Deregulation and Liberalization in Japanese General Insurance Market

29th October 2004

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SOMPO JAPAN INSURANCE INC.
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1. Features of Japanese General Insurance Market

Non-life Insurance Premium by Country 2003

USA, 46%
China, 1%
Japan, 8%
Other, 12%
Belgium, 1%
Swiss, 1%
South Korea, 1%
Australis, 1%
Netherland, 2%
Spain, 2%
Canada, 3%
Italy, 3%
France, 5%
UK, 7%
Germany, 7%

World Total
USD1,268,157M

Source: Swiss Re
1. Features of Japanese General Insurance Market

Insurance density and penetration in selected markets, 2003

Non-life insurance premiums per capita
Life insurance premiums per capita
Non-life insurance premiums in % of GDP

Source: Swiss Re
1. Features of Japanese General Insurance Market

**Number of Companies**

<table>
<thead>
<tr>
<th>Domestic insurers</th>
<th>29</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign insurers</td>
<td>23</td>
</tr>
</tbody>
</table>

※Domestic insurers: Licensed as domestic insurer
※Foreign insurer: Licensed on a branch or agent basis

(Domestic insurers with Foreign Capital: 4)

**Size of Industry**

- **Direct Premiums**: 8,748.1 billion yen
- **Savings-type Premiums**: 1,478.0 billion yen

**Number of Directors, employees and agencies**

- **Directors and employees**: 83,000
  (Member companies of the General Insurance Association of Japan as of April 1, 2002)

- **Full-time**: 16.8%
- **Part-time**: 83.2%
- **Corporate**: 38.9%
- **Individual**: 61.1%
- **Exclusive**: 78.8%
- **Multi-Rep.**: 21.2%

- **Number of Agencies**: 306,000
  (As of the end of FY 2003)

- **Weight of Direct Premiums**
  - Agents: 92.9%
  - Direct: 6.9%
  - Broker: 0.2%

- **Insurance Premium per capita**: 68,500 yen

**Assets and Investment**

- **Total Assets**: 32,942.0 billion yen
- **Investment Assets**: 29,691.4 billion yen

※as of March 2004
1. Features of Japanese General Insurance Market

Transition of Total Direct Premiums (※million yen)

Direct premium has increased from ¥60 billion to ¥8,750 billion, about 150 times during the 50 years.

Direct Premium by Class of Business

Automobile insurance has increased remarkably.

※compulsory automobile liability insurance
## 2. Development of Deregulation

### Legal Reform

<table>
<thead>
<tr>
<th>Year</th>
<th>Amendment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1936</td>
<td>Former Insurance Business Law</td>
</tr>
<tr>
<td>1948</td>
<td>Non-life insurance rating organization Law</td>
</tr>
<tr>
<td>1951</td>
<td>Amendment of Insurance Business Law and Non-life insurance</td>
</tr>
<tr>
<td></td>
<td>rating organization Law</td>
</tr>
</tbody>
</table>

### Liberalization of products

- Rating organization provides "Advisory Rate".
- "Obligatory Rate" Need to adhere to organization rate.

### 1996.4 New Insurance Business Law

- Mutual entry of life and non-life insurance companies thorough subsidiaries
- Introduction of Broker System
- Review of the tariff system
- Introduction of “File & Use” System for product development

- “Reference Expense Cost” (advisory expense cost for Fire insurance)

- File & Use for 14 products
## 2. Development of Deregulation

<table>
<thead>
<tr>
<th>Year</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996.11</td>
<td>Initiation of “Big Bang”</td>
</tr>
<tr>
<td>1996.12</td>
<td>Japan-US Insurance Talks completed</td>
</tr>
<tr>
<td>1998.07</td>
<td>Amendment of rating organization Law - &lt;Review of the Rating Organization System&gt;</td>
</tr>
<tr>
<td>2000.05</td>
<td>Amendment of insurance business Law - OTC Insurance sales by banks (partial)</td>
</tr>
</tbody>
</table>

**Legal Reform**

- “risk-segmented” automobile insurance (1997.09)
- “Reference Loss Cost” (advisory loss cost for Automobile, Fire, PA) (1998.07)
- Expansion of File & Use (1997.01, 1999.08)
3. Current Regulation of Insurance Products

1. “File & Use System” was introduced for limited classes in 1996 in accordance with Japan-US Insurance Talks.
2. Eligible class has been added up gradually since then.
   Remaining Prior Approval products are as follows.

Type of products still under “Prior Approval System”

- Compulsory Automobile Liability Insurance
- Earthquake Insurance on Dwelling Risks
- Third sector insurance (Personal accident insurance, Medical expense insurance, Overseas travelers’ personal accident insurance etc.)
- Automobile insurance (“Non-fleet” policyholders with less than 10 insured vehicles)
### Historical Development

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948</td>
<td>Establishment of “Non-Life insurance rating organization of Japan”</td>
</tr>
<tr>
<td>1951</td>
<td>Organization rate became mandatory for members to adhere to.</td>
</tr>
<tr>
<td>1964</td>
<td>Establishment of “Automobile insurance rating organization”</td>
</tr>
<tr>
<td>1996</td>
<td>Rate filing system shifted to “Notification” from “Approval”.</td>
</tr>
<tr>
<td>1998</td>
<td>Abolition of obligation of the members to adhere to organization rate. (with 2-year transition period)</td>
</tr>
<tr>
<td>2002</td>
<td>Merger of the two rating organizations</td>
</tr>
</tbody>
</table>
### 4. Rating Organization

**~March 96 Obligatory rate**
- **CALI Earthquake**
  - Rating Organization
  - Insurer
  - Full premium rate
    - Loss Cost
    - Expense Cost
  - Antimonopoly Act exempted
  - Obligation to adhere to organization rate

**April 96~ Obligation relaxed for Fire expense cost**
- **Automobile Fire Personal accident**
  - Rating Organization
  - Insurer
  - Full premium rate
    - Loss Cost
    - Expense Cost
  - Antimonopoly Act exempted
  - Obligation to adhere to organization rate

**July 97~ Advisory loss cost system**
- **Standard full rate**
  - Loss Cost
  - Expense Cost
- **Advisory pure risk premium rate**
  - Reference Loss cost
  - Each insurer can calculate Fire expense cost for “large mount” items.
  - Antimonopoly Act NOT exempted
  - No obligation to adhere to advisory rate (Auto, Fire, PA)

**Calculated by each insurer with reference to advisory rate**
- **Calculated by each insurer**
5. Progressed “Post” Regulation

1996

MOF

FSA

Financial Supervisory Agency

FSA

Financial Services Agency

Insurer Protection
(Regulation to avoid insolvency)

Preventive Regulation

“Ex post facto” Regulation
(transparent regulatory rules)

Policyholders Protection Measures

- Enhanced Disclosure
- Solvency Margin Ratio and Early Warning System
- Guarantee Fund System (Establishment of PPC)

Awareness of own risk (consumers)
Assuming enhanced responsibility (management)
Policyholder Protection against insurer insolvency

Progressed Post Regulation

Publication of Insurers Inspection Manual/ Guideline for Supervision

Off-site monitoring
**6. Early Warning Measures**

- A measure taken by the government urging insurance companies to improve their management at an early stage in accordance with solvency margin ratio
- Implemented in April 1999.

An order to submit a business improvement plan will be issued in accordance with the solvency margin ratio.

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Solvency Margin Ratio</th>
<th>Content of Measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not-applied</td>
<td>More than 200%</td>
<td>—</td>
</tr>
<tr>
<td>1st Criterion</td>
<td>Less than 200%</td>
<td>An order for submission of a business improvement</td>
</tr>
<tr>
<td>2nd Criterion</td>
<td>Less than 100%</td>
<td>• Orders for submission of plans to reinforce capital adequacy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• prohibition of dividends or executives' bonuses</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• decrease in expenses cost</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• a scale-down in business of subsidiaries etc</td>
</tr>
<tr>
<td>3rd Criterion</td>
<td>Less than 0%</td>
<td>An order for suspension of partial or total business operations</td>
</tr>
</tbody>
</table>
When a reliever appears..

Insolvent Insurer

Unable to complete contractual liability

Policyholder

Portfolio Transfer

Compensation (depends on the line)

Reliever Insurance Company

Application For aid

Financial Aid

Member Insurers

Annual Prior Contribution

Policyholder Protection Corporation
When a reliever doesn’t appear..

Insolvent Insurer

- Unable to complete contractual liability

Policyholder

Member Insurers

Portfolio Transfer

Compensation (depends on the line)

Policyholder Protection Corporation

- Administer transferred portfolio

- When a reliever appears, transfer the portfolio to the reliever.

Annual Prior Contribution
Eligible Contracts & Compensation Ratio

<table>
<thead>
<tr>
<th>Type of Product</th>
<th>Compensation Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Decided by the level of insolvent insurer’s reserve</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Eligible Contracts (Personal line products)</th>
<th>0%</th>
<th>90%</th>
<th>100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>• CALI</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Earthquake Insurance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Automobile insurance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Fire insurance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Third sector insurance (personal accident, medical expense etc.)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Non-Eligible Contracts Other than the above policies</th>
<th>0%</th>
<th>90%</th>
<th>100%</th>
</tr>
</thead>
</table>

Eligible Contracts: Cover by insolvent Insurer, Cover by PPC, No cover
Number of Non-life insurers

<table>
<thead>
<tr>
<th>Year</th>
<th>Domestic</th>
<th>Foreign</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>23</td>
<td>39</td>
<td>62</td>
</tr>
<tr>
<td>1995</td>
<td>26</td>
<td>31</td>
<td>57</td>
</tr>
<tr>
<td>1996</td>
<td>33</td>
<td>30</td>
<td>63</td>
</tr>
<tr>
<td>1997</td>
<td>33</td>
<td>32</td>
<td>65</td>
</tr>
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<td>1998</td>
<td>35</td>
<td>28</td>
<td>63</td>
</tr>
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<td>35</td>
<td>26</td>
<td>64</td>
</tr>
<tr>
<td>2000</td>
<td>38</td>
<td>26</td>
<td>64</td>
</tr>
<tr>
<td>2001</td>
<td>33</td>
<td>22</td>
<td>55</td>
</tr>
<tr>
<td>2002</td>
<td>30</td>
<td>24</td>
<td>54</td>
</tr>
<tr>
<td>2003</td>
<td>29</td>
<td>22</td>
<td>51</td>
</tr>
</tbody>
</table>

The top 6 market share: 59%

The top 6 market share: 91%
<<Development of mergers of the top 5>>

- **Sompo Japan**: Apr., 2002 to Jul., 2002 to Dec., 2002
  - DLPC
  - Nissan
  - Taisei

- **Tokio Nichido**: Oct., 2001 to Oct., 2004
  - Tokio
  - Nichido
  - Millea

- **Mitsui Sumitomo**: Oct., 2001
  - Mitsui
  - Sumitomo

- **Nippon Koa**: Apr., 2001 to Apr., 2002
  - Nippon
  - Koa
  - Taiyo

- **Aioi**: Apr., 2001
  - Dai-Tokyo
  - Chiyoda
9. Overview of Japanese financial sectors - Environments -

- Indication of recovery in economy
- Take off from deflation
- Progress of deregulation

Banks
- Bail-out from non-performing loan problem
- Balance sheet restructuring
- Expansion of fee business
- Further consolidation

Life insurers
- Narrowing negative spread
- Matured market
- Expansion of consultation style sales

Securities companies
- Intensified competition with newcomers
- Liberalization of brokerage fee
- Expansion of on-line trading

Non-life insurers
- 1st stage of consolidation is ending
- Matured market
- Stable underwriting profit

Rebound of stock market from the post-bubble historical low
Conversion from historically low interest rate
Relatively high financial stability among the financial sector

- Differentiated business strategy is critical
- Bipolarization to the winners and the losers
10. General Insurance Industry in Japan - Business Environment

Deregulation
- Liberalization of agency commission
- Diversity of distribution channels
- Flexible product development
- Hardening competition

Matured economy
- Slow growth of property insurance
- New business chance in the aging society
- Stable loss ratio

Change in distribution structure

Insurers
- Lowered barrier among the financial sectors
- Reengineering of business flow (between insurer and agent)
- Diversification of profit sources
- Alliance with different sectors

Products
- New products for longevity risk
- New product with higher cost efficiency
- Bipolarization of products consultation vs. commodity
- Development of Alternative Risk Transfer solutions

Agents
- Incorporation, merger and sophistication
- Promoting cross-sales of life and non-life
- Utilization of IT
- Flight to winners in the market

Stable loss ratio

New business chance in the aging society

Slow growth of property insurance

Insurers

Diversification of distribution channels

Agents

Flexible product development

Matured economy

Hardening competition

Change in distribution structure

Deregulation

Diversify profit sources through other financial and related industries where synergy is expected and risk correlation is low.

- **Healthcare and Other fee business**
  - Aggressive development through affiliation

- **Asset management business**
  - Mutual fund business will expand as individual financial assets shift from deposits to risk assets. If Defined Contribution market expands, mutual fund sales will flourish further.

- **Life insurance business**
  - Life Insurance subsidiary will contribute to consolidated profit.
  - Enhanced revenue by original distribution channel and product strategy

- **Non-life insurance business**
  - Increased profits through low-cost operation

- **Investment profit**