounder.

In response, the Bank of Japan took the plunge in January 2016 and introduced a negative interest rate policy for the first time in the country's history. The level of interest rates on government bonds was pushed down even further.

At the same time, the side effects of the Bank of Japan's financial measures also came to be notable. The extreme drop in interest rate levels caused the positive spread, which is equal to the difference between interest rates on loans and interest rates on deposits, to shrink and the generation of profit to become more difficult.

To counter these side effects, organizations began to take steps to obtain service fee earnings. For life insurance companies, reductions in investment yields made it more difficult to secure assumed interest rates and forced these companies to stop selling insurance products that are highly geared towards savings.

In this connection, the Bank of Japan shifted its guideposts from quantity to interest rates in September 2016. Yield curve controls were hammered out to curb to some degree the lowering of interest rates while taking the management of financial institutions into account.

The central bank aimed to restore long-term interest rates (yields on 10-year government bonds) to about 0% while continuing to maintain short-term interest rates (some interest rates on current accounts at the Bank of Japan) at negative 0.1%.

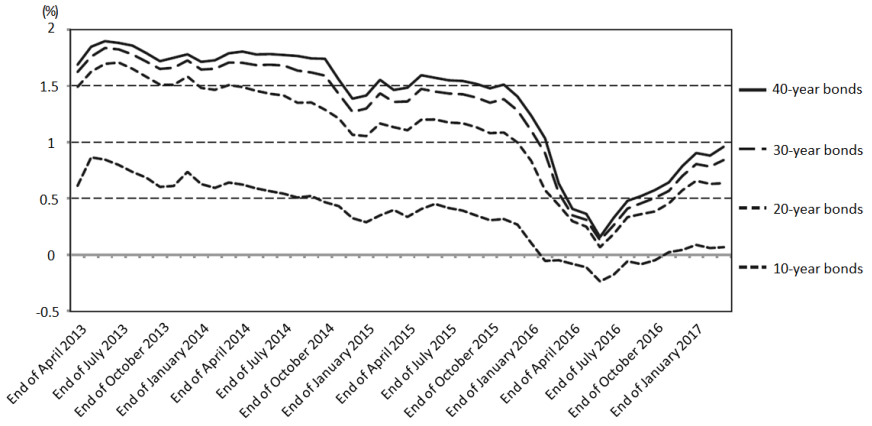
Nevertheless, the goal remained to stably maintain the rate of inflation at 2% while government bonds valued at 80 trillion yen were slated to be purchased per year. Thus, a stance by which interest rate levels are to be seen on the whole as corresponding to low levels will not change.

Figure 10-2 outlines government bond yields for 10-year, 20-year, 30-year, and 40-year government bonds from April 2013, when the Bank of Japan's unprecedented easing measures began going into effect, to now.

A look at this figure reveals that government bond yields are, in the main, trending downwards. Moreover, the downward pressure on government bond yields is intensifying due to the adoption of negative interest rates. In addition, the yield spread is shrinking with each passing period.

While yields are generally higher the longer the term of maturity is for government bonds, the spread in yields is rapidly getting smaller. In other words, the slope of the yield curve is flattening.

Figure 10-2. Changes in government bond yields



Government bond yields are not just decreasing on the whole in this manner. Long-term yields, too, are shifting more significantly downwards than they were in the past. This development is squeezing life insurance companies in their efforts to engage in the management of assets.

Since government bonds account for a large percentage – forty-something percent – of the assets invested by life insurance companies, it is clear to see that declining government bond yields are striking a terrible blow to the investment income being earned by life insurance companies.

Of course, interest income is not earned just from government bonds. It can also be obtained from local government bonds, corporate bonds, and loans. Together with interest earned from government bonds, interest accounts for sixty-something percent of investment earnings. The situation is also further compounded by the fact that such yields are declining, linked as they are to government bond yields.

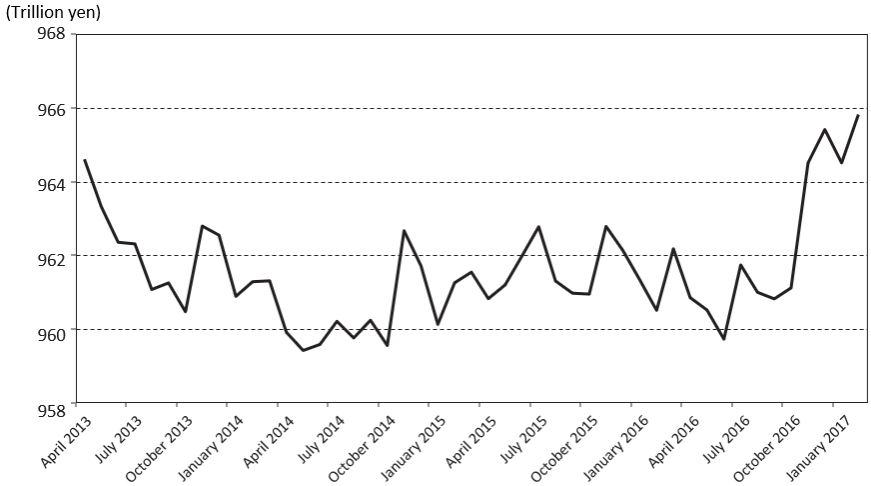
(2) Lowering assumed interest rates

The Bank of Japan boldly embarked on its unprecedented easing measures in hopes of extricating the Japanese economy from a state of deflation. The central bank has also been trying to turn around an economy that had been struggling over the course of many years. Nevertheless, it failed to reach its goal of achieving 2% inflation in two years. While the results that had initially been expected have so far remained beyond its reach, only time has passed since these

measures were first implemented.

The impact of this can be seen in the stagnation of the total amount of individual insurance policies in force for life insurance companies. Figure 10-3 shows changes in the total amount of insurance policies for individuals – equal to the sum of individual insurance policies and individual annuity insurance policies – in force based on monthly data since April 2013, when the central bank's unprecedented easing policies were first implemented.

Figure 10-3. Changes in the total amount of insurance policies for individuals in force



If the Bank of Japan's bold financial measures succeed, we should see the total amount of insurance in force trending upwards in line with the growth of the economy. Unfortunately, however, the total amount of insurance in force continues to rise at a sluggish pace.

Moreover, these unprecedented easing measures have also caused assumed interest rates to decline for life insurance companies. Operating under an environment of ultra-low interest rates, life insurance companies found it increasingly difficult to get investment yields to exceed assumed interest rates. If these circumstances persist, negative spreads will arise.

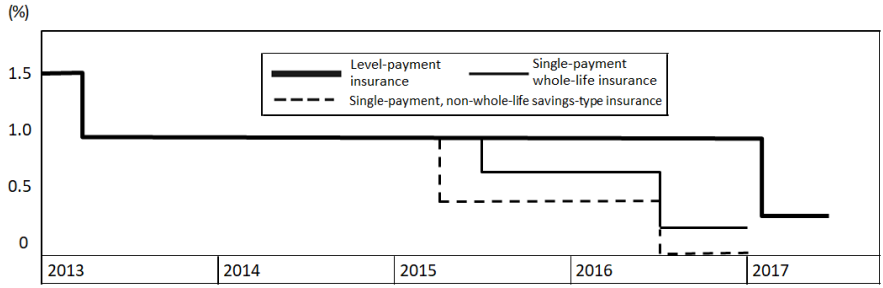
Negative spreads can constitute a serious issue affecting the core of elements of the management of life insurance companies. To avoid this, there is probably

no effective means other than the lowering of assumed interest rates.

Figure 10-4 traces changes in standard interest rates, a factor determining assumed interest rates. Following what happened with single-payment plans, level-payment life insurance products also underwent a drop in standard interest rates from 1.0% to 0.25% in April 2017. This caused assumed interest rates for which a certain level of investment yields was promised to policyholders to be lowered and, conversely, insurance premiums to be raised.

Since an increase in insurance premiums means an increase in the price of insurance for policyholders, there is a risk that this will lead to a slump in insurance sales. Alternatively, sales may come to be discontinued as they were for single-payment whole-life insurance plans. For this reason, the total amount of insurance in force is expected to shrink.

Figure 10-4. Changes in standard interest rates

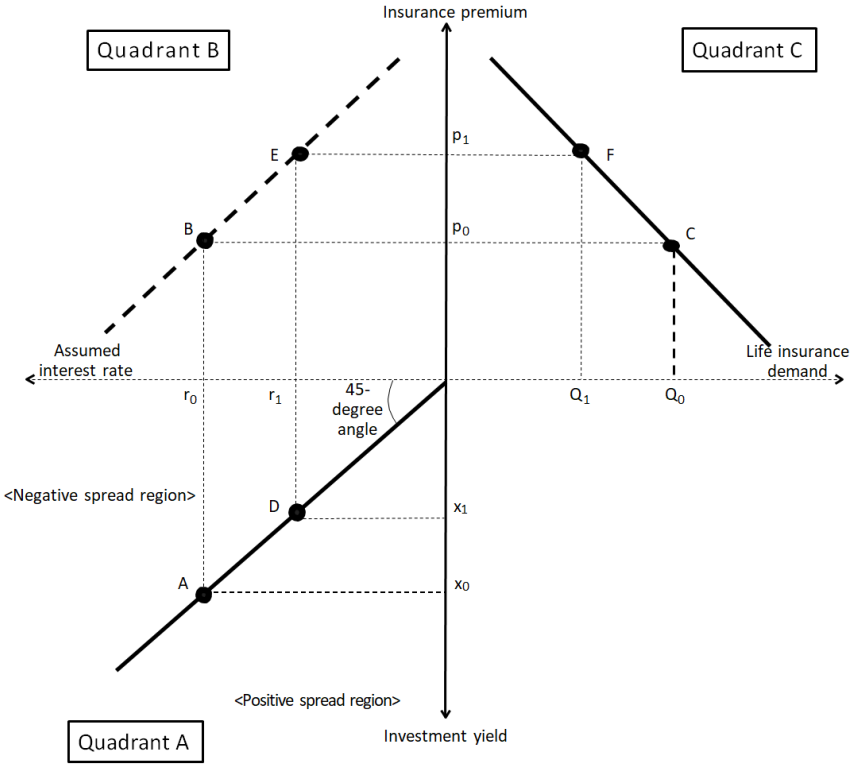


(Reference) The Nikkei; October 15, 2016

Figure 10-5 conceptually outlines these possible sequences of events. With Quadrant A in the bottom-left part of this figure, the state of concordance between investment yields and assumed interest rates is depicted with a 45-degree line. Neither negative spreads nor positive spreads will arise under these circumstances. For example, if the investment yield is at x_0, then the assumed interest rate from point A is r_0.

In contrast, the relationships between insurance premiums and assumed interest rates are shown in Quadrant B in the upper-left part of the figure. If the assumed interest rate is r_0, then the insurance premium from Point B is p_0. In Quadrant C in the upper-right part of the figure, the relationship between insurance premiums and life insurance demand is shown as a downwards-sloping curve.

Figure 10-5. Mechanism by which investment yields affect demand for life insurance



Thus, if the insurance premium is p_0, then the demand for life insurance from Point C is Q_0, thereby determining the amount of new policies coming into force.

However, the deteriorating investment environment today is causing investment yields to trend downwards. This is depicted by Point D in Quadrant A. If the investment yield is lower than x_0 at x_1, the assumed interest rate will likely be lowered from r_0 to r_1 in order to prevent negative spreads from arising.

In such a case, the insurance premium from point E in Quadrant B will increase from p_0 to p_1, and the demand for life insurance from point F in Quadrant C will decline from Q_0 to Q_1.

In this way, a lowering of investment yields will cause insurance premiums to rise through the lowering of assumed interest rates, which in turn will cause

life insurance demand to flounder. This will bring down the number of new policies coming into force, thereby ultimately shrinking the total amount of insurance policies in force and assailing the life insurance market.

Part 3: Negating the portfolio-rebalancing effect

The Bank of Japan's unprecedented easing measures gave rise to an investment environment that has proven to be very difficult for life insurance companies since the lowering of investment yields forced them to reduce assumed interest rates.

Under normal conditions, these measures would have elevated the Japanese economy, thereby automatically leading to increased demand for life insurance products. The resulting expansion in the number of new policies coming into force would have also increased the total amount of insurance policies in force.

However, the Japanese economy has, contrary to expectations, been unable to extricate itself from a deflationary state. The resulting outcome is one in which only interest rates have been lowered to abnormal levels. For life insurance companies, adverse winds blow accordingly.

In light of these developments, will the portfolio-rebalancing effect as tested by the Bank of Japan continue to be promoted as initially speculated? If interest rate levels generally decline, the appeal of safe assets typified by government bonds will fall on a relative basis.

Since the weight assigned to riskier foreign bonds will increase, a weakening of the yen is conceivable. Life insurance companies are in fact increasing their holdings of foreign bonds as a percentage of total assets while lowering their holdings of government bonds as a percentage of total assets.

In this context, the lowering of assumed interest rates could induce adverse developments, since the possibility that a company can avoid negative spreads even if it does not increase its holdings of riskier assets will rise. If this is the case, it would not be strange to see a shift towards lowering holdings of foreign bonds as a percentage of total assets from the standpoint of emphasizing the stability of financial affairs.

The biggest mission of a life insurance company is to properly carry out insurance policies to which it is bound. Such a company should choose to engage in sound investments to properly ensure that assumed interest rates are achieved rather than seek to obtain high levels of dividends through unreasonable

investments.

Therefore, life insurance companies will likely come to hold large amounts of highly safe assets while complying with a conservative investment philosophy. This approach would be more welcomed by policyholders as well.

The Bank of Japan lowered interest rate levels through its unprecedented easing measures and has been promoting a shift from government bonds to foreign bonds in hopes of getting life insurance companies and other financial institutions to achieve a portfolio-rebalancing effect. However, if life insurance companies were to lower their assumed interest rates, adverse developments could arise. As a result, they may shift from foreign bonds to government bonds, thereby negating moves to weaken the yen as sought by the Bank of Japan.

Ultimately, the Bank of Japan's unprecedented easing measures appears likely to bring about results that are contrary to expectations with the passage of time. There may be a further erosion of insurance policies, and we will not necessarily see holdings of foreign bonds turn favorably towards expansion. This is because unduly drastic financial easing measures caused interest rate levels to substantially decline, which in turn caused life insurance companies to lower assumed interest rates as a preventive measure. It is conceivable that this impact will gradually become more obvious in the coming years.

Conclusion

Declining birthrates and aging societies are a common feature of advanced nations everywhere. Once income levels increase and wealth to a certain extent is accumulated, the number of children in a country tends to decrease, while the number of elderly persons conversely increases. These trends have a negative impact on various areas of economics. One such example is the pension issue.

Pay-as-you-go public pension schemes rely on age distribution, such that a declining birthrate and aging society naturally combine to give rise to an impasse. In any case, benefit amounts will be cut. Shortfalls are offset by savings-type life insurance products, such as individual insurance plans offered by private-sector life insurance companies.

However, an ultra-low interest rate investment environment has persisted over an extended period of time. Under these conditions, high investment yields cannot be expected. For this reason, companies have no choice but to charge high premiums to fund a certain level of benefits as assumed interest rates fall. While it is true that such plans serve as a means of complementing public pension schemes, life insurance products are invariably subject to limits as well in the context of such a severe investment environment.

Amid this state of affairs, the problem of longevity risks is clamoring to be heard. Lifespans are increasing for both men and women, such that it is no longer uncommon to see centenarians out and about. While long life is certainly something to celebrate, a bankruptcy in one's post-retirement years is a distinct possibility in light of how funds might be managed over the lifetime of an individual.

In fact, there are more and more elderly persons whose funds become depleted and who are unable to live properly with just the benefits provided by their public pension plans. Someone who managed to live in financial comfort in his or her younger days would likely have enough savings for his or her post-retirement years and can thus adequately absorb the longevity risks in question, but this is perhaps beyond reach for many in society.

Even people who have worked hard their entire lives can potentially be reduced to poverty by living longer than they might have expected. In response to such changes in the economic environment, life insurance companies continue to provide conventional savings-type life insurance products.

While it is true that savings-type life insurance products bolster funds needed for post-retirement living, these funds could become depleted with age. Given how difficult it is to determine how much longer a client might live, a company is unable to easily formulate a solid financial plan.

Moreover, the more an individual grows older, the more he or she incurs medical expenses and becomes living in a state of anxiety. At the same time, there is a limit to how well you can amass sufficient funds for your post-retirement years from a young age.

Irrespective of the fact that longevity risks are materializing, the current reality is that effective solutions have not been identified. Nevertheless, if life insurance companies were to change their conventional mindset, they might still be able to offer people a sense of security to some extent for the leading of post-retirement lives. As mentioned in this book, this entails the selling of pure endowment insurance.

Individual annuity plans and other examples of modern pure endowment insurance products also include death protection. With a pure endowment insurance plan that provides coverage only for the protection of existence and that is moreover a fixed-term insurance plan, the difference between insurance money and insurance premiums increases with age. If this difference were regarded as earnings, it would be reflected in fairly attractive financial instruments.

Of course, pure endowment insurance is such that no insurance money would be paid out if the client dies. While it is a type of insurance product that is meaningless to an elderly person hoping to leave some money behind for surviving family members, death protection is not needed by an elderly person who is single or who has no children. Instead, funds for his or her own life would be more important for such a person. Thus, such a life insurance product would constitute a potent financial instrument capable of providing support for leading a post-retirement life.

Since earnings increase the longer clients live, this type of insurance not only provides economic benefits to provide support for leading a post-retirement life but also works positively from a psychological standpoint, since it naturally boosts a client's zest for life.

As age brackets get higher, the number of policyholders in a given age bracket declines, such that a limit to how much insurance can be sold might possibly emerge at some point. These sorts of policies, however, can be

sufficiently sold within certain bounds. I believe that this can ease, even if only to a small extent, a declining birthrate and aging society, problems that remain thorns in the side of the Japanese economy.

Generally speaking, life insurance products are associated with an important factor consisting of investment yields. No matter how much a company seeks to formulate an advanced investment strategy, high yields cannot be realistically sought given today's ultra-low interest rate investment environment. Even if you cannot expect to obtain much in terms of investment yields from a pure life insurance policy, the results for any given client are determined according to the probability of survival as calculated in accordance with a mortality table. Thus, higher rates of return can be obtained and greater stability is provided as clients get older.

The economic environment in which Japan operates is utterly at odds with what it was like in the past. Life insurance companies must sell products that also keep pace with everything that has changed over the years. Doing so will not only allow life insurance companies to grow but also give rise to favorable outcomes in terms of the economic welfare of the people.

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