

Life insurer's bankruptcies < our experience in Japan >

International Forum of Insurance Guarantee Schemes
2016 Asia Regional Meeting, April 2016

Nobuyasu UEMURA, Ph.D.
(Capitas Consulting Corporation)

Nobuyasu Uemura

- Managing Director, Capitas Consulting Corporation
 - Based on experience analyzing and assessing insurers' management as a credit analyst and regulator for about 20 years
- As an analyst at Rating and Investment Information Inc. (R&I), covering mainly insurance industry (1997-2010)
- In FSA Japan, mainly in charge of monitoring and encouraging enterprise risk management (ERM) of insurers (2010-12)
 - Also in charge of upgrading of solvency regulations
- Received Ph.D. in 2008, study of midsize insurers' bankruptcy in Japan
 - *“The Failure without Management: Truths behind the Seiho Crisis in the Heisei Era”*

Today's Agenda

1. Bankruptcy of Midsize Life Insurers

- A series of midsize life insurance companies failed from the late 1990s to the early 2000s.

2. Benefiting from the experience of failures

- Development of ERM (Enterprise Risk Management) accelerated in the Japanese insurance industry

1. Bankruptcy of Midsize Life Insurers

- the Seiho Crisis in the Heisei Era
 - From April 1997 to March 2001, seven mid-size life insurers failed in just four years
 - Combined assets of these 7 companies accounted for over 10% of the industry
 - Some of the major life insurers suffer from solvency problem later
 - Life insurance liabilities are usually long term
 - The mismatch between the durations of assets and liabilities
 - As the need for a whole-life protection is strong in Japan
 - Market and credit risks are also important
 - Stock price volatility risk
 - Bad loan problem in life insurers

1. Bankruptcy of Midsize Life Insurers

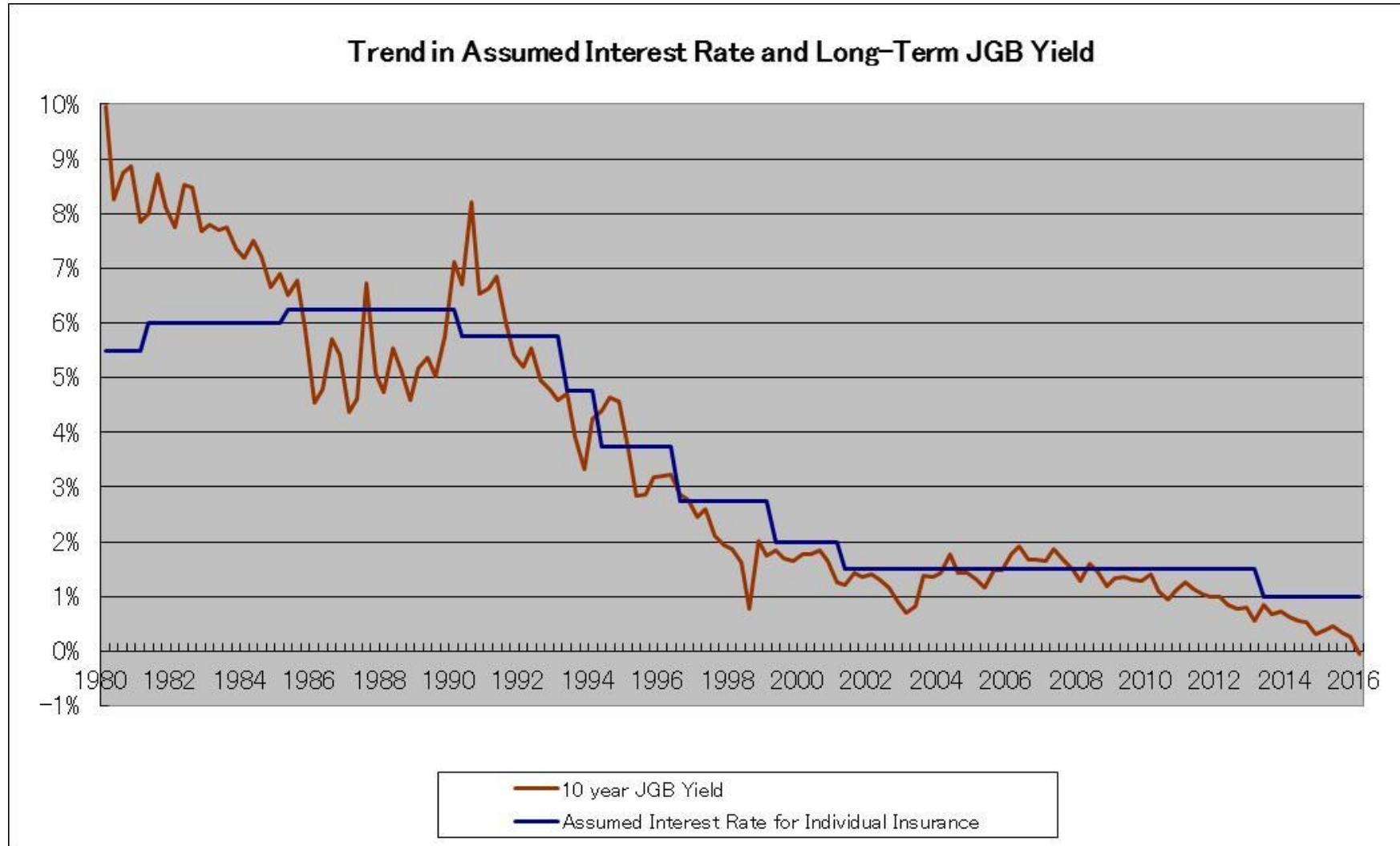
Life insurer's bankruptcy								
	Nissan	Toho	Daihyaku	Taisho	Chiyoda	Kyoei	Tokyo	Yamato
period of bankruptcy	Apr-97	Jun-99	May-00	Aug-00	Oct-00	Oct-00	Mar-01	Oct-08
procedure	insurance business law				rehabilitation procedure			
negative net worth	302.9bn.	650.0bn.	317.7bn.	36.5bn.	595.0bn.	689.5bn.	731.0bn.	64.3bn.
financial help	200.0bn.	366.3bn.	145.0bn.	26.7bn.	no	no	no	27.8bn.
cut of reserve	0%	10%	10%	10%	10%	8%	0%	10%+
goodwill	123.2bn.	240.0bn.	147.0bn.	7.0bn.	約320.0bn.	364.0bn.	32.5bn.	3.2bn.
guaranteed rate								
- before bankruptcy	unknown	4.79%	4.46%	4.05%	3.70%	4.00%	4.20%	3.35%
- after bankruptcy	2.75%	1.50%	1.00%	1.00%	1.50%	1.75%	2.60%	1.00%
early surrender charge	7 years	8 years	10 years	9 years	10 years	8 years	10.5 years	10 years
rehabilitation sponsor	LIAJ *	GE	Manulife	Yamato life	AIG	Prudential	Taiyo & Daido	Prudential

* Life Insurance Association of Japan

What Caused the Failure?

- View that “failure was inevitable”
 - Impact of the burst bubble economy
 - Decline in interest rates
 - Drop in stock and land prices, etc.
 - Business environment in 1980s
 - Assumed interest rate (guaranteed rate) raised
 - Burden from dividends to policyholders
 - Supervisory attitude of regulator, etc.
- Were these the only “external factors” accounting for the bankruptcies?

Decline in Interest Rate



Bankruptcy and Internal Factors

- Detailed examinations of individual cases
 - Interviews with relevant individuals
(Managers and actuaries at that time)
 - “Internal factors” unique to individual companies played important roles
 - (1) Related to business models
 - (2) Related to management team
 - (3) Related to management structure
 - The chain of internal and external factors ultimately drove insurers to bankruptcy

Nissan Life

Total assets		100 million yen, %		
	Nissan life		Industry	
		yoy		yoy
FY 1985	3,680	19.1%	538,706	17.8%
FY 1986	4,441	20.7%	653,172	21.2%
FY 1987	6,964	56.8%	792,684	21.4%
FY 1988	13,230	90.0%	970,828	22.5%
FY 1989	16,270	23.0%	1,173,439	20.9%
FY 1990	18,555	14.0%	1,316,188	12.2%
FY 1991	19,443	4.8%	1,432,341	8.8%
FY 1992	20,285	4.3%	1,560,111	8.9%
FY 1993	21,029	3.7%	1,691,221	8.4%
FY 1994	21,461	2.1%	1,779,655	5.2%

percentage of the individual annuity in total reserve

<FY 1986>		<FY 1989>	
Nissan	Industry	Nissan	Industry
12.3%	2.9%	55.9%	6.8%

- Rapidly expanded by sales of high-interest-rate savings-type products through “Bank Ag”, which later became a burden on the management

<Testimony>

“Actuaries warned management, but couldn’t restrain the sales division and warnings fell on deaf ears.”

“The only information reaching the president was that ‘things were all right because ...’”

“The nominal data was apparently good, but did not reflect the actual state of business.”

“Financial institutions took the initiative in sales and the insurer lost control.”

Chiyoda Life

- Suffered from a large number of bad loans
 - “Bad loans” concentrated the lending in the 2.5 years between 1988 to 1990
 - high-interest-rate saving-type products were being sold

<Testimony>

“The president assigned a close Mr. A, who was his right-hand person, with no experience in asset management.”

“Because he was backed by the president, and following the unusual transfer of several objectors, no one dared to speak him up.”

“To reduce criticism, the number of participants in asset management meetings was gradually reduced, and later, leading to a system in which plans were directly brought only to Mr. A.”

Kyoei Life

- Unique business base including teachers unions, but shifted to active sales of long-term saving-type products following other insurers in mid 1980s
- Suffered from a serious negative spread problem because Kyoei continued sales them after its rivals had already stopped

Total assets		100 million yen, %		
	kyoei life		Industry	
		yoy		yoy
FY 1985	12,124	20.5%	538,706	17.8%
FY 1986	15,037	24.0%	653,172	21.2%
FY 1987	18,996	26.3%	792,684	21.4%
FY 1988	24,601	29.5%	970,828	22.5%
FY 1989	30,009	22.0%	1,173,439	20.9%
FY 1990	35,034	16.7%	1,316,188	12.2%
FY 1991	39,343	12.3%	1,432,341	8.8%
FY 1992	44,803	13.9%	1,560,111	8.9%
FY 1993	50,641	13.0%	1,691,221	8.4%
FY 1994	54,357	7.3%	1,779,655	5.2%

<Testimony>

“Mr. B, who is the founder of the company, had thought himself he had retired in 1992. But his successors depended on his judgment, despite he merely expressed his feelings.

“Only to certain members of the management knew the real business status of Kyoei.”

2. Benefiting from the experience of failures

- Our experience is not a specific to Japanese life insurance industry, but something universal

< Governance >

- For failed insurers, both “self-discipline”, “solvency regulation” or “market discipline” did not work properly
- The most important internal factors are “related to managers”.
 - Top executive competencies / inappropriate behavior of those around them / dysfunctional management team

< Risk management framework >

- Even if perfect structures are put in place, risk control will not work as long as it is not used for top management.
 - It is not true that midsize life insurers were not aware of “risk” or “risk management” at that time.

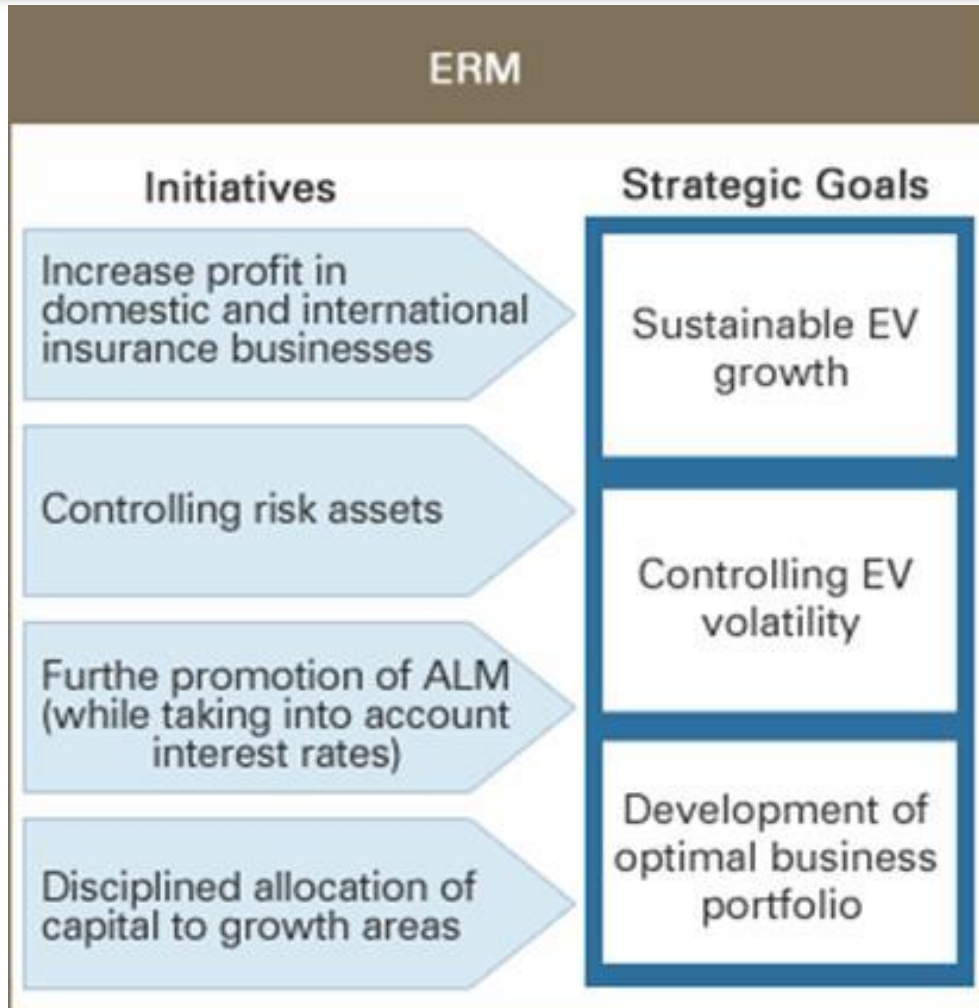
2. Benefiting from the experience of failures

- Development of ERM (Enterprise Risk Management) accelerated in the Japanese insurance industry
 - For sustainable and stable enhancement of corporate value with maintaining financial health under their risk appetite
 - Different from traditional “silo” risk management system
 - FSA Japan pays attention to insurers’ ERM.
 - FSA believes steady improvements in corporate value will help to protect policyholders.
 - Response to international trend in supervision, such as ICP16, FSAP, etc.
- => FSA requires ‘ORSA report’ since 2015.

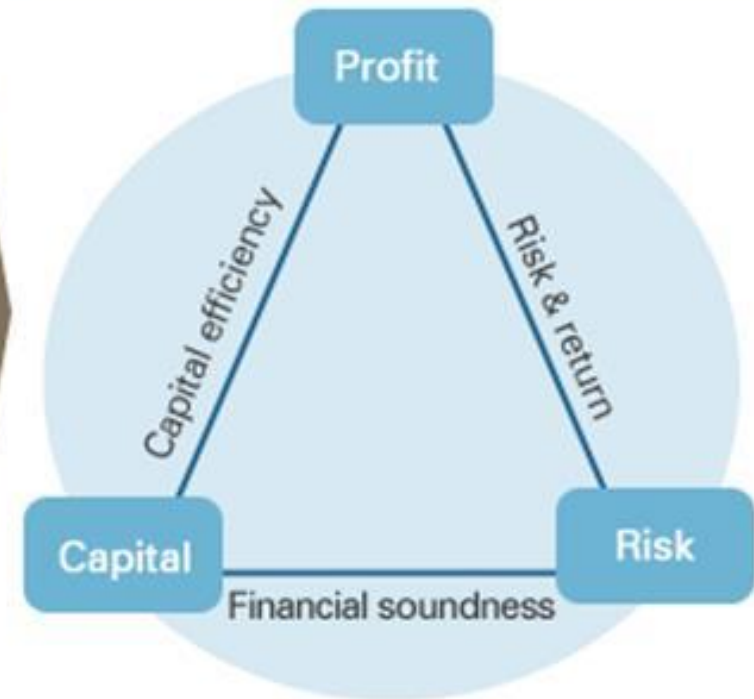
ERM and Traditional Risk Management

	ERM	Traditional Risk Management
Purpose of risk management	Achieving strategic goals while securing their capital	Avoiding and reducing losses
Covered risks	All types of risk (Incl. unquantifiable or potential risks)	Specified risks
Organization in charge	Not a specific division but the business as a whole (Company-wide activity involving the top executive)	Risk management division or other dedicated organization
Perception of risk	Integrated view of all risks	Recognized by risk type (silo approach)
Response to risk	Continuous activities	Response as needed

ERM related Disclosure (Dai-ichi Life)



Optimization of capital, risk, and profit



Trend of Asset Allocation

Asset portfolio (Japan)	(in trillion yen, %)						
	2008	2009	2010	2011	2012	2013	2014
Total	312	318	321	327	345	351	367
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Bonds	51.7%	52.0%	52.9%	55.0%	54.5%	53.8%	51.1%
Government bonds	39.7%	40.2%	41.3%	43.2%	43.1%	42.7%	40.5%
Local government bonds	3.1%	3.4%	3.7%	4.0%	4.0%	4.0%	3.8%
Corporate Bonds	8.8%	8.3%	7.9%	7.8%	7.3%	7.1%	6.8%
Loans	16.4%	14.7%	13.7%	12.9%	11.7%	10.9%	10.0%
Stocks	5.0%	5.9%	5.1%	4.5%	4.8%	5.1%	6.2%
Foreign Securities	12.8%	13.5%	14.3%	14.4%	16.2%	17.5%	20.0%
Bonds	9.8%	10.4%	11.2%	11.2%	12.8%	14.0%	16.1%
Stocks	1.4%	1.6%	1.5%	1.5%	1.5%	1.5%	1.7%
Tangible fixed assets	2.1%	2.1%	2.1%	2.0%	1.8%	1.8%	1.7%
Cash & cash equivalents	2.5%	2.2%	2.4%	1.8%	1.8%	2.0%	2.5%
Other assets	9.4%	9.6%	9.6%	9.4%	9.1%	8.8%	8.6%

Source: Life Insurance Association of Japan

Trend of Asset Allocation

Estimated bond maturities								(year, %)
	2008	2009	2010	2011	2012	2013	2014	vs.2006
Nippon	11.75	12.12	13.84	14.91	15.06	15.24	15.35	4.90
Dai-ichi	13.39	13.79	14.55	15.18	16.02	16.77	17.40	5.64
Sumitomo	11.68	13.52	14.58	15.12	15.88	16.32	16.78	9.56
Meiji Yasuda	10.35	11.96	14.47	15.40	15.39	15.50	15.62	7.87
Mitsui	12.85	13.29	13.58	13.92	15.27	15.48	16.34	5.42
Asahi	12.13	12.09	13.64	13.53	14.37	15.70	15.76	5.66
Taiyo	12.47	13.42	13.93	13.91	14.08	13.56	13.67	4.80
Daido	5.50	6.13	7.88	9.58	10.80	11.25	11.84	6.56
Fukoku	12.80	13.61	14.89	15.41	15.91	15.54	15.24	6.11

* Estimated bond maturities : calculated by 0-1 year = 0.5year, 1-3 year = 2year, 3-5 year = 4year, 5-7 year = 6year,
7-10 year = 8.5year, 10 and over 10 year = 20year

Product strategy

Dai-ichi Life

ブライト^{ウェイ}Way "Bright Way", whole life insurance
(with dividend every 5 years)

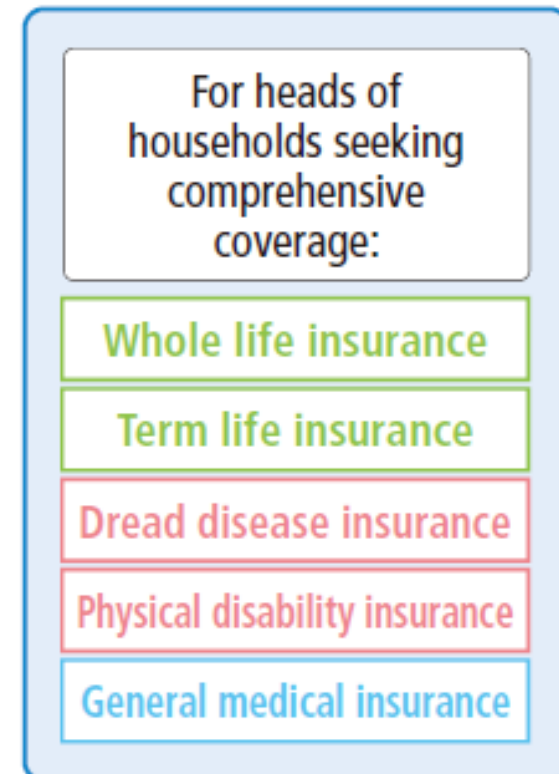
* with Waiver of premium rider

Whole life insurance	0.3 million yen
Assist Seven rider	29 million yen
Assist Seven Plus rider	1 million yen
Ino Ichiban NEO rider (60day type)	10,000 yen per day
Eight lifestyle-related disease hospitalization rider (120day type)	10,000 yen per day
Advanced medical care rider	

Nippon Life

(Mirai no Katachi)

Choose insurance as needed



Thank you !