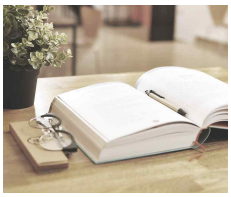

CEO Brief

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CEO Brief is a report highlighting key current issues the insurance industry faces.

Case Studies of Failed Japanese Life Insurers

ABSTRACT

The reasons of the failure of Japanese small and medium-sized life insurers are: first, as both of government and life insurers pursued policy purposes and management goals without understanding ALM, savings-type insurance that guaranteed high assumed interest rates during the asset price bubble period grew rapidly and the negative spread occurred on a large scale after collapse of asset price bubble. Second, asset management capabilities were insufficient and risk management consistent with the characteristics of savings-type insurance was not carried out. Thirdly, internal and external discipline for management was weak, and managers had no leadership or was dogmatic and did not understand asset management and actuarial system, and as a result, asset management was subordinated to sales. Learning from failures, Japanese life insurers have raised capital, and narrowed the duration gap between assets and liabilities. Moreover, they have strengthened the internal and external discipline through the introduction of an integrated risk management system and the disclosure of the embedded value of the company, and made an effort to improve profitability rather than external growth.

1. The Reasons of Japanese Life Insurer Failures

Despite falling long-term market interest rates, assumed interest rates were raised in 1976, in 1981, and in 1985; however, when the asset price bubble burst and market interest rates fell, the negative spread occurred.

Japanese life insurers raised assumed interest rates because of the following reasons: public opinion at that time was unfavorable to life insurers; their competitors, such as the Postal Life Insurance and the National Mutual Insurance Federation of Agricultural Cooperatives, raised assumed interest rates; Japanese life insurers had no knowledge of ALM (Asset Liability Management).

After being permitted to sell saving-type insurance products linked to bank loans during the period of asset price bubble, the asset expansion competition became fierce, and as life insurers were more exposed to market risk, interest rate risk, and credit risk, the possibility of insolvency increased. In addition, the supervisory authority demanded that life insurers strengthen their roles of providing savings-type insurance and invest in stocks in order to respond to financial liberalization, internalization, and population aging. In an effort to overcome inferior sales forces and solve chronic expense losses, small and medium-sized insurers focused more on savings-type insurance and asset expansion. As a result, six out of the eight small and medium-sized insurers that gained higher market share during the period of asset price bubble went bankrupt.

The lack of understanding of the characteristics of savings-type insurance, lack of autonomy of life insurers, and insufficient capabilities of asset management led to the failure of Japanese life insurers. Not only did asset management concentrate on high-risk assets, such as stocks, loans, and overseas securities during the period of asset price bubble, but even when the bubble burst and interest rates fell, investment in high-risk assets increased.

Managers of Japanese life insurers lacked a sense of responsibility, had no knowledge of ALM, and did not actively respond to the change of business environment. In addition, the internal and external discipline was very weak, and the supervisory authority was not concerned about liabilities and treated life insurers like banks.

2. The Cases of Failed Japanese Life Insurers

From April 1997 to March 2001, Nissan Mutual Life, Toho Mutual Life, Daihyaku Mutual Life, Taisho Life, Chiyoda Mutual Life, Kyoei Life, Tokyo Life went bankrupt in order. Nissan Mutual Life was excessively dependent on individual annuities with high assumed interest rates, which the ratio of individual annuities to policy reserve reached 56% in 1989 (industry average 7%). Toho Mutual Life, which had a high reliance on stocks for ordinary profits due to its low-profit structure and focused on savings-type insurance, suffered from large stock valuation losses and the increase in its non-performing loans when the bubble burst. Daihyaku Mutual Life, which had the lowest efficiency and productivity, did not carry out proper risk management, and failed to raise capital. Taisho Life was swindled in the process of raising capital in an effort to increase the solvency ratio. Chiyoda Mutual Life and Kyoei Life could cope with negative spread due to mortality profits and expense profits. However, for Chiyoda Mutual Life, increase in non-performing loans and a reduction in group pensions, and for Kyoei Life, absence of management and investment losses led to the failures. Tokyo Life focused too much on sales and relied on Daiwa Bank in asset management; however, as asset management was implemented in the perspective of the bank, the characteristics of insurance liabilities were not adequately taken into consideration.

3. Lessons to Japanese Life Insurers

Japanese life insurers have raised capital, and narrowed the duration gap between assets and liabilities. Moreover, they have strengthened the internal and external discipline through the introduction of an integrated risk management system and the disclosure of the embedded value of the company, and made an effort to improve profitability rather than external growth.

Seong Hun Yun, Senior Research Fellow
shyun@kiri.or.kr