Learning About Life Insurance for the Very First Time

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「はじめて学ぶ生命保険」英語版出版に寄せて

まずは、本書を英語版に翻訳していただいたアジア保険振興センターの方々に御礼を申し上げます。

本書は「日本の生命保険業」について、初歩的ではあるものの、情報を幅広く網羅することを通じて、生命保険業についての理解を初心者であっても深められるようにしたものです。ここでは大きく三つのことを述べたいと存じます。

最初の一点目ですが、本書では「日本の」生命保険業を取り扱っています。この意味として、まず一つ目が、日本の家族のかたちを前提として生命保険商品が設計され、事業が発展してきたということです。伝統的には、養老保険や終身保険に、高額な定期保険を特約で付加するといった死亡保障を重視した商品が多く販売されてきました。これは戦後の核家族において、家計の主な収入源が夫であり、妻が専業主婦やパートなどであった戦後日本の家庭環境を前提としていました。貯蓄性がありつつも、死亡保障を重視するいわゆる遺族のための保険を販売してきました。しかし、女性の社会進出によって共働き世帯が当たり前となったことや、そもそも結婚しない人が増加したことなどを背景に、医療保障といった病気に備えた保障や、個人年金などの老後保障といった自分のための保険が多く販売されるようになりました。

二つ目には日本の社会保障制度との関係があります。日本では公的医療保険によって医療については国民皆保険が実現しています。医師の受診や薬の処方といった基本的な医療費の大部分（原則7割）は公的保険で給付されます。そのため民間医療保険は公的医療保険がカバーできていない保障ニーズをカバーするように設計されています。日本で多く販売されている民間医療保険は、差額ベッド代や入院による家族の交通費などをカバーするため、入院したことや入院日数によって、固定された金額で給付金を提供するような商品となってます。

三つめは生命保険の販売チャネルです。一つ目とも関係がありますが、伝統的な生命保険会社においては、主に女性である専業の生命保険募集人によって保険商品が販売されてきました。これは戦争によって配偶者をなくした女性の働き先を確保することを意味していました。しかし、昨今では規制緩和や通信技術の発展により大規模な乗合代理店や銀行窓販、あるいはネット販売が増加してきています。

次に、大きく二点目は、海外の生命保険事業との関係で注目すべき事情

があります。日本の生命保険業界には、戦後早くから海外からの生命保険会社が参入してきていました。日本の生命保険会社が死亡保障を中心に販売していたのに対して、海外からの生命保険会社は日本において医療保険やがん保険などを中心に販売をしていました。

その後、高予定利率の貯蓄性商品を販売していた日本の生命保険会社がバブル崩壊に伴う逆ザヤなどの理由で破綻すると、その破綻会社を買収することで、海外の保険会社が日本に多く進出するようになりました。これらの外資保険会社は、定額個人年金や変額個人年金、あるいは外貨建保険など貯蓄性・投資性の保険を中心に販売するようになってきました。

他方、日本の保険会社の海外展開も進んできています。当初は米国などへの進出が目立っていましたが、昨今は東南アジアや南アジア、あるいはオーストラリアなど、今後、生命保険が普及すると考えられる市場への参入を行うようになってきました。

そして最後、三点目ですが、現在の日本の生命保険会社においては、通信技術の発達によるビジネス展開や気候変動などへの対応が要請されてきています。

一つ目にはインシュアテックによる商品の開発が挙げられます。生命保険会社においては、デジタルとの連動による健康増進型商品の開発・販売が行われ、また商品の説明から加入まですべてネットで完結するネット専用型保険などが販売されています。

二つ目にはサステナブルな事業展開が要請されていることです。世界の投資市場における大きな流れとして、ESG（環境、社会、ガバナンス）を投資基準に組み込むことが求められます。生命保険会社では投融資にあたって、投資先がESGにどの程度取り組んでいるかを投資判断において考慮します。また生命保険会社の経営についてもサステナブルであることが求められています。

以上のような内容をこの本で学ぶことができます。全体的な生命保険事業の基本を押さえつつ、なるべく最新の状況を取り入れるように努めています。本書によって多くの方に日本の生命保険業に関する理解が広まれば幸いです。

2022年10月
松澤　登

On preparing an English-language version of *Learning About Life Insurance for the Very First Time.*

I would like to begin by expressing my appreciation to everyone at the Oriental Life Insurance Cultural Development Center for translating this book into English (and Chinese).

This book is intended to help even beginners deepen their understanding of the life insurance industry by covering a broad range of information, albeit of an elementary nature, on Japan's life insurance industry. I would like to expound on three major points here.

The first point goes to the fact that this book deals with the life insurance industry in Japan. What this means, firstly, is that life insurance products have been designed and business has been developed on the basis of the structure of the family in Japan. Traditionally speaking, many products that emphasized the provision of death coverage whereby term insurance offering a higher death benefit amount was added as a rider to an endowment insurance or whole-life insurance plan were sold. This was predicated on the way families were structured in postwar Japan, such that the husband served as the main breadwinner and the wife served as a homemaker or part-time worker. Despite having a savings component, insurance was typically sold with a focus on providing death coverage; in other words, this type of insurance was meant for surviving family members. However, as women entered the workforce to usher in an era in which dual-earner households became the norm and, indeed, as the number of people who never married increased, more and more policies designed for the policyholder, such as plans that provide medical insurance coverage against illnesses and plans that offer individual annuities for old-age coverage, came to be sold.

Secondly, there is a relationship between insurance and Japan's social security system. In Japan, universal healthcare is provided through a public medical insurance scheme. A significant portion of basic medical costs (in principle, 70%), including costs for doctors' visits and prescriptions for drugs is covered by the public system. Thus, private medical insurance is designed to address coverage needs that are not covered by the public medical insurance scheme. Many private medical insurance plans sold in Japan are products that provide a fixed amount of benefits upon hospitalization or in accordance with the length of a hospitalization stay in order to cover, for example, the cost of a

hospital room upgrade or the costs of transportation for family members due to hospitalization.

Thirdly, sales channels for life insurance products are also uniquely Japanese. At long-established life insurance companies, insurance products have been sold by captive-agents consisting primarily of women, a phenomenon that is tied to what I noted above regarding the structure of the family in Japan. In other words, women who had lost their husbands in the Second World War were able to secure jobs for themselves in this industry. These days, however, deregulation and advancements in communication technology have given rise to an increase in large-scale independent agencies, the selling of products on an over-the-counter basis at banks, and Internet sales.

The second significant point goes to circumstances that should be noted in connection with the overseas life insurance business. Foreign life insurance companies began entering the Japanese life insurance industry soon after the end of the Second World War. Whereas Japanese life insurance companies were focused on selling policies providing death coverage, life insurance companies from abroad chose to sell primarily medical insurance, cancer insurance, and other such options in the Japanese market.

Japanese life insurance companies that had been selling savings-type products that came with high assumed interest rates subsequently went bankrupt due in part to negative spreads and other issues caused by the collapse of the bubble economy, whereupon many overseas insurance companies were then able to enter the Japanese market by acquiring such failed companies. These foreign-affiliated insurance companies then came to sell mainly savings- and investment-type products, including fixed-amount individual annuities, variable-amount individual annuities, and foreign currency-denominated insurance.

At the same time, Japanese insurance companies have also been making progress in their efforts to expand overseas. While forays into such markets as the United States in the beginning were notable, companies have more recently been entering markets – such as Southeast Asia, South Asia, and Australia – where life insurance is expected to become increasingly popular in the years to come.

Finally, the third significant point goes to the fact that modern Japanese life insurance companies are now required to develop their business through advancements in communication technology and respond to such issues as

climate change.

Firstly, we should note that products are being developed based on insurtech. Life insurance companies are developing and selling health-promoting insurance coupled with digital technology and selling Internet-exclusive insurance for which everything from the provision of product explanations to enrolment is completed online.

Secondly, sustainable business development is now a requirement. The need to incorporate ESG (environment, society, and governance) into investment criteria has emerged as a major trend in the global investment market. In making investments and loans, life insurance companies take into account the extent to which investment targets address ESG issues. Life insurance companies are also required to ensure that the way they are managed is also sustainable.

You can learn about the contents outlined above in this book. I have endeavored to acknowledge the latest developments as much as possible while covering the basics of the overall life insurance business. It would please me greatly to know that this book is helping many people gain a greater understanding of the life insurance business in Japan.

October 2022
Noboru Matsuzawa

Introduction

This book was written to explain the circumstances of the insurance business conducted by life insurance companies to beginners. While there are technical aspects to the business of life insurance, I tried to make my explanations as easy-to-understand as possible for those without any knowledge of life insurance.

This book provides a broad range of explanations with a focus on matters that I would like to see students with an interest in the life insurance industry and those who have just begun working for a life insurance company or elsewhere in the financial sector – rather than those who wish to enroll in a life insurance plan – be knowledgeable about. If you are interested, I encourage you to pick up more specialized books to delve deeper into individual topics.

This book is structured as follows:

In Chapter 1, you will learn about the basics of life insurance, including the history of and reasons for the existence of life insurance and the entities that are involved in the provision of life insurance.

In Chapter 2, you will learn about life insurance products. The rules of life insurance products as well as specific products, including individual insurance plans and group insurance plans, are explained.

In Chapter 3, you will learn about life insurance solicitation. An outline of life insurance solicitation as well as explanations on specific life insurance solicitation channels and insurance solicitation rules will be provided.

In Chapter 4, you will learn about what comprises the operations of life insurance companies. Explanations will be provided on the underwriting of life insurance policies, insurance accounting, asset management, and other topics.

Chapter 5 addresses current environmental changes affecting life insurance companies and the ways life insurance companies are dealing with these changes. I will explain how life insurance companies are responding to such environmental changes as the declining birthrate and aging population and changes in competitive conditions brought about by digitalization and other trends.

Please begin by reading Chapter 1. I wrote this book in such a way that you could subsequently begin reading from any other chapter and understand what you are learning without difficulty.

Noboru Matsuzawa
February 2021

Profile of the author

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Graduated from the Faculty of Law, University of Tokyo, in 1985; obtained an LLM from Harvard Law School in 1989; served as an expert member of the Financial System Council (2004-2008) and is currently serving as a director of the Japanese Society of Insurance Science (since 2020) and managing director of the Institute of Life Insurance Management (since 2021).

[Key books and papers]

A New Bankruptcy-Resolution System for Financial Institutions and the Challenges Faced by Insurance Companies, p 51, Journal of Insurance Science, No. 626 (2014); *Q&A Insurance Law and Families* (co-authored), NIHON KAJO Publishing Co., Ltd. (2010); *Examining International Bankruptcy-Resolution Systems for Life Insurance Companies – Based on EU and US Systems*, p 99, Journal of Insurance Science, No. 609 (2010); *Insurance Law Issues and Perspectives* (co-authored), Shojihomu Co., Ltd. (2009), *A Study of the Ombudsman System in the U.K. – With a Focus on the System of Disclosing Matters*, p 207, JILI Journal, No. 168 (2009); *Insurance Brokers and the Rules Governing Solicitation – Comparing Japan, the EU, and the United States*, p 255, JILI Journal, No. 164 (2008), *Principle-Based Supervision in the UK and Japan*, p 195, JILI Journal, No. 161 (2007), and more

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Chapter 1: Basic knowledge of life insurance

Let me begin by defining the terms I will be using in this book. We may speak of selling or offering life insurance, but this concept has two aspects if we are being precise. First, *insurance underwriting* is the term that describes what happens when a life insurance company concludes an insurance agreement with a client. By underwriting an insurance policy, a life insurance company becomes responsible for covering a client and will be obligated to pay insurance money in the event of death or other contingency. On the other hand, an insurance company employee or agency will mediate between the insurance company and the client to get the insurance company to a point where it can underwrite a policy; this is referred to as *insurance solicitation*. In this book, I will in principle be using the terms *insurance underwriting* and *insurance solicitation*. I may, however, still describe the process in terms of the selling of insurance from time to time for the sake of clarity in a given context.

In Chapter 1, you will learn about the basics of life insurance. While this book is focused on life insurance, I will also touch on medical insurance and other forms of insurance that can be underwritten by life insurance companies at appropriate junctures.

In this chapter, I will first provide some basic knowledge by explaining what life insurance is and why you might need it. I would also like to examine social insurance, which exists in a complementary relationship with private life insurance. I will then lay out the history of the process by which life insurance came to be. We can then review who the players are in the life insurance industry and the organizations that oversee them. Finally, I will talk about the industries that operate adjacent to the insurance industry.

I. What is insurance that is underwritten by life insurance companies?

In this section, you will learn about the basics of life insurance. In addition to life insurance, insurance consists of non-life insurance and other forms of insurance known as third-sector insurance, such as medical insurance. I will explain what these types of insurance are and the extent to which life insurance plays a role in Japanese society.

1 What do we mean by *insurance*?

(1) To insure something

"Let's go camping this Sunday. But let's go bowling instead if it rains." This action is known as "coming up with a back-up plan" in everyday conversation. In other words, if there is bad weather unsuitable for camping, we should prepare an alternative course of action for having fun in advance.

Insurance as we generally think of the term is also regarded as a mechanism by which we prepare other options in case problematic circumstances arise to prevent us from having to be adversely affected. For example, a primary feature of life insurance is the death protection. If a husband and wife are both working and raising children, we can assume that the death of either parent will make it difficult to secure funds to cover the costs of educating the children and general living costs. To prepare for the possible occurrence of an accident involving death (we will assume here that an accident refers to death irrespective of whether the death is due to an illness or injury), you might enroll in a death insurance policy, which is designed to provide an option in the form of a death benefit to offset the lost income that would have been earned by the deceased husband or wife had he or she not met with an unfortunate end.

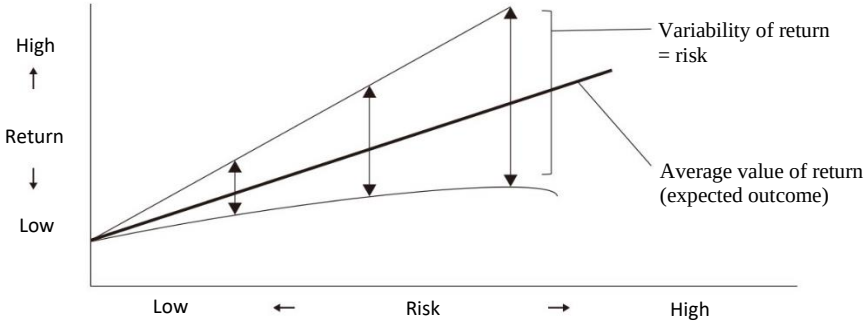
(2) Risk

The person in our household who works and earns a living may die and no longer have an income. This is what we refer to as risk. The word "may" means that we do not know if such an event will occur. In other words, it is uncertain whether an accident will occur. Risk is what describes our uncertainty as to whether a certain thing will happen and, if such a thing were to take place, the timing and manner in which the thing will happen.

Risk is, fundamentally speaking, not something that refers only to adverse

outcomes. It may be somewhat difficult to wrap your mind around this notion but risk is the variability of the actual outcome compared with the outcome that was initially expected. For example, let us look at investments. Any difference between the actual return and the expected return on an investment vehicle is referred to as risk. The increase in return above what was expected is included in the meaning of risk in a positive sense. To illustrate, imagine that you purchased an investment vehicle with an expected return of 2%. The risk in such a scenario can refer to a return that ends up being 3% or -1% (Figure 1).

Figure 1 **Risks associated with and returns on investment instruments**



On the other hand, if we limit our focus to insuring something in terms of the provision of coverage, there is no need to prepare for anything good that might happen. In this connection, I would like to proceed, for Chapter 1 only, with an understanding that risk simply means "the possibility of the occurrence of an event (accident) that would give rise to a need for money".

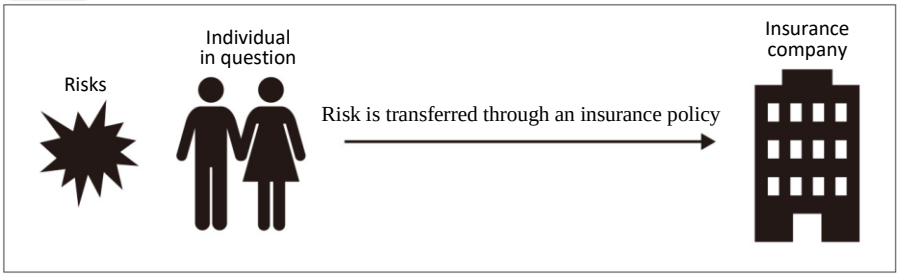
(3) Risk transfer

There are several methods of dealing with risks. To avoid the risk of getting into an automobile accident, you could simply quit driving altogether. However, risks are an inescapable part of leading an everyday life. Instead, you could try transferring risks through an insurance policy by paying insurance premiums (Figure 2 on the following page).

By transferring risk, the insurance company will take the place of the individual in question and satisfy the individual's need for money in the event that an uncertain event itself occurs. It should be noted, however, that insurance works not by having individual A's risk assumed by individual B but rather by

promoting mutual aid whereby a group of people who may have a similar need (as a group) come together to assist one another. The ability to calculate need in monetary terms is also an element of insurance.

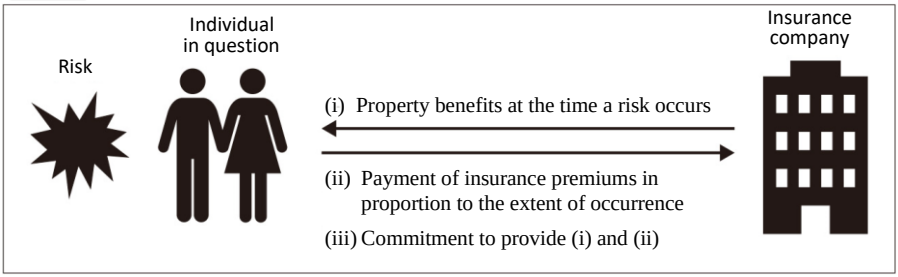
Figure 2 **Insurance serves to transfer risks**



The essence of insurance is that it allows the individual in question to lead a life with peace of mind by shifting risk to others.

While it may be a bit complicated, let us take a look at the Insurance Act, which is a statute related to insurance policies, in order to help us arrive at a definition of insurance. Figure 3 sets forth what is provided for in item (i) of Article 2 of the statute.

Figure 3 **Definition of insurance under the Insurance Act**



In simple terms, that provision stipulates that an insurance policy, regardless of its name, (i) is set up to have the insurance company pay money in the event of the occurrence of a risk, (ii) is set up to have insurance premiums that have been calculated in proportion to the extent of the occurrence of a specified risk paid by the individual in question, and (iii) represents a commitment by and between the insurance company and the individual in question to carry out (i) and (ii) above. Under the law, risks are referred to as perils.

This definition is just a legal rephrasing of what I have discussed up to this point in this book. While (i) and (iii) go without saying, I would like to focus at this time on the payment of insurance premiums "in proportion to the extent of the occurrence of a risk" as stated in (ii) hereof. This is a necessary component of insurance techniques and will be explained in more detail in III-1 of this chapter. For now, you should know that the life insurance premiums of a person with a high level of risk are greater than those of a person with a low level of risk.

2 What do we mean by *life insurance*?

There are two types of insurance: life insurance and non-life insurance. There is also a type of insurance known as third-sector insurance, such as medical insurance. While this book primarily focuses on life insurance and third-sector insurance options that can be underwritten by life insurance companies, I will begin by examining non-life insurance. Non-life insurance is insurance that "compensates for damage that arises from certain unintended incidents". Simply put, non-life insurance works by "compensating for the actual loss" that is sustained when an incident occurs. To illustrate, non-life insurance would compensate you for any damage you or someone else sustains up to the amount of the actual loss for which you are liable in the event that a fire destroys your home and you suffer damage or you are involved in an automobile accident in which an injury for which you are liable is caused to a pedestrian.

In contrast, life insurance "provides certain insurance benefits in connection with the survival or death of a person". Typical examples of life insurance consist of term insurance, which provides coverage in the event of a person's death, and annuity insurance, which provides coverage with a focus on the survival of a person.

In this way, life insurance pays out for the "survival or death of a person". It is for this reason that life insurance is sometimes known as *insurance of human lives.* As you can attach no price to human life, however, the survival or death of a person per se does not constitute damage. In other words, life insurance is not designed to compensate for damage.

Nonetheless, the death of a person will result in the drying up of funds to cover the living expenses of his or her dependents. Living a long life may be a cause for celebration but will also incur more living expenses. "Certain insurance benefits" – in other words, a predetermined fixed amount of payment

– will be issued to cover the monetary needs that arise in such an event. Life insurance is sometimes referred to as "fixed payment" insurance since it pays a fixed amount in this way.

Whereas life insurance is insurance whose elements pertain to "the life or death of a person" and "fixed-amount payments", non-life insurance is insurance whose elements pertain to "damage caused to property (things)" and "compensation for actual loss" (Figure 4).

Figure 4 **Elements of life insurance and non-life insurance**

	Reasons for payment	Standards for calculating benefits
Life insurance	Survival and death of a person	Fixed amount
Non-life insurance	Damage to property (tangible things)	Actual damage sustained

This is important due to the existence of a type of insurance known as third-sector insurance, as explained in the following section.

3 What do we mean by *third-sector insurance*?

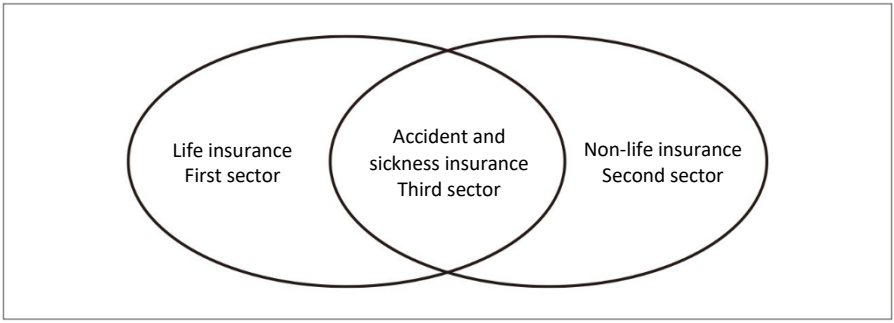
The Insurance Business Act, a statute that regulates the insurance business, stipulates that a life insurance company may underwrite third-sector insurance policies while engaging in the life insurance business.

The first sector refers to life insurance while the second sector refers to non-life insurance. Third-sector insurance encompasses such types of insurance as the aforementioned medical insurance and cancer insurance, and is designed to pay for hospitalization, surgery, and enduring disabilities due to an injury or illness. These products will henceforth be referred to as accident and sickness insurance.

First, while accident and sickness insurance is "insurance for people", it is not insurance related to the life or death of a person, which means that it cannot really be referred to as a life insurance product. On the other hand, the hospitalization benefit or surgical benefit paid by an accident and sickness insurance plan is often a fixed amount – such as 10,000 yen per day ‐irrespective of the actual amount that is incurred. As accident and sickness insurance is therefore not designed to compensate for actual loss, it cannot really be referred to as non-life insurance either.

Given that accident and sickness insurance effectively possesses the characteristics of both life insurance and non-life insurance, both life insurance companies and non-life insurance companies are allowed to underwrite it (Figure 5).

Figure 5 **Illustration of third-sector insurance (Insurance Business Act)**



Incidentally, some accident and sickness insurance policies pay out prescribed amounts, such as 10,000 yen per day for hospitalization and 200,000 yen for surgery. These products are known as fixed-amount accident and sickness insurance.

On the other hand, there is also a type of accident and sickness insurance that is designed to compensate for actual losses. Such an insurance policy might pay a fixed percentage of medical costs actually paid by an enrollee to the hospital. Under the public health insurance scheme in Japan, one normally pays thirty percent of medical costs that are actually incurred. Such an insurance policy is a product that would cover the thirty percent of medical costs that would otherwise be paid out of pocket by the patient and is known as insurance against loss from an accident or sickness.

Business conflicts between the life and non-life insurance industry **Column 1**

The Insurance Business Act that is mentioned in this book regulates life and non-life insurance companies. Before it was amended in 1995, this statute stipulated nothing at all in regard to third-sector insurance (accident and sickness insurance). For this reason, the regulatory authorities allowed life insurance companies and non-life insurance companies to underwrite products by imposing restrictions on product

characteristics and how they could be sold. When the statute was subsequently amended in 1995, a system to enable both life insurance companies and non-life insurance companies to underwrite third-sector insurance without restrictions based on product characteristics was developed. Major life insurance companies were not allowed to underwrite cancer insurance until 2001 due to the impact of Japan-U.S. insurance talks.

The Insurance Act, which sets forth the contents of insurance policies, was enacted in 2008, at which time policies with fixed benefit amounts were positioned as fixed-amount accident and sickness insurance, a type of policy different from life insurance policies and non-life insurance policies. On the other hand, insurance policies against loss from an accident or sickness, which are designed to provide benefit amounts that compensate for actual losses incurred, were positioned as a type of non-life insurance. While the Insurance Business Act allows insurance against loss from an accident or sickness to be underwritten by both life insurance companies and non-life insurance companies, insurance policies against loss from an accident or sickness are handled differently as a type of non-life insurance policy under the Insurance Act.

4 Scale of the life insurance industry

I would now like to present several numbers to give you an idea of the scale of the life insurance industry.

(1) Size of policies underwritten by life insurance companies

A life insurance company underwrites both insurance for individuals and insurance for groups, but I am only going to explore insurance for individuals in this section. Insurance policies for individuals consist of individual insurance and individual annuities.

(i) Individual insurance

Figure 6 is a table outlining the number of new and in-force individual insurance policies, the amount of these policies, and the annualized premiums for these policies. Of these, the amount of individual insurance policies is the sum of the death benefit and other main insurance amounts as provided for in these insurance policies.

The amount of annualized insurance premiums is the sum of insurance premiums paid by the policyholder in a one-year period.

Figure 6 **Amount of individual insurance policies in force in fiscal year 2019**

Number of individual insurance policies		Amount of individual insurance policies (insurance amount)	
New policies	Policies in force	New policies	Policies in force
20.8 million policies	187.48 million policies	49,717.2 billion yen	829,900.3 billion yen

Annualized insurance premiums for individual insurance	
New policies	Policies in force
1,545.7 billion yen	22,040.4 billion yen

Source : Excerpted from "2020 Life Insurance Trends", The Life Insurance Association of Japan

While insurance premiums for a year simply need to be added up for a monthly-paid insurance policy, the handling of products for which insurance premiums are paid in a lump sum when the policyholder takes out the policy, such as a single-premium product, can be challenging. In such a case, the amount is considered to be the annual premium on the assumption that payments have been made in equal instalments over the course of the insurance term. Conversions are carried out in this way because simply adding up the insurance premiums for the current fiscal year will make the performance look too big in years when many single-premium products are sold and too small in years when such products are not sold at all.

Historically, performance in the life insurance industry was thought to be primarily based on the extent to which the amount of policies increased or decreased. However, insurance products offering low insurance payments (benefits), such as medical insurance, came to be sold in large numbers, such that it is now believed that the amount of policies alone is insufficient for measuring changes in performance. Thus, annualized insurance premiums, which represent the earnings of life insurance companies, are aggregated to constitute a measure of performance.

If we look at the number of individual insurance policies in force in this country, we see that, with a population of approximately 126.5 million people in Japan, there are approximately 1.5 individual insurance policies that have been taken out per capita. In addition, it may be difficult to understand what it means to say that the amount of individual insurance policies totals 829 trillion yen. By way of comparison, this amount is approximately 1.5 times the size of Japan's nominal GDP, which is equal to approximately 552 trillion yen (2019).

(ii) Individual annuities

Next, various figures corresponding to the number of new and in-force individual annuities, policy amounts, and annualized premiums are shown in Figure 7.

Figure 7 **Amount of individual annuities in force in fiscal year 2019**

Number of individual annuity policies		Amount of individual annuity policies (pension resource)	
New policies	Policies in force	New policies	Policies in force
920,000 policies	21.23 million policies	5,253.4 billion yen	102,509.3 billion yen

Annualized insurance premiums for individual annuities	
New policies	Policies in force
392.8 billion yen	6,195.8 billion yen

Source: Same as for Figure 6.

When it comes to the policy amounts for individual annuities, it should be noted that the annuity premiums that are paid in for a monthly-payment individual annuity policy accumulate monthly. The amount that will have been accumulated as of the time annuity payments commence is called the pension resource. The sum of pension resources equals the amount of an individual annuity plan.

There are 21.23 million individual annuity policies in force, the aggregate amount of which totals 102 trillion yen. It is believed that about one in six individuals is enrolled in an individual annuity plan. Given that Japan's regular budget is approximately 100 trillion yen in size, it can be said that the total amount of policies is comparable to the size of this country's national finances.

(2) Paying insurance money

Figure 8 on the following page indicates the amount of insurance money paid out by life insurance companies. In addition to what is outlined in this figure, the amount paid out by life insurance companies includes surrender values and annuities. This figure lists primary payments consisting of death and maturity benefits as well as benefits for hospitalization and surgical procedures.

Slightly less than 6 trillion yen in death and maturity benefits are paid out each year.

Figure 8 **Insurance money paid out in fiscal year 2019**

Death benefits		Maturity benefits	
Number of payments	Amount	Number of payments	Amount
1.18 million	3,200.8 billion yen	1.22 million	2,682.9 billion yen
Hospitalization benefits		Surgical benefits	
Number of payments	Amount	Number of payments	Amount
7.57 million	733.0 billion yen	4.71 million	468.3 billion yen

Source: Same as for Figure 6.

In addition, the high number of times benefits for hospitalization and surgical procedures are paid out should be noted. Both benefits are also often paid together for hospitalization and surgical procedures on the same occasion. Both of these benefits together account for approximately 12 million payments made per year.

(3) Changes in total assets

Figure 9 outlines changes in total assets by fiscal year. Total assets for the entire industry exceed 390 trillion yen.

To convey a sense of just how big the industry is, allow me to compare this with the banking industry. According to materials issued by the Japanese Bankers Association, total deposits held by the five big city banks (mega-banks) equal 411 trillion yen and total deposits held by regional banks (excluding second regional banks) equal 291 trillion yen. Assets managed by life insurance companies are comparable in size to those managed by the banking industry.

Figure 9 **Trends in total assets by fiscal year (all companies)**

FY 2015	367,167.8 billion yen	FY 2018	387,794.5 billion yen
FY 2016	375,505.1 billion yen	FY 2019	392,735.0 billion yen
FY 2017	381,275.1 billion yen		

Source: Same as for Figure 6.

II. The necessity of life insurance and accident and sickness insurance

In this section, I will explain the necessity of life insurance and accident and sickness insurance (third-sector insurance). In thinking about the necessity of these types of insurance, it is of course important to ascertain how much money will actually be needed when one dies or is hospitalized. I will also talk about social insurance in this section since private insurance is arguably necessary where social insurance is insufficient to fully address needs.

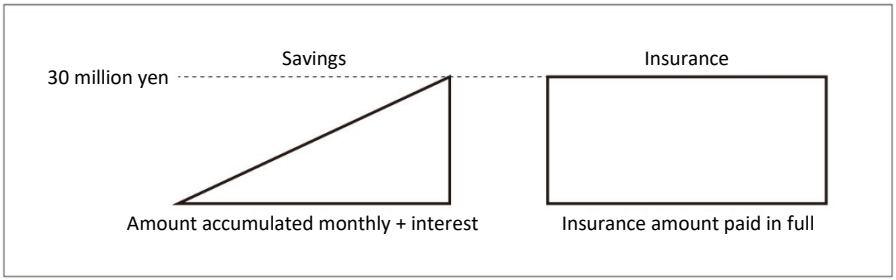
1. Why is life insurance necessary?

(1) Insurance payable at death

First, I would like to think about insurance that is payable at death. With such insurance, insurance money is paid out when a given person dies. As mentioned in the example given earlier, financial difficulties would ensue if, in a situation involving a young couple with a small child, one of the adults were to die.

To begin with, as they are a young couple, they would likely not have that much savings accumulated. They are probably at the stage of their lives when they are thinking about saving money for the future. In this connection, life insurance is needed. There is a saying that applies here: "Savings form a triangle and insurance is a square" (Figure 10).

Figure 10 **"Savings form a triangle and insurance is a square"**



In other words, with savings, the 10,000 yen you deposit into your account this month will only be worth 10,000 yen. With insurance, however, if you were enrolled in an insurance plan that would pay out 30 million yen at death with a premium of 10,000 yen, the 10,000 yen you pay this month would yield 30

million yen in benefits in the unfortunate event that you, as the insured, were to die.

(2) Individual annuity insurance

What about insurance for survival, which is another type of life insurance? Individual annuity insurance is an example of an insurance product that focuses on coverage for survival. This type of insurance is intended to guarantee retirement funds for the insured. You could also rely on savings and a retirement allowance to fund your retirement. There are also public pensions as stated below, including the Employees' Pension Plan and the National Pension Plan. However, whether the amount of benefits that will be paid out by a public pension is sufficient depends on the individual. According to the Ministry of Health, Labour and Welfare, the average amount of benefits paid out by public pension plans to a model household consisting of a husband who had been enrolled in the Employees' Pension Plan and a wife who was a full-time homemaker is approximately 230,000 yen per month. What do you think of this amount?

The problem of retirement funding **Column 2**

A report issued by a deliberative council of the government that indicated that up to 20 million yen is required by each individual to fund his or her own retirement gave rise to a hot topic. In just looking at the media reporting, it feels as if the two issues at hand were discussed without much in the way of an effort to distinguish one from the other. There is the issue as to whether the government can continue to maintain the public pension system and the issue as to whether the public pension benefits to be paid to each individual out of this scheme are sufficient to fund that individual's retirement.

The public pension system has introduced tax-financed public funds to a certain extent and is also designed to prevent a collapse of its finances by controlling the amount of pensions and raising the amount of insurance premiums paid by enrollees. It is for this reason that the public pension system is believed to be financially sound.

On the other hand, there are surely some people for whom the public pension amount is insufficient to fund their retirement. In the example given earlier, the amount of public pension benefits paid out to a model household is approximately 230,000 yen. According to a questionnaire-based survey conducted in fiscal year 2019 by the Japan Institute of Life Insurance (JILI), however, the minimum average

amount of daily living expenses for a retired couple is approximately 221,000 yen. Yet, when asked how much is necessary to cover living expenses for a comfortable retirement, respondents indicated an average total of 361,000 yen, including the minimum amount of daily living expenses noted above. It is believed that the extent to which one should prepare funds beyond that which can be provided for by the public pension system depends on the lifestyle one is willing to adopt in retirement.

This report was produced by a subcommittee operating under the purview of the Financial System Council but was ultimately not discussed at a general assembly of this council. However, as it did manage to generate significant media coverage, the need to prepare funds for retirement became better known to the public.

(3) Social insurance

In thinking about the necessity of life insurance and accident and sickness insurance, I will now look at the state of the public insurance scheme, since private insurance options consisting of life insurance and accident and sickness insurance would not be needed if coverage under the public scheme was sufficient. In addition, the fact that social insurance benefits exist means that social insurance addresses problems that are universally faced. By looking into social insurance, we can thus see where the need for private insurance lies (Figure 11).

In Japan, public security is administered through a social insurance system. There are two conceivable means of providing social security: a tax system and a social insurance system.

Figure 11 **Relationship between social insurance and its supplementary private insurance**

	Social insurance	Private insurance
Pension	Old-age employees' pension, old-age national pension	Individualannuity, group pension
Insurance payable at death	Survivors' welfare pension, basic survivors' pension	Insurance payable at death
Disability	Disability welfare pension, basic disability pension	Severe disability insurance (insurance payable at death)
Medical	Public health insurance	Medical insurance
Long-term care	Long-term care insurance	Long-term care insurance, dementia insurance

For example, the National Health Service (NHS), a public health insurance

scheme operated in the United Kingdom, is funded by taxes and utilizes a tax system. Under a tax system, the funds for benefits are collected through taxation. In a tax system, taxes are not collected from persons whose income is below a certain minimum taxable threshold (distinct from consumption tax), but security benefits are still provided to such citizens.

Under a social insurance system, an individual who fails to contribute premiums will not be entitled to receive benefits even if he or she has paid all taxes owing. However, certain considerations are made, as can be seen in a system for exempting those without an income from paying premiums.

In Japan, the national health insurance scheme is a social insurance system, but some municipalities collect premiums for this scheme by nominally referring to them as an insurance tax.

2 Characteristics of social insurance

(1) Compulsory enrolment

Those who satisfy certain criteria are subject to compulsory social insurance enrolment, but enrolment has never been refused by the social insurance system. This is because this system is a means by which the government provides a minimum guarantee of a healthy and cultural life and because excluding sick people from the health insurance scheme would be inconsistent with the aims of the system.

Private insurance enrolment is voluntary for policyholders. The insurance company is also free to decide whether or not to conclude an agreement. As will be explained in Chapter 4, life insurance and medical insurance plans are typical products for which a risk selection process takes place. Those who are sick or who otherwise fail to meet the criteria set by an insurance company may be unable to take out such insurance.

(2) Benefit amount

While some social security benefits, including parts of the public pension system, vary according to the premiums that have been paid in, most benefits are paid out based on need. In the case of health insurance, need refers to medical expenses incurred for the treatment of an injury or sickness.

With private and especially life insurance policies, a certain amount as contractually determined in advance is paid. It does not matter whether this amount is sufficient to cover the expenses that are actually incurred.

(3) Premiums

Social insurance premiums are collected based not on the benefit principle, whereby costs are shouldered in proportion to the benefits gained by the enrollee, but on the ability to pay, which is based on the extent to which an enrollee is capable of shouldering the premiums. In addition, premiums are collected irrespective of the risks to which the enrollee is exposed.

With private insurance, premiums are determined according to the amount of insurance benefits to be paid. In other words, the benefit principle applies. Furthermore, premiums are determined according to the risks to which the enrollee is exposed.

(4) Source of funds

With social insurance, a scheme is fundamentally financed by premiums. In many cases, however, a social insurance scheme is financed by public funds based on taxes. In addition, a scheme that is expected to have a deficit will be supported financially by a different scheme. While actual numbers vary from scheme to scheme, it is estimated that premiums account for 60% of social insurance schemes overall and taxes account for the remaining 40%.

A private insurance scheme is financed with just premiums.

3 Public pensions

I will hereby describe the public pension system first as a social insurance system. One normally enrolls in a public pension system for the purpose of obtaining an old-age pension after retirement. Old-age pensions correspond to individual and group pension insurance policies among the products provided by life insurance companies.

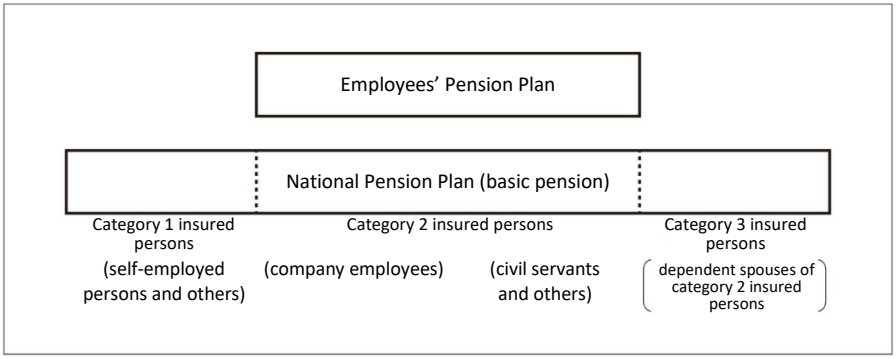
In addition, public pensions have the same function as insurance payable at death in that they both provide certain survivor pension benefits on the death of a spouse.

In addition, they have the same function as the severe disability insurance benefit paid under life insurance payable at death and disability income insurance (see Chapter 2-III-3 (5)) in the sense that a disability pension benefit is provided in the event that an enrollee becomes disabled (see Figure 11 above).

Figure 12 on the following page is a conceptual diagram outlining the public pension system. Persons between the ages of 20 years and less than 60 years

residing in Japan must be enrolled in the National Pension Plan. Moreover, employees and civil servants working at establishments where the Employees' Pension Plan is in effect (see (2) below) shall be enrolled in such a plan.

Figure 12 **Structure of Japan's public pension system**



(1) National Pension Plan

Anyone between the ages of 20 and 60 years who resides in Japan and who is not enrolled in the Employees' Pension Plan is a category 1 or category 3 insured person. Category 1 insured persons include students, self-employed persons, agricultural workers, and others who are not enrolled in the Employees' Pension Plan.

Anyone who is dependent on a person insured by the Employees' Pension Plan and who makes less than 1.3 million yen a year in income (who resides in Japan and is between the ages of 20 and less than 60 years) is a category 3 insured person.

Even if a person's annual income is less than 1.3 million yen, he or she would be insured by the Employees' Pension Plan (as a category 2 insured person) if he or she makes at least 1.06 million yen a year at a part-time job or side job and satisfies certain conditions.

The premium for a category 1 insured person is 16,540 yen per month (fiscal year 2020). The premium for a category 3 insured person is included in and is deemed to be paid as part of the premium for the Employees' Pension Plan of the person on whom he or she depends.

The fixed-amount component for insured persons under the Employees' Pension Plan is shared in common with the National Pension Plan (and is

referred to as a basic pension; see (2) below).

(2) Employees' Pension Plan

The offices of joint-stock companies and other juridical persons and offices of sole proprietorships with five or more full-time employees fall under the category of "applicable offices". Anyone who works in an applicable office and who satisfies the following requirements is obligated to enroll in the Employees' Pension Plan.

First, a full-time employee under the age of 70 is obligated to enroll in the Employees' Pension Plan. Someone who is not a full-time employee but who is working for shorter periods of time is also obligated to enroll if he or she is engaged in work that minimally satisfies prescribed standards. Someone who is under the age of 20 years is still obligated to enroll in the Employees' Pension Plan if he or she is employed at an applicable office.

Premiums for the Employees' Pension Plan shall be paid by multiplying the insured person's salary (standard monthly remuneration amount) and bonus (standard bonus amount) by a certain percentage for each (18.3%). The premium is split between the enrollee and the employer. This percentage has been raised over time but is not expected to increase again in the future.

The Employees' Pension Plan consists of a fixed-amount component (see (1) above) and a remuneration-proportional component. The fixed-amount component is shared in common with the National Pension Plan as mentioned in (1) above and is referred to as a basic pension. A person enrolled in the Employees' Pension Insurance Plan is referred to as a category 2 insured person.

The pension amount for the remuneration-proportional component of the Employees' Pension Insurance Plan is calculated and paid on the basis of the standard monthly remuneration amount or the sum of the standard monthly remuneration amount and standard bonus amount. As the formula is complicated, it will not be presented here. Anyone who is interested in delving further into this topic should visit the website of the Japan Pension Service.

(3) Public Pension Plan benefits

Public pension benefits, such as the old-age national pension and old-age employees' pension, are primarily used to provide security for the aged. The amount of the old-age national pension payable to someone who has paid the full amount of the National Pension Plan for the entire period of enrolment

(category 1 or 3 insured person) is a uniform annual amount equal to 781,700 yen (fiscal year 2020). This amount is reduced if there were any periods during which premiums were unpaid or exemption periods.

As the amount of the old-age employees' pension varies according to income, it is not possible to indicate what the full amount is. That said, however, the average old-age pension amount for recipients of Employees' Pension Plan benefits is 144,000 yen per month as of fiscal year 2018 ("Overview of the Employees' Pension Insurance and National Pension Plan", Ministry of Health, Labour and Welfare). Even if a married couple were both working and had paid premiums in full for the Employees' Pension Plan, they would be entitled to receive benefits amounting to approximately 290,000 yen. The model household described earlier (1(1)) would as mentioned above receive around 230,000 yen. These are unavoidable levels given the fact that we are living in a super-aging society and the fact that the old-age pension is a life pension. As indicated in Column 2 above, those who believe that this amount is insufficient for their own needs might want to consider enrolling in an individual annuity insurance plan.

It is often overlooked when it comes to an examination of public pensions but disability pensions and survivors' benefits are surprisingly important matters.

Disability pensions consist of the basic disability pension that is provided by the National Pension Plan and the disability employees' pension that is paid out to persons insured by their Employees' Pension Plan. These pensions are paid out to persons who fulfill certain conditions, such as by having paid or been exempted from paying premiums for at least a certain period of time and by not having failed to pay premiums in the last 12 months, and who come to suffer a prescribed disability. The basic disability pension is paid as a fixed amount while the disability welfare pension is paid as an amount calculated based on the period of enrollment and standard remuneration amount. According to the Ministry of Health, Labour and Welfare, the average monthly amount of disability pensions paid is 102,855 yen (fiscal year 2018).

In addition, a survivors' pension is, in principle, paid to a spouse with a child under the age of 18 years in the event that a person insured by the National Pension Plan dies. In the event that a person insured by the Employees' Pension Insurance Plan dies, a survivors' welfare pension is paid to the wife if the wife has a child under the age of 18 years. Moreover, there is also a system that allows for widows of a certain age (between 45 and 65 years of age) to receive additional pension. According to the Ministry of Health, Labour and Welfare,

the average monthly survivors' pension amount is 83,704 yen (fiscal year 2018).

Some SNS posts suggest that you cannot rely on public pensions and should instead enroll in an individual annuity plan offered by a private insurance company and refrain from paying public pension premiums. In light of the fact that public pensions provide lifetime benefits as well as disability and survivors' pensions, the nonpayment of social insurance premiums is a non-starter. It is important to consider how you can combine social security with life insurance and disability income insurance to best prepare yourself.

4 Public health insurance

(1) Outline of the system

In Japan, a universal national health insurance system has been adopted. The public health insurance system is generally administered for the following categories:

(i) The employees of private-sector companies enroll in a health insurance association set up by the company or the Japan Health Insurance Association (Kyokai Kenpo).
(ii) Public servants and faculty members at private universities enroll in different mutual aid associations.
(iii) Persons not belonging to the foregoing categories enroll in the National Health Insurance Plan as administered by municipalities.
(iv) All persons aged 75 years or over enroll in the latter-stage elderly healthcare scheme.

A separate health insurance scheme is provided to seafarers.

(2) Premiums

Premiums are paid monthly for as long as the person being covered is insured. The amount of premiums is as follows. There are two types: the one that is deducted from your monthly salary and the one that is deducted from your bonus.

Monthly premium
= salary of insured person (standard monthly remuneration amount)
x premium rate (common insurance premium rate + long-term care insurance premium rate (long-term care insurance premium is payable only for those 40 years of age or over))

Premium payable at bonus time
= bonus of insured person (standard bonus amount)
x premium rate (common insurance premium rate + long-term care insurance premium rate (long-term care insurance premium is payable only for those 40 years of age or over))

The common insurance premium rate applicable to premiums for medical care differs from scheme to scheme.

In this section, I will discuss only the premiums for health insurance associations.

The premium for a health insurance association equals the standard monthly remuneration amount (each month) and standard bonus amount (at bonus time) multiplied by a certain premium rate, which varies depending on the association. As the standard premium rate for the Japan Health Insurance Association (Kyokai Kenpo), in which the employees of companies lacking a health insurance association are enrolled, is 10%, there are many health insurance associations that offer a lower rate. Premiums are borne by the employer and employee. The contribution rates of each can be voluntarily set by an association.

(3) Benefits

Benefits in kind are generally provided by public health insurance systems. In other words, an insured person does not pay the full actual costs on an out-of-pocket basis whenever he or she visits a doctor or is hospitalized. Rather, the health insurance association will basically pay the medical institution. The provision of medical services per se constitutes the insurance benefit in question.

However, a certain percentage of medical costs incurred must be paid on an out-of-pocket basis at the medical institution where the treatment was provided. Copayment rates are as follows:

(i) Before starting compulsory education: 20%
(ii) From compulsory school age to under 70 years of age: 30%
(iii) From 70 years of age to under 75 years of age: 20%
(30% if the individual is earning an income on par with the working-age population)

(iv) From 75 years of age: 10%
(30% if the individual is earning an income on par with the working-age population)

Since a certain percentage of medical costs are borne by the insured person as a copayment amount, there is the risk that a person will be forced to assume an excessive burden if he or she becomes seriously ill. In this connection, there is a system that provides for a portion of costs exceeding a certain amount (maximum out-of-pocket amount) to be reimbursed later in the event that the copayment amount corresponding to medical costs incurred in a calendar month (from the first to the last day of the calendar month) becomes too high.

This is known as the reimbursement system for high-cost medical care.

Costs incurred when you are hospitalized consist not just of treatment costs but also the costs of upgrading your hospital room and the costs of transporting family members. The Japan Institute of Life Insurance (JILI) conducted a survey on life security in fiscal year 2019 to determine the extent to which costs are incurred during hospitalization. This survey revealed that costs average 23,300 yen per day. Thus, it would be a good idea to consider enrolling in a private medical insurance plan.

5 Public long-term care insurance

Long-term care insurance is a social insurance system for people who are 65 years of age or over and people who are between the ages of 40 and 64 years who are enrolled in a health insurance or other public medical scheme.

Someone aged 65 years or over is entitled to receive long-term care services if he or she is certified as requiring long-term care or support as a category 1 insured person. Someone aged between 40 and 64 years is entitled to receive long-term care services if he or she requires long-term care or support due to one of certain illnesses caused by aging as a category 2 insured person. Municipalities are the entities administering long-term care insurance.

(1) Premiums

Premiums for category 2 insured persons are collected together with public health insurance premiums. The premium is a fixed percentage of the standard monthly remuneration amount and standard bonus amount. The Japan Health Insurance Association (Kyokai Kenpo) has set this rate at 1.79% (beginning at the end of March 2020).

Premiums for category 1 insured persons are collected by public pension deductions. The premium rate is divided into six standard levels according to the insured person's income. According to materials provided by the Ministry of Health, Labour and Welfare, the average premium nationwide is a little under 5,000 yen per month.

(2) Financing

Fifty percent of the funding for long-term care insurance is derived from public sources of financing, which is broken down as follows: national government (25%), prefectural governments (12.5%), and municipal governments (12.5%). The remaining 50% consists of premiums collected from insured persons, which in turn is broken down as follows: 23% from the premiums paid by category 1 insured persons and 27% from the premiums paid by category 2 insured persons. Premiums paid by category 2 insured persons are not directly allocated to the municipalities where these persons reside. Rather, they are pooled nationally before being distributed according to the fiscal situation in each municipality.

(3) Benefits

The benefits provided by long-term care insurance consist of benefits in kind and include the following:

(i) Home-based services: Home-visit care, ambulatory care, and more
(ii) Community-based services: Regular routine-visiting and as-needed home-visit care and nursing care, communal care for dementia, and more
(iii) Facility-based services: Welfare facilities for the elderly, geriatric healthcare facilities, and more

In order to receive benefits, the insured person first needs to be certified as requiring long-term care by his or her municipality. Once an individual is certified as requiring long-term care or support, a care plan will be drafted. Generally speaking, a care plan will be produced by a care manager belonging to a private home-care support agency where an individual is certified as requiring long-term care and by a care manager working for a community comprehensive support center where an individual is certified as requiring support.

Long-term care services or long-term care preventive services are provided in line with this care plan. In using such services, the user will in principle pay 10% of the costs but may be required to assume 20% or 30% of the costs if his or her income is high.

Given that we no longer live in a time when two or three generations live together and support one another and that elderly persons aged 75 years or over numbered approximately 18.72 million (approximately 15% of the population) in 2020, the existence of long-term care insurance is important in Japan.

However, long-term care insurance – aside from certain facility-based services – does not entail round-the-clock care for people who need to receive long-term care. Thus, a burden will be placed on family. Such issues as that of caregivers quitting their jobs to care for their own parents are becoming a problem for society.

According to the Japan Institute of Life Insurance (JILI)'s 2018 national survey on life insurance, the average period of long-term care is four years and seven months, during which time average monthly long-term care costs of 78,000 yen, which includes copayments for public long-term care insurance services, are incurred. Given the implication of these sorts of figures, it can be said that advance preparation is required as a way for people to help themselves.

6 Summary

You may have heard about social insurance in fragments but might not have had a real opportunity to properly learn about it. There is a full array of ways in which social insurance provides coverage, such as by way of pensions and coverage for accidents and death, medical care, and long-term care. Amid a declining birthrate and aging population in Japan, however, the number of people paying premiums is declining and the number of people receiving benefits is increasing. Since these trends are a function of changes in the demographic composition of this country, we cannot expect to see these trends significantly change anytime soon.

In addition, there are aspects of social insurance that an examination of these systems and schemes reveals are not sufficient for everyone.

Products offered by life insurance companies help to complement the coverage provided by social insurance. It is important that you consider enrolling in a life insurance plan in order to prepare for death or an injury as well as for the golden years that are sure to come in time.

III. The way insurance works

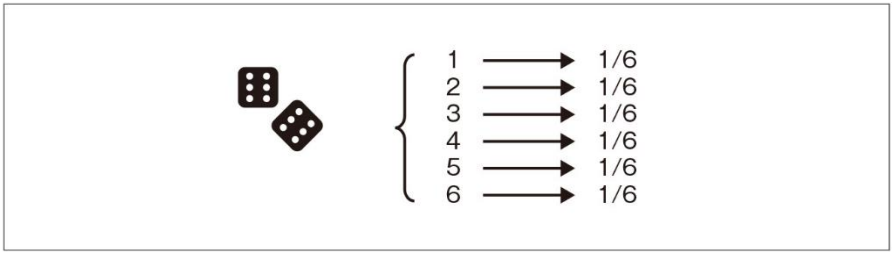
In this section, I will explain the way it is possible for life insurance to be offered, the parties involved in life insurance, and the basic terminology and principles that you should be familiar with to learn about life insurance money and other aspects of life insurance. This section will form the foundation for reading the rest of this book.

1 The laws and principles that make it possible for life insurance to be offered

(1) The law of large numbers

As noted in I above, insurance is a system of mutual aid for people dealing with the same risks. The life insurance business is one that is based on the law of large numbers. The law of large numbers can be explained by talking about dice. A die features six sides numbered from one to six, each of which is understood to have an equal probability of being rolled. Thus, you cannot say that you will definitely produce a one once if you roll a die six times. The more you roll a die, however, the closer you will get to a one-in-six chance of coming up with any given side (Figure 13).

Figure 13 **Law of large numbers**



When it comes to insurance payable at death, mortality rates by age for men and women are extensively researched. For example, we do not know whether Mr. A, a specific 30-year-old male individual, will die. What we do know, however, is the probability of a 30-year-old male individual dying.

Thus, once you bring together a large number of 30-year-old male individuals, you can figure out with a certain probability how many of them will die in the

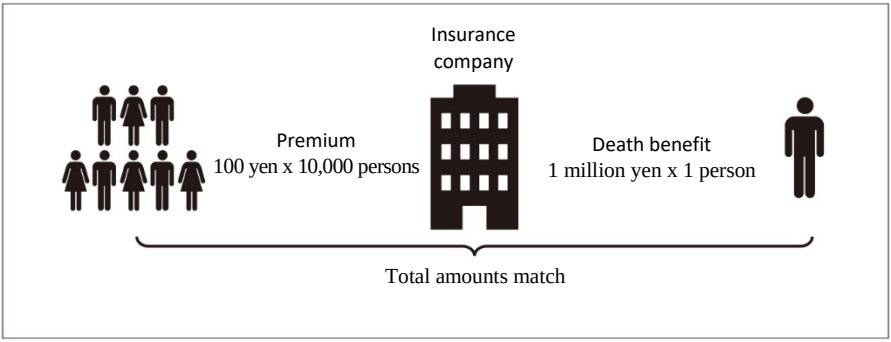
same way that probability works when you roll a die many times.

Once you know the probability of the occurrence of an event in this way, you can estimate the amount of insurance money you may be eventually required to pay out. Once the amount of estimated payments is known, you can divide this amount by the number of enrollees to come up with the amount of premiums to be collected in advance.

(2) The principle of equivalence between proceeds and disbursements

Next is the principle of equivalence between proceeds and disbursements. This principle states that you should set premiums so that the total premium income equals the total payments of insurance money for claims (Figure 14).

Figure 14 **Principle of equivalence between proceeds and disbursements**



For example, let us say that one in 10,000 30-year-old male individuals dies each year. This probability figure is obtained from the application of the aforementioned law of large numbers. If the amount of the death benefit is set at 1 million yen, then the annual premium to be paid when 10,000 30-year-old male individuals sign on as enrollees (to be paid at the beginning of the term) would be as follows:

Annual premium (payable at the beginning of the term)
= 1 million yen x 1 person ÷ 10,000 persons = 100 yen

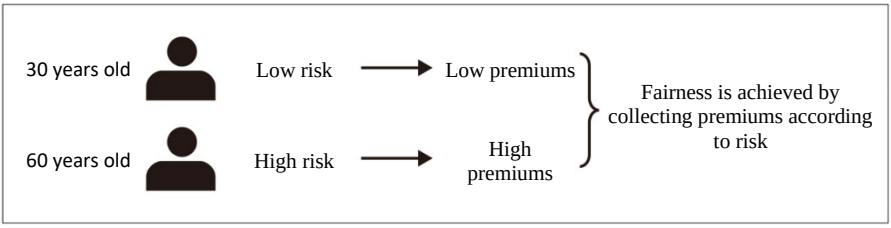
(3) The individual equivalence principle

While this principle can be conflated with the principle of equivalence between proceeds and disbursements, it differs in that it is a principle that

focuses on the individual.

It is a principle by which an individual taking out a life insurance policy should pay premiums according to the probability of his or her own death (Figure 15).

Figure 15 **The individual equivalence principle**



In other words, premiums are high for someone at higher risk and low for someone at lower risk. By varying the premium level in this way, fairness among enrollees is achieved.

To illustrate, we see that the probability of death for a 60-year-old man is higher than it is for a 30-year-old man. Therefore, even if both individuals wish to purchase the same insurance product, the premiums to be paid by the 60-year-old man will be higher than the premiums to be paid by the 30-year-old man.

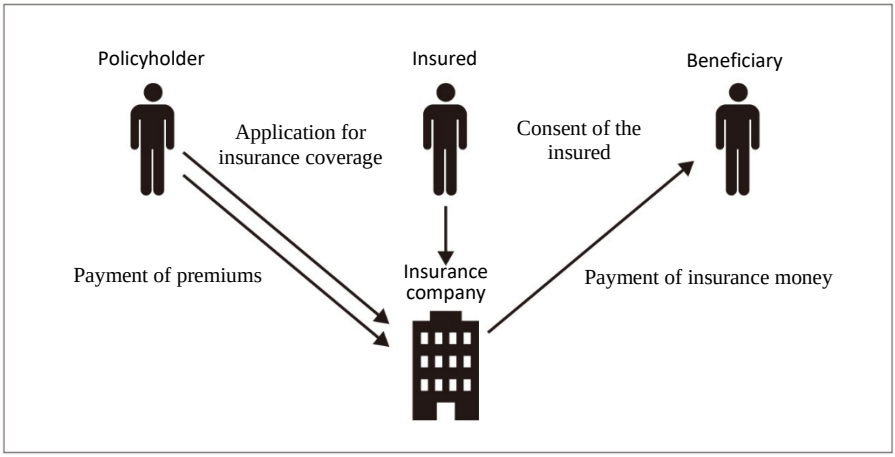
2 Life insurance parties

With life insurance, the life insurance company underwrites insurance policies as the insurer. The person who enters into a life insurance contract with a life insurance company is called the policyholder. The policyholder applies for a policy with the insurance company and pays premiums.

The person whose life is insured is known as the insured. In other words, the person for whom insurance money is paid out upon his or her death or upon his or her survival to a certain age is the insured. The policyholder and insured can be the same person or different people.

Furthermore, the person who receives insurance money in the event the insured person dies or an event triggering the payout of an insurance benefit occurs is known as the beneficiary (Figure 16 on the following page).

Figure 16 **The policyholder, the insured, and the beneficiary**



There are three concerned parties other than the life insurance company: the policyholder, the insured, and the beneficiary. In many cases, the policyholder and the insured are the same person.

For example, let us imagine that there is a couple. The husband concludes a contract for life insurance in which he designates himself as the insured, which means that the policyholder and the insured are the same person. By designating the wife as the beneficiary in this case, the policy is effective as a means of providing security for surviving family members in the event of the death of the husband.

If the policyholder and the insured are different people, the insured will need to consent to the conclusion of a life insurance contract at the time of its conclusion. The beneficiary shall be designated by the policyholder.

The acquisition of the consent of the insured and the designation of the beneficiary shall be dealt with as described in Chapter 2-II-2(3) and (4).

3 Money for life insurance policies

After concluding a contract for life insurance, the policyholder needs to pay premiums. It would be correct to suggest that the payment of premiums is more or less the only obligation of the policyholder after the conclusion of a life insurance contract.

In contrast, in the event of the death of the insured or the occurrence otherwise of a reason for paying insurance money (known as an insured event),

the life insurance company shall be obligated to pay insurance money to the beneficiary. This insurance money consists of a death benefit payable upon the death of the insured and maturity insurance money to be paid at the end of the promised term of the policy. Incidentally, money paid by a life insurance company under a medical insurance plan is referred to not as insurance money but as a benefit.

Premiums are money paid by the policyholder to the life insurance company while insurance money and benefits are paid by the life insurance company.

Another important item is the surrender value, which is the money that the life insurance company will pay upon the cancelation of a life insurance contract by the policyholder prior to the expiration of the insurance term.

These points are explained in greater detail in Chapter 4-IV.

IV. How insurance came to be

In this section, you will learn about the history of life insurance. It has been about 260 years since the emergence of modern life insurance and around 140 years since the introduction of modern life insurance in Japan.

Modern life insurance products are essentially based on techniques established two or three centuries ago. Life insurance has evolved against the backdrop of socioeconomic conditions, and I will hereby provide explanations with this point in mind.

1 History of life insurance in Europe

The origins of life insurance are murky and not very clear. Nevertheless, there are several examples in history of what can be regarded as the earliest forms of life insurance.

It is said that a prototype of life insurance can be found in the *collegia* of ancient roman society. *Collegia* that served as burial societies could be joined by paying a subscription fee; upon the death of a member, his or her funeral costs were paid.

In Europe, trade associations of commercial or industrial proprietors, known as guilds, sprung up beginning in the latter half of the tenth century in concert with the development of commerce and industry. Guilds featured a mechanism for providing mutual assistance in the event of the death of a member.

The Age of Exploration that began in the fifteenth century saw the emergence of adventure loans (or maritime loans) whereby merchants would cover the costs of voyages for traders and, if a voyage turned out to be successful, obtain massive profits by receiving repayment with substantial interest. If a voyage failed, the prepaid expenses did not have to be reimbursed. Similar arrangements were made with respect to the lives of those involved in maritime shipping and travelers at this time. Adventure loans were suppressed for a time as an act designed to earn unreasonably high amounts of interest.

In this connection, the following type of agreement would have been concluded. First, money would be nominally loaned by a trader to a merchant. If the trade ended up being successful, the agreement would be cancelled. On the other hand, if the voyage failed, the agreement would not be canceled and the money that was supposedly loaned by the trader to the merchant would be

reimbursed to the trader. The amount would then be applied by the trader to vessels and goods lost at sea as part of the failed voyage. For such an agreement, it appears that a part of the amount would have been paid by the trader to the merchant in advance. Such an arrangement formed the prototype of insurance as we know it today.

In this way, that which effectively constitutes insurance was originally provided in the form of monetary loans. Agreements that were squarely drawn up as insurance agreements were concluded in Italian city states in the latter half of the fourteenth century.

2 How modern life insurance came to be in the United Kingdom

(1) Friendly societies

The working class was subsequently established upon the occurrence of the Industrial Revolution in the latter half of the eighteenth century.

Labor movements came to occur frequently, and labor unions were formed in response to harsh working conditions. Formed at the same time as these labor unions were friendly societies in the United Kingdom, which served to provide mutual assistance, such as death benefits, to their members. Friendly societies adopted a system of premiums that were levied uniformly on all members regardless of age. For levy-based premiums, the full sum of insurance money to be paid out in a given year is collected from members in the same year.

Friendly societies were initially banned due to their deep connection to labor disputes and the fact that the French Revolution was then underway. Their significance as a means of providing mutual assistance among the working class later came to be recognized, whereupon they were then legalized by the Rose Act of 1793. As friendly societies adopted a system of premiums that were levied uniformly on all members, their finances tended to worsen over time as their members became older, such that more than a few such societies went bankrupt. Nonetheless, friendly societies in the United Kingdom have continued to operate to the present day.

(2) How insurance companies that operate as enterprises providing assessment insurance came to be

In the United Kingdom, various insurance companies were established as enterprises that adopted a levy system, such as the Mercers' Company in 1698 and the Amicable Society in 1706. While the Mercers' Company went bankrupt shortly after its inception, the Amicable Society went with a system by which

the company fixed contributions, accumulated a certain percentage of total contributions, and paid out the rest as death benefit payments. Thus, the death benefit was subject to fluctuations, such that a higher number of deaths would mean a smaller death benefit amount would be paid to each beneficiary. The Amicable Society continues to exist today even as it has gone through mergers in the past.

The problem with the levy system is that the contribution amount is the same regardless of whether a member is old or young. While this is great for an older person, it means that younger people will be paying too much in contributions.

If this is not addressed, fewer young people will enroll with the passage of time after an insurance business is set up. Eventually, the policyholder base will consist of nobody but older people, which would usher in a worsening of the financial situation.

(3) Establishing the Equitable Life Assurance Society

With the founding of the Equitable Life Assurance Society in 1762, the basis of modern life insurance was formed. A life table was produced by Edmond Halley, the astronomer of comet fame, who then recommended that life insurance products should be priced according to age. A life table (or mortality table) is a table outlining the results of a statistical survey of mortality rates by sex and by age.

In line with this recommendation, mathematician James Dotson and others came up with a plan to establish the Equitable Life. The 1760s were a decade that coincided with the earliest years of the Industrial Revolution; it was during these years that the Equitable Life was established and the London Underground (metro) was opened (1763).

The Equitable Life adopted a system of level premiums that were meant to stay constant throughout the period of enrolment by using expected mortality rates based on life tables and setting premiums according to the age of the individual at the time of the individual's enrolment (Figure 17 on the following page). The Equitable Life stayed in business until 2000 when it stopped selling new policies due to operational difficulties.

Figure 17 The Equitable's innovations in the life insurance business

Item	Description
Level premiums by age	Premium amounts as determined by age at enrolment will continue.
Sales of whole life insurance	Coverage is provided for life.
Surrender value and dividends	Policyholder's equity is recognized and refunded on cancelation; surplus is distributed.
Actuarial appointments	Professionals are appointed to carry out actuarial calculations of premiums and policy reserves.
Medical examinations	Health-related risks are measured.

A series of short-lived insurance companies came and went in the years after the Equitable Life was founded. The Life Assurance Companies Act of 1870, however, put in place the foundations of modern insurance oversight.

The Life Assurance Companies Act introduced a system of insurance oversight that remains in place today, the components of which includes the establishment of a policy reserve, capital adequacy regulations, and the appointment of actuaries. Details concerning insurance oversight are dealt with in Chapter 4.

3 Growth in the United States

The modern life insurance industry that was established in the United Kingdom also developed in the United States. With the Declaration of Independence being adopted in 1776 in that country, the domestic market became a single national market to facilitate economic development and growth. However, there was political wariness concerning the idea of a strong central government, such that there remains substantial debate over the distribution of power between the federal and state governments. The insurance industry is still largely governed by the states.

In the United States, the Pennsylvania Company for Insurance on Lives and Granting Annuities, which was established in 1812, engaged in proactive efforts to expand its operations through the use of agencies.

In 1861, Massachusetts insurance regulator and actuary Eliza Wright enacted the Non-Forfeiture Act, which mandated that a surrender value be paid whenever a life insurance policy is canceled. At the time, life insurance policies did not pay refunds when they were canceled even if funds had been accumulating over time; this way of treating the cancelation of a policy was then banned. In 1867, Yukichi Fukuzawa traveled to the United States to investigate the state of

insurance in that country at the time, as discussed below.

There have also been cases in the United States as well in which short-lived life insurance companies came and went and in which top managers treated their companies as easy sources of cash.

At the turn of the twentieth century, the Armstrong Investigation surveyed the life insurance industry in 1905 and came up with a number of recommendations. In the wake of the findings of this investigation, the insurance law in New York State was revised. Specifically, the powers of the directors of life insurance companies were curtailed and investments in their shares were prohibited. Furthermore, the revised law prohibited deferred dividends and imposed restrictions on new business aquisition cost.

4 History of life insurance in Japan

In Japan, mutual assistance was given by associations for the provision of mutual assistance or loans during the Edo Period (1603– 1868). In 1867, the year of the restoration of imperial rule, Yukichi Fukuzawa introduced Western-style life insurance in his *Conditions in the West* (travel guide on the West), which would shortly help to usher in modern life insurance to Japan.

At first, agencies working for overseas insurance companies began offering insurance for the Japanese market. In 1880, the Kyosai-gohyakumeisha company was established. While it was established as a company that charged levy-based premiums, it could eventually no longer sustain its own operations and underwent a developmental dissolution. This episode was the starting point for the subsequent emergence of the Yasuda Life Insurance Company (now the Meiji Yasuda Life Insurance Company).

The first to start a modern insurance business was Meiji Life Insurance (now the Meiji Yasuda Life Insurance Company), which was founded in 1881 by a protégé of Yukichi Fukuzawa. The company used British mortality tables and, in response to disclosures, sold whole-life insurance policies and other products. Teikoku Life Insurance (which is now the Asahi Mutual Life Insurance Company) and the Nippon Life Insurance Company were founded in 1888 and 1889, respectively. Thereafter, the industry coalesced around three major players: Meiji, Teikoku, and Nippon. As many short-lived insurance companies were also established at this time, laws and regulations were enacted in 1889 and 1890. As part of this process, insurance companies were allowed to form mutual companies; the Dai-ichi Life Insurance Company began its operations as a

mutual company in 1902.

The need for insurance payable at death came to be understood and life insurance grew in popularity in the wake of the Sino-Japanese War in 1894 and the Russo-Japanese War in 1904. The economic boom brought about by the First World War in 1914 led to the growth of life insurance companies.

On the other hand, the worldwide spread of the Spanish flu that began in 1918 claimed nearly 400,000 victims in Japan alone. More than 100,000 people died or went missing when the Great Kanto Earthquake of 1923 struck. These were just some of the notable events that increased the level of interest in the concept of life insurance.

With the arrival of the Second World War, life insurance came to be used as part of a national policy to finance the country's military. With the strife that attended the end of the war, life insurance companies faced operational difficulties due to the loss of foreign assets, an increase in payment of death benefits, and higher business costs owing to inflation. Amid these circumstances, joint-stock life insurance companies converted to mutual companies in an attempt to enable operations to continue.

In the postwar years, life insurance companies hired huge numbers of female sales agents to strengthen their sales force and worked to greatly expand their business during the period of rapid economic growth in the country.

In Chapter 5, I will provide an overview of trends in the life insurance industry since the Heisei Period. See Chapter 2 for a history of life insurance products and Chapter 3 for trends in solicitation channels.

V. Groups and organizations related to the life insurance industry

In this section, I will be looking at groups and organizations with a connection to the life insurance industry. Since the life insurance industry is one that is subject to special regulations, there are supervisory authorities as well as special organizations that have come into being with the involvement of the industry.

1 Life insurance companies

The entities that operate a life insurance business are life insurance companies, the types of which include joint-stock companies and mutual companies.

With a joint-stock company, the rights that are vested in owners of the company are distributed and issued in the form of shares. The shareholders who own shares are owners of the company. A joint-stock company is a for-profit corporation in the sense that profits are distributed to shareholders.

A mutual company is a type of company that is unique to the insurance industry. In a mutual company, policyholders are 'employees', not in the sense that they are part of the workforce but in the sense that each policyholder is an owner. Thus, taking out insurance as offered by a mutual company means that you become an owner of the mutual company. Mutual companies are not for-profit entities, but neither are they public-interest corporations. For this reason, they are known as intermediary corporations.

While large and medium-sized insurance companies used to include many mutual companies, fewer companies consist of mutual companies these days either because they transferred their policies to a joint-stock company and shut down operations due to increasingly difficult management circumstances or because they converted themselves into joint-stock companies in order to take advantage of greater flexibility in developing their business operations.

There are now forty-two life insurance companies in Japan (as of February 2021).

Governance of mutual companies **Column 3**

Since policyholders are 'employees' in a mutual company, the highest body in the company is the general meeting of 'employees', which is equivalent to the general meeting of shareholders in a joint-stock company. Since a life insurance company has a huge number of 'employees', however, delegates are normally elected to represent 'employees' and meetings are held with the participation of these delegates. These meetings are known as meetings of delegates.

As the mutual company itself is effectively involved in the election of delegates, efforts are made to ensure that those who are unbiased towards management are selected. First, someone who can act at arm's length from the mutual company is appointed the head of the committee for selecting delegates. Delegate nominees selected by the committee for selecting delegates are put to an 'employee' vote. Policyholders, who are 'employees', can vote no-confidence with respect to any delegate nominee they believe is unsuitable. A delegate nominee shall not be elected if at least ten (10) percent of votes comprise votes of no-confidence.

In addition, round-table conferences that are open to all policyholders are held in various regions. Opinions put forth at these conferences are reported to meetings of delegates. A discussion committee may organize a meeting to obtain advice on management matters; opinions put forth at these meetings are reported at meetings of delegates.

Mutual companies are characterized by the fact that, where a surplus is generated by the insurance business, it is distributed only to policyholders ('employees'). At a joint-stock company, a surplus would be distributed to policyholders and shareholders (in the case of a dividend-paying insurance policy).

2 Insurance solicitation business

In the life insurance business, individuals and groups that sell life insurance policies are exceedingly important.

I will explain matters in greater detail in Chapter 3, but it should be noted here that the solicitation of insurance is carried out by sales agents and solicitation agencies. In some cases, direct solicitation is also carried out by insurance companies through call centers. With life insurance, sales agents and solicitation agencies act only as intermediaries for life insurance policies. To put it another way, they only act to bring the life insurance company and the policyholder together.

On this point, an agency might sometimes have the authority to conclude a

contract for non-life insurance coverage. For example, if someone came to a non-life insurance agency for automobile insurance, a contract could be concluded with the acceptance of the agency. When it comes to life insurance, only the life insurance company has the authority to conclude a contract, which means that no agency can conclude a contract.

3 Financial Services Agency

The Financial Services Agency is a government agency operating under the purview of the Cabinet Office. A life insurance company needs to obtain a license from and be subject to oversight by the Prime Minister, but it is the Financial Services Agency that engages in actual supervisory functions.

The Financial Services Agency supervises on both an on-site and off-site basis. For on-site supervision, it visits life insurance companies to conduct inspections. Off-site supervision is carried out by requesting reports from insurance companies or by examining and approving basic documents prepared by life insurance companies, including articles of association and the provisions of policies.

Where the operations, affairs, or systems of a life insurance company are found to be inadequate, the Financial Services Agency shall undertake administrative measures by issuing a business improvement order or business suspension order.

4 The Life Insurance Association of Japan (LIAJ) and the Japan Institute of Life Insurance (JILI)

The Life Insurance Association of Japan (LIAJ) is an association whose membership consists of life insurance companies. It fulfills very important roles. First, it mediates complaints submitted by life insurance policyholders. It also has a system by which an adjudication board responds if a response provided by a life insurance company to a matter does not satisfy a policyholder; under this system, a dispute resolution service is provided to the consumer as an alternative to litigation (see Column 4).

In addition, a system is operated to allow a life insurance company to determine whether excessive amounts of insurance money are being committed upon the enrollment of someone in a life insurance policy. Another system that enables information to be exchanged among life insurance companies to determine whether there are any fraudulent claims for payment is also operated.

The Life Insurance Association of Japan also produces various guidelines to promote proper operations on the part of life insurance companies and sets forth standards for business operations undertaken by each company.

The role of the Japan Institute of Life Insurance (JILI) is to disseminate knowledge on life insurance. In addition to carrying out surveys and research, it undertakes awareness-raising activities for consumers.

Alternative dispute resolution (ADR) system **Column 4**

A designated dispute resolution organization (alternative dispute resolution; ADR) refers to an organization whose business is to resolve disputes without relying on the courts. The ADR system in Japan is modeled on the ombudsman system in place in the United Kingdom. Where a policyholder or beneficiary is not paid insurance money or is otherwise dissatisfied with the handling undertaken by an insurance company, matters are first discussed with the insurance company in question. There are nevertheless cases in which a resolution cannot be reached despite such efforts. In such a case, litigation is a possibility but would be costly and time-consuming.

In this connection, the ADR system was established with the aim of reaching a resolution by way of allowing policyholders to obtain decisions from a party operating independently of the insurance company. ADR in the life insurance industry consists of an adjudication board established within the Life Insurance Association of Japan. Insurance companies conclude an agreement with this adjudication board, which is a dispute resolution organization designated by law. In the event that a policyholder requests that dispute resolution procedures be undertaken, the insurance company is compelled to participate in these procedures.

The adjudication board endeavors to propose a settlement between the insurance company and the policyholder. Where a settlement is accepted by the policyholder, the insurance company must accept the terms of the settlement unless it chooses to pursue litigation.

The costs incurred by the adjudication board are borne by the insurance industry. For this reason, no monetary burden is imposed on policyholders.

5 Life Insurance Policyholders Protection Corporation of Japan

The bankruptcy of a life insurance company due to financial difficulties does not imply that life insurance policies underwritten by the company cease to exist. The Insurance Business Act has provisions to enable life insurance policies to

remain in force by allowing some of the reserves accumulated by the life insurance company for policies to be cut and the provisions of policies to be reviewed. If necessary, contributions made by life insurance companies and set aside with the Life Insurance Policyholders Protection Corporation of Japan shall be furnished to any insurance company that bails out a failing insurance company.

The Life Insurance Policyholders Protection Corporation of Japan fulfills a role in protecting life insurance policyholders, such as by furnishing such funds and getting involved in procedures for the restructuring of failed life insurance companies.

VI. Businesses that are peripheral to the insurance business

In Chapter 1, you learned about the life insurance industry. Incidentally, there exist other industries that provide products similar to life insurance. For example, the mutual aid industry provides life mutual aid. In this section, I will describe these other industries.

1 Mutual-aid enterprise

Although it falls outside the scope of the definition of insurance business under the Insurance Business Act, the mutual aid business exists as a business that provides products similar or identical to insurance products provided by insurance companies. The mutual aid business is large; according to the Japan Cooperative Insurance Association, there are approximately 77 million members, approximately 135 million policies, and approximately 845 trillion yen in mutual aid (Figure 18).

Figure 18 **Business outline of mutual aid members of the Japan Cooperative Insurance Association**

	FY 2018	FY 2019	Year-on-year change (%)
Membership (x 10,000)	7,667	7,731	100.8
Number of policies*1 (x 10,000)	13,711	13,543	98.8
Mutual aid amount*2 (x 100 million yen)	8,587,034	8,450,606	98.4
Mutual aid contributions received (x 100 million yen)	74,849	65,093	87.0
Mutual aid money paid out (x 100 million yen)	55,727	51,255	92.0
Total assets (x 100 million yen)	665,678	657,518	98.9

*1: The number of policies, mutual aid amount, and mutual aid contributions received correspond to the actual policies in force.

*2: The mutual aid amount does not include actual results corresponding to automobile mutual aid and mutual aid for compulsory automobile liability insurance.

Source: "Overview of the Mutual Aid Business", Japan Cooperative Insurance Association

Like the insurance business, the mutual aid business provides coverage against death, injury and sickness, fires, automobile accidents, and other contingencies through mutual aid policies. The structure of a mutual aid policy

is more or less the same as that of insurance and the Insurance Act likewise applies as it does to insurance policies. However, the mutual aid business differs from the insurance business in that, in principle, mutual aid can only be provided to those with certain qualifications, which are met by, for example, living in a certain region or by working in a certain profession. In addition, unique features set mutual aid providers apart from insurance companies in that the provision of mutual assistance by a mutual aid business is strongly emphasized. The laws on which business is based include the Consumer Cooperatives Act.

Nevertheless, some organizations permit enrolment in a mutual aid policy even by people without the requisite qualification if such actions fall within certain limits or allow enrolment in a mutual aid policy by anyone upon the payment of several hundred yen to qualify for the privilege. For these reasons, it is believed that mutual aid providers are becoming more like ordinary insurance companies in terms of their attributes.

Leading enterprises include JA Kyosai, Kokumin Kyosai Coop, and Kenmin Kyosai (Prefectural Mutual Aid).

(1) JA Kyosai

JA Kyosai is a program carried out by Zenkyoren (National Mutual Insurance Federation of Agricultural Cooperatives) and JA (Japan Agricultural Cooperatives). Mutual aid policies are sold to those engaged in farming based on the Agricultural Cooperatives Act. In addition to life mutual aid and medical mutual aid, JA Kyosai offers such products as automobile mutual aid and housing mutual aid. In comparing JA Kyosai to an insurance company, we could say that JA Kyosai is characterized by the fact that it underwrites both life and non-life insurance policies.

JA solicitation channels consist of persons in charge of selling JA policies in each region. During intensive months, however, the JA workforce works together on solicitation activities.

(2) Kokumin Kyosai Coop

Kokumin Kyosai Coop used to operate under the name Zenrosai (National Federation of Workers and Consumers Insurance Cooperatives). The implementing entity is the National Federation of Workers and Consumers Kyosai Cooperatives. The Consumer Cooperatives Act is the statute governing Kokumin Kyosai Coop. In the beginning, it was a mutual aid scheme for labor

union members. These days, however, it offers mutual aid policies to members of the general public after contributions are made.

In addition to life mutual aid and medical mutual aid, Kokumin Kyosai Coop sells such products as automobile mutual aid and property mutual aid. Kokumin Kyosai Coop also underwrites the equivalent of both life and non-life insurance policies.

Solicitation activities are carried out by the Kokumin Kyosai Coop program through labor unions, by local promoters, and by way of direct marketing based on the placement of ads in newspapers and elsewhere.

(3) Kenmin Kyosai (Prefectural Mutual Aid)

Through the Kenmin Kyosai program, the National Consumers' Cooperative Union and thirty-nine prefectural member consumers' cooperatives offer such products as mutual aid for citizens of Tokyo, mutual aid for citizens of Hokkaido, and mutual aid for citizens of other prefectures. The governing statute is the Consumer Cooperatives Law. The Kenmin Kyosai program also underwrites the equivalent of both life and non-life insurance policies but does not sell automobile mutual aid, which is something that distinguishes it from the JA Kyosai and Kokumin Kyosai Coop programs.

Solicitation activities are carried out by the Kenmin Kyosai program through the use of newspaper inserts and direct marketing facilitated by the placement of brochures at financial institutions.

2 Small-amount short-term insurance business

(1) Mutual aid not subject to a governing law

Before it was amended in 2005, the Insurance Business Act considered entities that underwrote insurance for "unspecified large numbers of persons" to be operating an insurance business. This meant that an entity that underwrote insurance for "specific persons" was not subject to the regulation of the insurance business.

Beginning in the latter half of the 1990s, enterprises offering "mutual aid not subject to a governing law" in the form of products similar to insurance to those who become members or purchase specific products grew in scale. While the aforementioned JA Kyosai and others engage in operations while governed by such statutes as the Agricultural Cooperatives Act, there were enterprises that operated programs without such a basis in law, which were known as enterprises

that offered mutual aid not subject to a governing law.

Some enterprises offering mutual aid not subject to a governing law emerged as operators that could not be seen as sound insurance businesses, including those that promoted pyramid schemes developed together with network businesses.

In this connection, the amendment of the Insurance Business Act in 2005 brought about two significant changes related to mutual aid not subject to a governing law. First, the definition of insurance business was changed and the requirement of an "unspecified large numbers of persons" was eliminated. Consequently, the Insurance Business Law came to apply to insurance businesses that catered to specific persons and that were not previously subject to a governing law. Second, the Insurance Business Law came to permit operations on the part of small-amount, short-term insurers. Small-amount short-term insurers can now be recognized as a form of business under the Insurance Business Act by having mutual aid not subject to a governing law properly registered.

(2) Rules applicable to small-amount short-term insurance providers

Small-amount short-term insurance providers are subject to more relaxed regulations than insurance companies, but are limited in terms of the products that can be underwritten and the scale of their business. This is to prevent policyholders from becoming seriously affected in the unlikely event of the failure of a small-amount short-term insurance provider.

Whereas insurance companies are licensed, small-amount short-term insurance providers are registered. It is also easier for small-amount short-term insurance providers to enter the market given that the minimum capital requirement is 10 million yen unlike the minimum capital requirement of 1 billion yen for insurance companies. However, the insurance term can be no longer than 1 year for life insurance and medical insurance and 2 years for non-life insurance policies; monetary limits also apply, such as an upper limit of 3 million yen for sickness and death insurance and 800 thousand yen for hospitalization and other benefits.

Asset management is limited to safe assets, such as deposits and national government bonds. There is also no safety net in the event of the collapse of a small-amount short-term insurance provider that corresponds to the Life Insurance Policyholders Protection Corporation of Japan.

As of February 2021, there were 108 small-amount, short-term insurance providers. While business was initially developed in areas not traditionally served by insurance companies, such as pet insurance, completely new types of insurance products falling within the framework of small-amount short-term insurance providers are now being offered (see Chapter 5-IV).

Small mutual aid providers or intra-company mutual aid schemes with no more than 1,000 enrollees and low-value mutual aid plans with an insurance value of no more than 100,000 yen are not regulated by the Insurance Business Act. This is to exclude internal get-togethers and other such events through which nominal amounts are offered to employees.

To solicit products offered by small-amount short-term insurance providers, one must be certified as a small-amount, short-term insurance solicitor.

3 Former Postal Life Insurance Service (Kampo)

(1) From the former Postal Life Insurance Service to Japan Post Insurance Company

In materials released by the Life Insurance Association of Japan are written such expressions as “including Kampo” and “excluding Kampo”. While Japan Post Insurance Company, Ltd., is a life insurance company that has been granted a license by the Financial Services Agency, its predecessor was a life insurance scheme run by the government.

This scheme was originally launched in 1916 as a low-cost, monthly insurance scheme for the general public for which no medical examination was necessary to enroll. It was the era of Taisho democracy, when awareness of the need to implement universal suffrage and otherwise promote equality among the people was growing. This scheme was begun as a government-run insurance scheme for the general public despite assertions voiced by private life insurance companies to the effect that the private sector was being squeezed. Postal life insurance proved to be highly popular as a government monopoly. While the state monopoly over postal life insurance was abolished after World War II, the scheme continued to enjoy an edge over private insurance in that the payment of insurance money was guaranteed by the state and there was no need to pay corporate taxes. The belief on the part of critics that the private sector was being squeezed was persistently held. For this reason, bloat-prevention measures were taken, such as by establishing marketability benchmarks and enrolment limits.

In 2001, the Ministry of Posts and Telecommunications, which had overseen

postal life insurance, and the Ministry of Internal Affairs and Communications were merged to give rise to the new Ministry of Public Management, Home Affairs, Posts and Telecommunications. At that time, the Postal Savings and Life Insurance Bureau of the Ministry of Posts and Telecommunications was also eliminated. The Postal Services Agency, which operates postal services and savings services, was established as an auxiliary body of the Ministry of Public Management, Home Affairs, Posts and Telecommunications.

In 2003, the Postal Services Agency was transformed into a public corporation named Japan Post.

The privatization of the three postal services of the time subsequently became a major political issue. In 2005, then Prime Minister Junichiro Koizumi decided to break up the postal system and proceeded to secure a major victory in a lower house election. Consequently, a bill to privatize the postal system was passed and enacted, whereupon postal privatization was achieved in October 2007. It was then that the insurance operations of the post office became independent and the Japan Post Insurance Company, Ltd., was accordingly founded.

(2) Postal privatization and Japan Post Insurance (Kampo Life Insurance)

In privatizing the postal system, Japan Post Holdings Co., Ltd., came to be structured as a holding company under which Japan Post Insurance, Japan Post Bank, and companies in charge of post offices and postal operations (which at the time of privatization consisted of Japan Post Network Co., Ltd., and Japan Post Service, Limited; these companies later merged to become Japan Post Co., Ltd.) operate.

Under the privatization plan, it was expected that the government's share of Japan Post Holdings Co., Ltd., would be reduced to a little more than one-third and that the government would sell off all of its shares in Japan Post Insurance and the Japan Post Bank. When Japan Post Insurance came into being, the aim was to make it a fully privatized life insurance company. It became a member of the Life Insurance Association of Japan as well as a company that came within the scope of coverage extended by the Life Insurance Policyholders Protection Corporation of Japan.

Since then, however, there have been changes in the political climate, among which was a change of government from the Liberal Democratic Party to the Democratic Party of Japan, as a result of which approximately two-thirds of the

shares of Japan Post Insurance remains held by Japan Post Holdings Co., Ltd. A majority of the shares of Japan Post Holdings Co., Ltd., approximately 56.9 percent, are held by the national and local governments. For this reason, it remains difficult to assert that the company has been fully privatized.

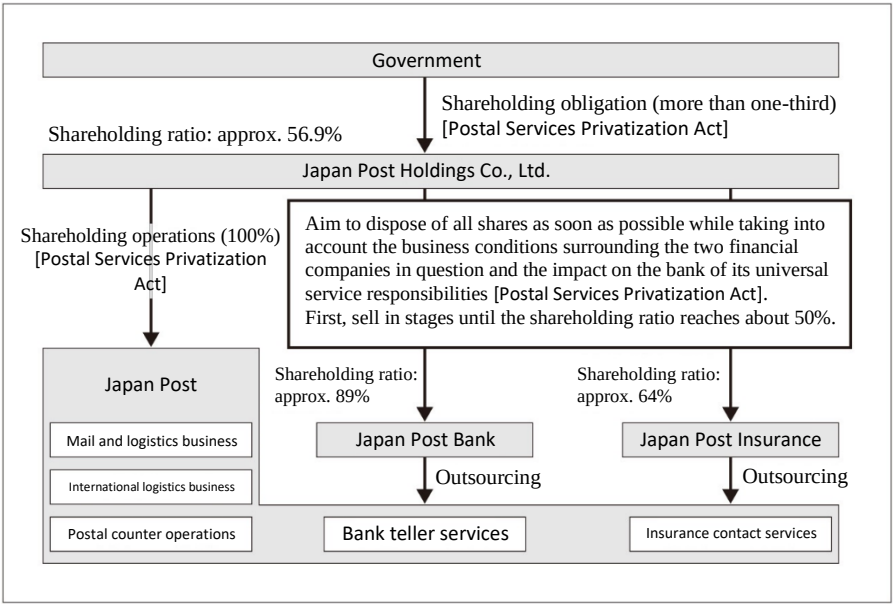
Predominant features of Japan Post Insurance include the following:

(i) It is indirectly owned by the government through Japan Post Holdings Co., Ltd.
(ii) The company's size per se is large, as it is contracted to manage assets and policies tied to the former Postal Life Insurance Service.
(iii) On the other hand, the company is not performing well in terms of new policies, such that it cannot be considered a major life insurance company in terms of new business.

Given this background and these circumstances, the company might sometimes be listed separately from ordinary private life insurance providers under various categories of statistics.

While Japan Post Insurance also markets its own products, these products are primarily sold at post offices. The composition of the Japan Post Group and Japan Post Insurance is as shown in Figure 19 hereof.

Figure 19 Japan Post Group and Japan Post Insurance



Source: Produced based on an integrated report by Japan Post Insurance Company, Ltd.

Chapter 2: Life insurance products

In Chapter 2, you will learn about life insurance products.

First, I will provide an overview of, among other matters, changes in life insurance products over time and the forms these products take.

Next, I will explain the rules that apply to life insurance policies.

In the column, I will touch on the mandating of a question-and-answer format for disclosing matters and on insurance products with a narrower range of matters to be disclosed.

I will then survey specific products corresponding to products for individuals and products for groups.

Finally, I will take a brief look at taxation matters as they pertain to life insurance.

I. Life insurance products

In this section, you will learn about life insurance products. I will begin by exploring the changes in key products in the earliest years of life insurance during the Meiji Period (1868-1912). I will then explain the need for life insurance products, insurance terms and premiums, and various product innovations.

1 Changes in life insurance products to date

(1) Life insurance products at the outset

During the earliest years of life insurance in Japan during the Meiji Period, life insurance was sold as whole life insurance where the coverage period was for a lifetime and only a death benefit was paid. By the end of the Meiji Period, the focus shifted to endowment insurance for which the amount of insurance money payable upon the death of the insured and the amount of maturity insurance money were the same. With endowment insurance, maturity insurance money is paid upon the expiration of the insurance term. Whole life insurance too has a substantial savings component, and it can be argued that life insurance policies that are not non refeundable, such that they provide some sort of maturity refund, have come to be preferred.

With non refundable insurance, the payment of premiums entitles you to receive insurance coverage for unlikely contingencies. Since insurance money is paid out in the unlikely event that a contingency occurs, this function allows you, in essence, to purchase peace of mind. This can be described as the insurance company becoming contractually obligated to shoulder a given risk.

(2) Life insurance products since the period of rapid economic growth

During the period of rapid economic growth, the population migrated from rural areas to the cities and there was a shift towards the nuclearization of families in line with economic growth, which led to a rise in demand for death coverage. Under these conditions, products for which term insurance was added as a rider to the main endowment insurance policy to increase the death coverage for a certain period of time became a bestseller beginning in the 1960s. It addressed the demand for expanded death coverage that existed even as people had an aversion to term policies. Initially, products had a low multiplier. For

example, with a triple policy, an endowment insurance policy of 1 million yen might be supplemented with a term insurance rider of 2 million yen for a total death benefit payout of 3 million yen. The multiplier is a term that indicates the extent to which the amount of the death benefit is greater than the maturity value of the main savings endowment insurance policy. The amount of the death benefit increased in the form of a larger term insurance rider in line with greater demand for death coverage (to provide, for example, a multiplier of 15).

Around this time, the increased popularity of automobile use among households in a way that outstripped the pace at which roads were being developed led to a rash of vehicular accidents and the emergence of the phrase "traffic wars". An accidental death rider that would pay out insurance money in the event of a death or any of certain types of severe disability caused by a traffic accident or otherwise unforeseen accident was developed in response.

In the 1970s, a sickness rider to cover the costs of illness came to be added.

(3) Life insurance products during the bubble era

Later, beginning in around 1980, whole life insurance with a term insurance rider became the main product in the years leading up to the bubble era. Endowment insurance with a term insurance rider, which had previously been a bestselling product, was disadvantageous in that the life insurance policy would become extinguished upon the maturation of the main endowment insurance policy. There would be no such disadvantage if the main policy were made to consist of whole life insurance. Furthermore, by having the main policy consist of whole life insurance with a smaller savings component than endowment insurance, greater coverage could be obtained for the same premium amount.

In addition, a high volume of single-premium endowment insurance policies based on the use of high interest rates in the market were sold during the period leading up to the bubble. Variable insurance policies under which the amount of insurance received varied according to investment performance were also introduced.

(4) Life insurance products since the collapse of the bubble economy

With the subsequent bursting of the bubble economy in 1991, sales of life insurance products temporarily declined, in part due to a decrease in the number of new insurance policies sold.

Following the amendment of the Insurance Business Act in 1995 and the

spearheading of the Financial Big Bang by the Ryutaro Hashimoto Cabinet in 1998, numerous life insurance subsidiaries of non-life insurers and foreign-affiliated life insurance companies entered the life insurance industry to offer new products.

As the number of dual-income households increased, there was a growing need for medical insurance, personal annuity insurance, and other forms of insurance for clients themselves to go along with coverage in case of death.

Most recently, we have seen products that address an aging society, such as long-term care insurance and dementia insurance, as well as IT-based products come to be offered. These recent developments are covered in Chapter 5.

Incidentally, interest rate levels these days are low, especially domestically, and have even dipped into negative territory from time to time. This makes it hard to stably manage the savings component of savings products, as a result of which it has become more challenging to plan and sell savings products.

For these reasons, products that utilize high foreign interest rates, such as foreign currency denominated annuity insurance plans, have come to be provided. However, general interest rate levels have generally fallen in foreign countries as well, thereby making it all the more difficult to plan and offer products to clients.

2 Life insurance needs

The Japan Institute of Life Insurance (JILI) conducts a survey of life insurance-related needs once every three years. Figure 1 on the following page presents the results of a survey that was conducted in fiscal year 2018. Heads of households and their spouses were asked multiple-response questions through which they could indicate what kind of coverage they wanted to have if they were inclined to enroll in a new plan or add to a current plan.

This survey reveals that the three big needs are conceivably medical coverage, security for survivors, and old-age coverage. In recent years, it has also come to be recognized that there is a certain level of need for long-term care coverage.

Between household heads and their spouses, there is a slightly higher need for security for survivors among household heads and a substantial need for medical insurance among spouses.

Figure 2 on the following page shows, by policy numbers, what kinds of insurance products for individuals have been sold and what kinds of insurance products for individuals continue to be sold.

Types of insurance that are being sold these days include medical insurance, term insurance, and whole life insurance. At the same time, whole-life insurance, medical insurance, cancer insurance, and term insurance are quite popular in terms of policies in force.

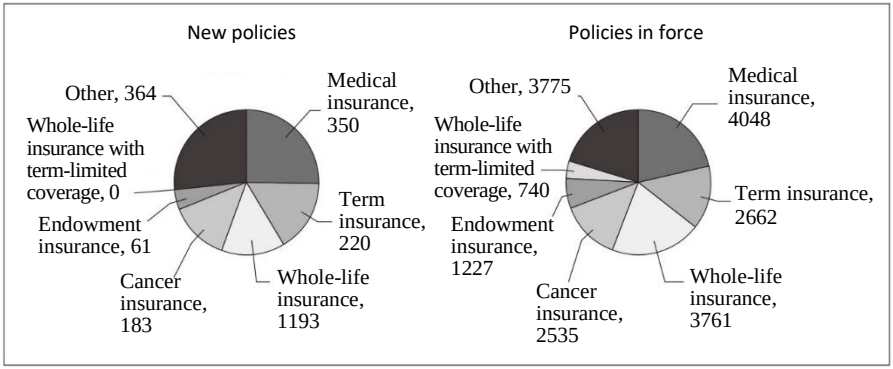
Figure 1 **Desired coverage if inclined to enroll in a new plan or add to a current plan**

(Multiple responses) (Unit: %)

	Household head	Spouse
Coverage for treatment or hospitalization in the event of an illness or injury	52.0	56.9
Policy that focuses on coverage required in the event of an illness, disaster, or accident	50.7	44.5
Policy that focuses on preparing a fund for retirement living	45.0	39.9
Policy that offers a combination of coverage and savings	35.8	29.3
Policy that focuses on preparing for long-term care costs	35.2	26.5
Policy that focuses on savings	15.3	12.3
Policy that focuses on setting aside a fund to pay for the costs of a child's education or wedding	13.5	7.9
Other or unknown	3.0	3.2

Source: Excerpted from "National Survey on Life Insurance" (2018), Japan Institute of Life Insurance (JILI)

Figure 2 **Number of policies by policy type (2019) / (Unit: x 10,000)**



Source: Excerpted from "2020 Life Insurance Trends", The Life Insurance Association of Japan

3 Type consisting of a main policy and riders and type consisting of a single policy

(1) Type consisting of a main policy and riders

Traditionally, major life insurance companies in particular have tried to

provide comprehensive coverage for the various needs of their client base. This was carried out through an approach that entailed the use of main policies and riders. With this approach, clients are meant to feel peace of mind by way of their enrolment in a single product. Such a product is also known as a package product.

Figure 3 **Approach based on the use of a main policy and riders**

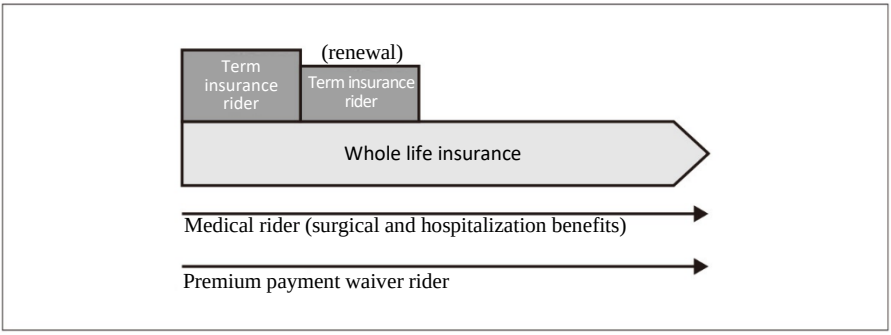


Figure 3 is an example of a main policy consisting of whole life insurance with term insurance or medical insurance added as riders. If this approach is taken, death coverage can continue to be in force for life and can be used to pay for funeral costs and prepare funds for inheritance tax payments upon the death of the insured.

In addition, term insurance can be bolstered while a child of the insured is a student to enhance coverage at a lower cost than increasing the amount of whole life insurance coverage. With many policies, it is possible to renew term insurance riders. If you wish to renew at the same amount, however, premiums will normally rise since you will be older than at the time of your initial enrolment. Some television commercials will claim that your premiums will remain the same for the rest of your life but such commercials are not talking about policies that involve this sort of renewal mechanism for term insurance.

In this example, a premium payment waiver rider has been added. A premium payment waiver rider is a rider that makes it unnecessary for the insured to continue paying premiums from the time he or she becomes afflicted with a certain condition caused by a predetermined illness, such as cancer or a stroke. Coverage remains in force even if premiums are no longer being paid. Recently, some companies have moved away from the approach that is based on the use

of main policies and riders and are instead offering products through which every kind of coverage can be combined under a single main policy on a relatively flexible basis.

(2) Type consisting of a single policy

In contrast to the use of main policies and riders by major life insurance companies, foreign-affiliated life insurance companies and life insurance companies that primarily sell via mail order or online channels have come to emphasize the offering of products on a single-item basis for ease of understanding. These companies sell medical insurance and term insurance as single items. Since consumers read explanations published in newspaper ads or posted on the Internet when enrolling in such policies, they can enroll with peace of mind if the product is one that is easy to grasp.

Costs can be reduced by simplifying the disclosure and application processes required to enroll in an insurance policy; these cost savings can go towards lowering premiums, which would also appeal to potential clients. However, policies that provide medical coverage sometime provide only hospitalization and surgical benefits and no other types of coverage, which means that it is important that you verify what you are getting before enrolling in a policy in terms of coverage with the understanding that not all products are the same.

In addition, since not everyone can receive advice on their own coverage needs, there are probably clients who would like to consult with someone to determine whether a given policy offers enough coverage. It is in this sense that the existence of a face-to-face life insurance solicitation channel can be meaningful (see Chapter 3).

4 Insurance term and premium payment period

An insurance term during which a death benefit and other benefits are to be paid is set forth in a life insurance policy. An insurance term can either be fixed or for life. In terms of insurance policies that only pay a death benefit, those with a fixed term are known as term insurance and those that are in force for life are known as whole life insurance (as explained later in 1(2) of III).

For a fixed-term policy, the insurance term – such as five or ten years – is specified at the time of application. Once the insurance term expires, the policy comes to an end.

The period during which premiums are paid and the insurance term during

which coverage continues to be provided are not always the same.

For example, there is a type of whole-life insurance known as a short-term payment type for which premiums are paid until the insured turns 60 or 65 years of age, when income is still being earned. There is another type known as the whole-life payment type, for which premiums are paid throughout the insurance term. Premiums for the former type, for which the premium payment period is shortened, are higher than they are for the latter.

5 Premium payment method and payment channels

Policies for which premiums were paid once a year used to be common in the past. However, premiums for most policies these days are paid monthly. In some cases, a premium is paid on a single-premium basis at the beginning of the insurance term. The single-premium basis is often used with savings-type products.

These days, premiums are paid mostly by way of automatic bank transfers from deposit accounts and the use of credit cards. Other payment channels include an occupational system whereby amounts are deducted from paychecks by the employer of the insured, who then pays the premiums to the insurance company on behalf of the insured.

In the Showa Period (early postwar years), payments were made primarily through the door-to-door collection of premiums by an insurance sales agent in charge of a given area. Since clients would be seen face-to-face each month with this approach, it was advantageous in that it facilitated flexibility in responding to changing needs.

However, this approach is almost entirely non-existent today as it carries a risk of loss while handling cash and a risk that amounts cannot be reconciled by the agent upon his or her return to the office and as too much time and effort would be spent on this task.

6 Product development innovations

Life insurance is not so simple that one can assert that the policy with lower premiums is always going to be better. When it comes to dividend-paying insurance, costs are determined only after dividends and benefits are paid. In designing a product, you can also lower premium amounts by cutting coverage or reducing benefit amounts.

However, this certainly does not mean that companies do not need to make

an effort; indeed, a life insurance company is required to offer coverage at a reasonable price that does not adversely affect its health. In this section, I will introduce a number of innovations that can be used to lower premiums.

(1) Discounts for persons in good health

First, premiums can conceivably be lowered for those with lower levels of risk. The basic mechanism for setting premiums as a function of risk was incorporated into life insurance products from the outset. As discussed in more detail in Chapter 4-IV-2(3), some insurance products set a standard premium rate for healthy people and a high premium rate for persons with a certain level of risk. This is slightly different from the notion of giving a discount to persons in good health.

A non-smoker discount is a type of discount for persons in good health, which is a system of proactively discounting premium rates charged to healthy people. The premium rates of non-smokers are discounted under this system. This discount is not widely used, however, since it is rather difficult to verify whether one has smoked or not and since it is not clear how much smoking contributes to the risk of death.

These days, premium rates are discounted for some products when a person undergoes a medical checkup or performs certain exercises. See Chapter 5 for more information on such products.

(2) Low- and no-surrender value-type insurance

(i) Low-surrender value-type insurance

A surrender value is normally paid upon the cancelation of a life insurance policy with the exception of non refundable insurance such as term insurance policies and medical insurance policies. A life insurance company accumulates funds from the premiums paid by policyholders in order to pay future claims (see Chapter 4-III for details). When a policyholder cancels a policy before the expiration of the policy term, the portion accumulated for that person's policy (reserve fund) is refunded. However, this amount will be reduced to a certain extent (surrender charge) if a policy is canceled within a certain period after the policy is concluded.

This reserve fund is built up and managed together within a group of insurance policies whose premiums are calculated in the same way (called an insurance cohort). If the surrender value is kept low or not paid at all, it can be

used to fund payments of claims corresponding to other insurance policies. Thus, by keeping the surrender value low, you can lower premiums in totality. Low surrender value-type policies are sold for life insurance with a large savings component, such as whole life insurance.

(ii) No-surrender value-type insurance

Many medical insurance policies these days have no surrender value are also common.

With medical insurance, the insurance policy does not come to an end once benefits are paid; instead, benefits are paid over and over again. This means that some policies that have paid out more in benefits than premiums paid by the insured to date will continue to remain in force.

If a surrender value is to be paid to the insured upon the cancelation of a policy that has paid out more in benefits than premiums paid by the insured to date, then an amount over and above the premium amounts must be collected in advance to enable the payment of a surrender value. Thus, companies decide not to pay surrender values.

On the other hand, there are also agreements that provide congratulatory payments or dividends on policies that have not paid out medical insurance benefits for a certain period of time. For such products, premiums are correspondingly higher.

7 Individual insurance and group insurance

Life insurance where the policyholder is an individual is called *individual insurance* and life insurance where the policyholder is a company or organization and the employees or members thereof are the insured is called *group insurance*. Different products are sold for each; special policies are offered to groups.

A form of insurance whereby a company's employees are the policyholders and premiums are deducted from paychecks issued by the company is sometimes referred to as *group coverage* and can also be referred to as *occupational coverage* and *professional group coverage in Japan*. This form of insurance constitutes individual insurance for which premiums are simply paid through a company or other employer.

In addition, insurance for which a company may be the policyholder but the president as an individual or each board member as an individual is the insured

through the use of a type of product geared towards individuals is categorized as individual insurance.

Both insurance for individuals and insurance for groups can offer robust protection and savings features (Figure 4).

Figure 4 **Individual insurance and group insurance**

	Individual is the policyholder	Group is the policyholder and members are the insured
Purpose: Coverage	Individual insurance	Group insurance
Purpose: Pension benefit	Individual annuity	Group pension

II. Life insurance policy rules

The Insurance Act was touched on briefly in Chapter 1. This statute defines insurance, defines life insurance, defines non-life insurance, and defines accident and sickness insurance. It also sets forth basic rules governing insurance policies.

In this section, I will focus primarily on matters set forth by the Insurance Act that do not relate to definitions.

1 Application of Insurance Act rules

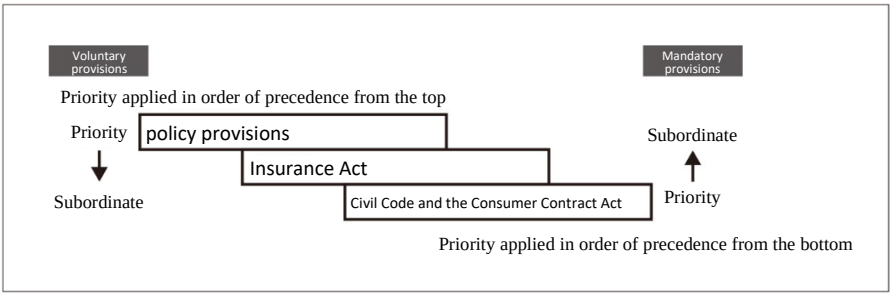
The legal rules governing general contracts that are applicable to sales contracts and lease contracts are set forth by the Civil Code and the Consumer Contract Act (limited to cases involving a contract between a business and a consumer). The Civil Code and other such statutes stipulate how contracts are to be formed and other pertinent matters.

The Insurance Act applies as a set of rules that directly govern the types of contract that are used to provided insurance coverage. It is positioned as a set of special provisions of the Civil Code.

Detailed arrangements for insurance policies are set forth in the policy provisions as drafted by each insurance company.

As for the relationship among these three sets of rules, the Insurance Act prevails over the Civil Code and the policy provisions prevail over the Insurance Act with respect to voluntary provisions, in other words, matters concerning which commitments separate from matters mandated by law can be made. On the other hand, the Insurance Act prevails over the policy provisions and the Civil Code prevails over the Insurance Act with respect to mandatory provisions for which anything other than statutory provisions cannot be regarded as valid. Many mandatory provisions are set forth in the Insurance Act (Figure 5 on the following page).

Figure 5 **Voluntary provisions and mandatory provisions**



Below, I will primarily explain life insurance and add any explanations of the way matters are handled differently with fixed-amount accident and sickness insurance where applicable. In this section, I will not provide an explanation of insurance against loss from an accident or sickness, which is classified as non-life insurance.

2 Concluding an insurance policy

(1) Application and acceptance

An insurance policy is concluded when an application is made by a prospective insurance policyholder and accepted by the life insurance company as the insurer. An agreement concluded with just the agreement of both parties is known as a consensual agreement; an insurance agreement (policy) is a consensual agreement. While an insurance certificate is normally issued, such an action is not a necessary condition for concluding an agreement.

However, an insurance certificate is an important document in that it is often sent as a notice of acceptance of the insurance policy by the insurance company, and in that many life insurance companies will require the presentation of an insurance certificate to facilitate various procedures at a later date. Information to be included in an insurance certificate are set forth in the Insurance Act.

Since life insurance companies determine whether they will issue an insurance certificate, some companies no longer issue an insurance certificate in this paperless age. In such cases, a written document will be sent to inform the insured that the insurance policy has been accepted but the insured will not be asked to present this document whenever an insurance claim is made.

(2) Duty to disclose

In applying for a life insurance policy, the policyholder and the insured must answer important questions posted by the life insurance company, which relate to, for example, the current state of health of the insured, the history of visits made by the insured to and treatment received by the insured from medical doctors, and the insured's occupation. Normally, the insured will complete a disclosure form prepared by the life insurance company for this purpose or provide answers to a company physician working for or a physician commissioned by the life insurance company.

Mandating a question-and-answer format for disclosing matters — Column 5

Under the Insurance Act, a question-and-answer format has been mandated for disclosing matters. Under the previous law (old Commercial Code), the duty to disclose matters was regarded as an obligation to make a voluntary declaration, which ostensibly meant that the insured had to voluntarily inform the life insurance company of any illness, physical condition, or other such important matters. Thus, the insured had to declare any important physical anomalies even if he or she was not specifically asked about such matters in the disclosure form.

However, in practice, an insured would only respond to questions asked in the disclosure form; this approach was replaced with a mandated question-and-answer format under which the insured only has to answer questions asked in the disclosure form. Since the insured only needs to answer questions asked by the life insurance company, the life insurance company needs to make sure that the disclosure form is both concise and easy for anyone to understand.

Eased underwriting standards (limited disclosure) and non-selective insurance — Column 6

Some life insurance policies consist of products for which there is a narrower range of matters to be disclosed. Such products are sold on the basis that they can be taken out even if the insured has a pre-existing medical condition. Such products are called eased underwriting standards-type insurance or limited disclosure-type insurance. There are also life insurance products for which no disclosure is required and for which no risk selection process is undertaken at all.

There are two points that you should be aware of when taking out such insurance. The first is that it is possible that no death benefit will be paid or that the death benefit will be reduced if the insured dies within a certain period – for

example, two years – after the date on which the policy is concluded. The second is that premiums for insurance for which no risk selection process is undertaken tend to be higher than they are for common insurance policies since this type of insurance tends to be taken out by higher-risk individuals. There are cases in which healthy persons would be better off enrolling in a ordinary life insurance plan since such a course of action would result in lower premiums.

In addition, some whole life insurance policies underwritten by companies that claim that premiums will remain constant for the rest of your life will lower payout amounts after the insured reaches a certain age. In any case, you need to carefully read the ads and brochures that pertain to a product and inquire with the call center or agent if you have any questions.

As mentioned below, a life insurance policy may be canceled or death benefits may not be paid if matters have not been properly disclosed (breach of the duty to disclose). Provisions pertaining to cancelation due to a breach of the duty to disclose are also set forth in the Insurance Act.

(3) Consent of the insured

As outlined in Chapter 1, the consent of the insured is needed for an insurance policy that pays out a death benefit if the policyholder and insured are different persons. There are several reasons why the consent of the insured is required, one of which is to prevent more risks. An example of a moral risk is the intent, in the back of the policyholder's mind, to cause an insured accident. In an extreme case, a policyholder might even take out a life insurance policy on someone in hopes of obtaining death benefits by deliberately causing that person's death. In order to prevent such actions, the consent of the insured is required.

These days, there is a strong belief in the importance of the consent of the insured in terms of respecting the personal rights of the insured.

When it comes to fixed-amount accident and sickness insurance, the consent of the insured is not needed if the beneficiary and the insured are the same person unless the policy pays out a benefit only in the event of a death from an accident or sickness. This is due to the fact that it would be unrealistic to require the consent of, for example, everyone participating in a sports event to whom accident insurance is being provided.

(4) Designating and changing the beneficiary

With life insurance policies, it is often the case that the insured under the policy is different from the beneficiary. In concluding a life insurance policy, the beneficiary is not required to give consent like the insured and is not involved in procedures for taking out the policy.

The policyholder can designate and change the beneficiary. At the time of the conclusion of an insurance policy, the insured will consent based on an understanding of who the beneficiary is. When the policyholder wishes to change the beneficiary, the consent of the insured will again be required.

To have a change of the beneficiary take effect, the policyholder only needs to unilaterally inform the life insurance company. In addition, if a policyholder (who is also the insured) dies after having left a will in which he or she indicated a desire to change the beneficiary from current beneficiary A to new beneficiary B, the change of the beneficiary will also take effect when the will is notified to the life insurance company by a bereaved family member after the death of the insured. In such a case, payment of the death benefit by the life insurance company to original beneficiary A due to a failure to notify the life insurance company of the will shall be considered effective. In other words, the life insurance company will not be required to make a duplicate payment to new beneficiary B.

3 Insurance benefits

(1) Insurance claims

When it becomes known that an event for which a death benefit can be claimed (death of the insured) has occurred, the beneficiary must immediately notify the life insurance company.

While a delay in providing this notification does not immediately mean that the insurance money will not be paid, the right to claim insurance money can become extinct by prescription. If a claim for insurance money is not made within three years, the right to make a claim will be extinguished. However, whether the life insurance company will insist on extinguishing this right by prescription is up to the life insurance company. Many life insurance companies will still pay if certain unavoidable circumstances were in play, such as where the insurance certificate could not be found right after death and only showed up much later.

(2) Where insurance money is not paid

There are three main scenarios in which no death benefit is paid:

(i) Disclaimers

The first is disclaimers as set forth by the life insurance company. Disclaimers include the following statements:

Disclaimers as set forth by the life insurance company

a) Suicide as carried out by the insured
b) The policyholder intentionally causes the death of the insured
c) The beneficiary intentionally causes the death of the insured
d) The insured dies due to a war or other situation involving strife and bloodshed

With disclaimers a) through c), the life insurance company will be deemed to be not liable for paying insurance money in light of the fact that the death of the insured in such cases will have been intentionally caused.

The insurance money is not paid since there was a moral risk in play.

With a), it would be problematic if the policyholder (as the insured) were to enroll in a life insurance plan for the purpose of having a death benefit obtained before he or she proceeded to commit suicide. This is because not only is the use of life insurance in this manner inappropriate, but life insurance could end up encouraging more people to commit suicide. However, if there was no intent to commit suicide at the time of enrolment and the insured later committed suicide because he or she ran into financial difficulties, some might argue that insurance money should be paid out to surviving family members. On this point, whereas the Insurance Act allows for nonpayment on an indefinite basis, the provisions stipulated in more recent policies sometimes allow for the payment of a death benefit even in the event of a suicide committed at least three years after enrolment (or one or two years under some older policies).

(ii) Breach of the duty to disclose

The second is the cancelation of a policy due to a breach of the duty to disclose. I explained above that the policyholder and insured have a duty to disclose. Nevertheless, the life insurance company is entitled to cancel an insurance policy due either to an intentional failure to disclose or to a failure to disclose something that the insured should have known had to be disclosed if a minimal degree of care had been exercised. In addition, no death benefit will be paid if the reason for the failure to properly disclose is related to the cause of death. On the other hand, a death benefit will be paid in a case in which the

insured dies in an automobile accident even if the insured failed to inform the life insurance company that he or she was told by a doctor that he or she needed to undergo re-examination for cancer since there is no real connection between cancer and automobile accidents.

Under the Insurance Act, a policy cannot be canceled more than five years after the conclusion of a life insurance policy or more than one month after the life insurance company finds out about the existence of grounds for cancelation. This five-year period after the conclusion of a life insurance policy is normally reduced to two years in the provisions of a policy. Thus, a life insurance company cannot cancel an agreement even if it becomes aware of a breach of the duty to disclose more than two years after the conclusion of a policy.

Furthermore, the life insurance company cannot cancel a policy if it knew about the matters to be disclosed or if the insurance solicitor working for the life insurance company had encouraged the policyholder to refrain from disclosing the matters to be disclosed. This is because the fault would lie with the life insurance company in these cases.

(iii) Serious reasons

The third is the cancelation of a policy due to a serious reason. A serious reason refers to an act of bad faith on the part of the policyholder that makes it difficult to maintain the policy in question. When such an act of bad faith is carried out, the life insurance company is entitled to cancel the insurance policy. Specifically, a policy can be canceled in any of the following cases:

Cancelation due to a serious event

a) The policyholder or beneficiary intentionally caused or attempted to cause the death of the insured
b) The beneficiary committed or attempted to commit fraud with respect to a claim for insurance money under a life insurance policy
c) In addition to the above, any other serious event that undermines the trust of the insurer and makes it difficult to enable the life insurance policy to remain in force

While a) is similar to the first disclaimer listed above (intentional on the part of the policyholder), it has the effect of allowing the life insurance company to cancel a policy before an event to trigger a claim occurs; in other words, even if the policyholder fails to intentionally cause the insured to die (in other words, an attempt is made). An example of b) would be where, even though the insured is

not dead, a claim for a death benefit payment is made with a completely fraudulent death certificate. An example of c) would be where a moral risk is highly suspected of being in play, such as where the insured is covered by a death insurance policy of an unnecessarily high amount or by an unnecessarily high number of death insurance policies.

These are handled in almost the exact same way for fixed-amount accident and sickness insurance. However, there are some differences. With an accident and sickness insurance policy, the insurer is exempt from liability if the insured deliberately or by gross negligence causes an accident rather than commits suicide. When it comes to cancelation due to a serious event, the policy is subject to cancelation even if the insured him or herself caused a benefit payout-triggering event. Since the disability or illness of the insured, rather than the death of the insured, is the benefit payout-triggering event in an accident and sickness insurance policy, the insured getting himself or herself deliberately injured is grounds for exempting the insurer from liability and for allowing the insurer to cancel the policy.

With a personal accident insurance policy that covers only injuries, the insurer is exempt from liability when an accident is caused by drunk driving, driving without a license, or a criminal act.

III. Products for individuals

In this section, I will specifically look at products for individuals in the following order: products for survivors' security, products for old-age protection, and third-sector products.

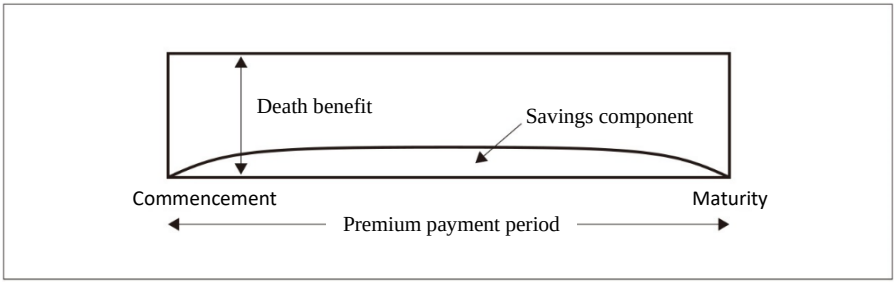
1 Products for survivors' security

(1) Term insurance

Term insurance consists of products that provide death coverage for only a fixed period of, for example, ten or twenty years.

When the insured dies, only a death benefit is paid out; no maturity benefit would be received. For this reason, there is usually pretty much no savings component in a term insurance policy. Since there is almost no amount that is refunded if the policy is canceled prior to its expiration, this type of insurance is known in Japanese as "pay and discard" insurance. Their advantage is that you can obtain a high amount of coverage at low premiums (Figure 6).

Figure 6 **Illustration of term insurance**



What you should be aware of is that coverage comes to an end upon the expiration of the insurance term. Incidentally, if the insured dies during the insurance term, insurance money will still be paid out even if a claim for its payment is made after the end of the insurance term. Term insurance is often added as a rider to endowment insurance or whole life insurance policies.

Term insurance can be taken out as a stand-alone policy from an insurance company that sells policies through a mail-order or online channel. As mentioned above, it is also often added as a rider in packages consisting of a

main policy and riders as offered by major life insurance companies.

Increasing term insurance — Column 7

Term insurance where the amount of insurance money to be paid out increases in the second half of the insurance term is known as increasing term insurance. This type of insurance only pays out a death benefit but is designed to pay out a larger death benefit amount in the second half of the insurance term than would be paid out in the first half. Unlike typical term insurance, a certain amount of savings is accumulated in preparation for the payment of a higher death benefit amount in the second half of the insurance term. For this reason, cancelation of the policy prior to its expiration will result in the payment of a surrender value.

An increasing term insurance policy would be purchased by a company with an executive as the insured in order to apply the death benefit paid out in the event of the death of the executive to the death severance pay that would be owing. The policy can also be canceled to allow the surrender value to be applied to the service bonus to be paid to the executive when the executive resigns from his or her post at the end of his or her term of office.

While the premiums for this type of insurance are treated as a financial loss for a term insurance policy, it became questionable as to whether it was appropriate to treat even products that give rise to a substantial savings component as a loss under taxation laws. Consequently, treatment under taxation laws changed to allow only products where the amount of insurance money to be paid out increases by up to a certain extent to be treated as a loss.

Accidental death rider — Column 8

Adding a disaster term insurance rider (accidental death rider) is one way to enhance death coverage. This rider pays out insurance money in the event of a death caused by an unforeseen accident, such as one involving a motor vehicle crash. As coverage does not extend to death by illness, coverage can be enhanced for a lower premium amount. However, as this rider constitutes accidental term insurance, no insurance money will be paid out unless conditions for finding that the accident in question was unforeseen – in other words, sudden, accidental, and external – are met.

The life insurance business is essentially a type of business that operates by paying out insurance money immediately without needing to conduct a very

thorough investigation upon the death of the insured. For this reason, the underwriting of an accidental death rider is a bit complicated. This is because the insurance company, when paying out insurance money, needs to investigate to determine whether or not the cause of death was an unforeseen accident.

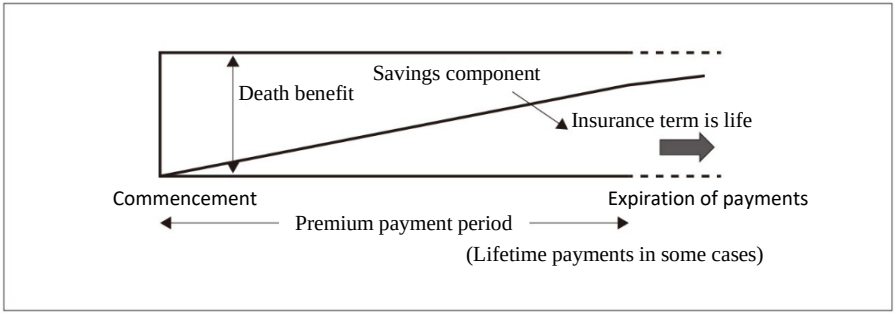
For example, if an elderly person with a pre-existing condition were to die by drowning in his or her bathtub, the insurance company would need to investigate to determine whether or not this death was accidental. There are some who believe that insurance money should be paid if the direct cause of the death in this example was drowning even if the individual had collapsed due to a brain hemorrhage. In addition, it is also difficult to simply investigate to determine what the direct cause of death was in the first place.

(2) Whole life insurance

Whole life insurance is a product that only pays out a death benefit. What distinguishes this product from term insurance is that the policy remains in force until the insured dies. If the insured were to live to 100 years of age, the insurance term would extend up to that point in time.

Only a death benefit is paid out and no maturity benefit is received (Figure 7).

Figure 7 **Illustration of whole life insurance**



The advantage of whole life insurance is that the premium amount does not change throughout the premium payment period, such that, if you were to take out a whole insurance policy at a young age, the coverage amount at the time of enrolment would be maintained at the same premium amount that was initially charged.

Since the insurance term does not expire as it does with term insurance, a death benefit will definitely be paid out unless the policy were canceled by the

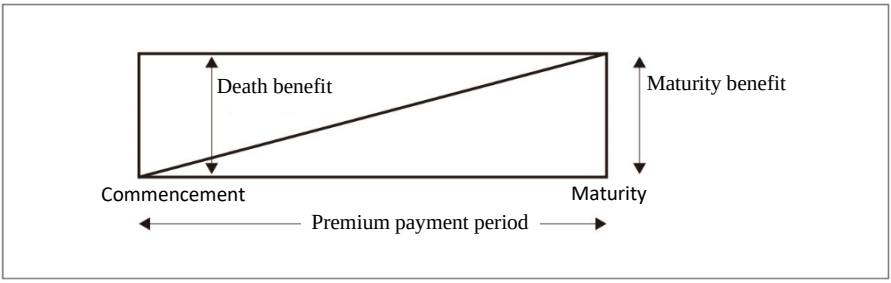
policyholder. For this reason, a substantial savings component needs to be set up in preparation for the payment of claims in the future. Thus, premiums are higher than they are for term insurance policies.

A whole life insurance policy is not like a simple term insurance policy in that a certain amount of surrender value will be returned upon its cancelation. By focusing on this point and paying what is owed in a single premium payment, you can obtain coverage while securing a certain amount of savings. This approach to sales is especially prevalent in over-the-counter sales at banks (see Chapter 3 IV-4).

(3) Endowment insurance

Endowment insurance is term insurance where the death benefit during the insurance term and the maturity benefit upon the expiration of the insurance term are the same. With a 10-year, 3 million yen endowment insurance policy, 3 million yen will be paid out whether the insured dies during the insurance term or survives to maturity. The premium is higher from a coverage standpoint in order to increase the savings component enough to pay for the maturity benefit upon the expiration of the insurance term (Figure 8).

Figure 8 **Illustration of endowment insurance**



Payment is made in the form of a single payment in order to further enhance the savings nature of this type of insurance. During the bubble era, high-yield single-premium endowment insurance policies were sold in high numbers. This led to the separate taxation at source of insurance money from single-premium endowment insurance policies of five years or less, as is the case with other financial products. Taxation matters are explained in more detail in V below.

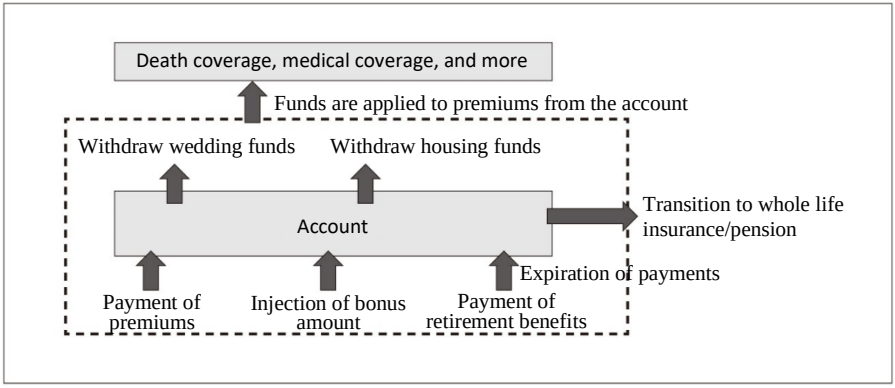
(4) Interest sensitive whole life insurance (account-type insurance)

This type of product is known as account-type insurance. It is a product that was modeled after universal life insurance, a major product sold in the United States.

The insurance component of this product, which corresponds to the main policy with a function for accumulating funds, is called the account and is constituted by a variable-rate savings-type whole life insurance policy. The main policy can be supplemented by insurance providing various coverage functions as riders or by being combined with stand-alone insurance policies.

This type of insurance is based on whole life insurance with a function for accumulating funds through the regular payment of premiums into the account or the payment of a lump-sum amount. Applicable to the account is an interest rate that is set at the time of enrolment and that fluctuates in line with market interest rates. From the account are applied funds to pay premiums for riders that are freely designed and added, including riders providing death coverage and riders providing medical coverage (Figure 9).

Figure 9 **Illustration of account-type insurance**



The policyholder can also be given partial refunds whenever funds are needed.

By utilizing savings in the account, coverage can be flexibly revised or the premium to be paid can be adjusted in accordance with any change in circumstances after the policy is concluded.

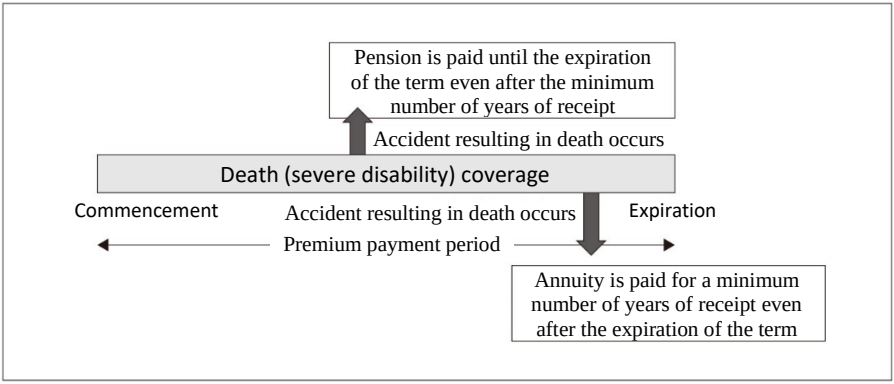
When the premium payment period comes to an end, the account component will be transitioned into a simple whole life insurance policy or annuity.

(5) Income-protection insurance

With term insurance and whole life insurance policies, a death benefit is paid as a lump-sum payment. An income-protection insurance policy is a policy that pays out an annuity when the insured dies. If the insured dies during the policy term, an annuity will be paid until a minimum number of years of receipt as initially promised have passed or until the expiration of the policy term, whichever is later. Since the death benefit is paid as an annuity, it is as if the income of the deceased individual is being supplemented annually.

If the insured dies at the beginning of the insurance term, insurance money will be received annually for many years but the total amount of the death benefit will decrease over time (Figure 10).

Figure 10 **Illustration of income-protection insurance**



(6) Educational endowment insurance

This type of insurance is also known as "children's insurance". The policyholder is the father or mother of a child and the child is the insured. It was originally a type of insurance designed for the purpose of savings by which funds could be accumulated in order to pay benefit amounts when the child turns either 18 or 22 years of age. Some examples pay out a congratulatory benefit when the child turns 12 or 15 years of age prior to the expiration of the insurance term.

If the father or mother as the policyholder dies, subsequent premium payments are waived. With some products, a scholarship annuity is paid upon the death of the policyholder. This is a unique type of product in that payments are also made on the death of the policyholder.

If the child as the insured dies, a death benefit is paid but the amount that is

paid usually equals the aggregate amount of premiums paid plus investment income earned to date.

(7) Variable insurance

Variable insurance was introduced in 1986. There are two types of variable insurance: Variable fixed-term insurance and variable whole life insurance. While variable fixed-term insurance is structurally the same as endowment insurance and variable whole life insurance is structurally the same as whole life insurance, variable insurance has a savings component that is invested, the results of which are reflected in the surrender value and maturity benefit.

In either case, the death benefit amount is guaranteed but the maturity benefit (in the case of variable fixed-term insurance) and surrender value are subject to change according to investment performance.

Problems with variable insurance **Column 9**

While it is stated in the text that variable insurance was introduced in 1986, it should be noted that this was three years before the bubble economy reached its peak in 1989; stock prices were soaring at that time. Stock prices in Japan reached their zenith at the end of 1989 before beginning to decline. Right after 1990, stock prices embarked on a long-term drop even as some observers felt that this was just a temporary situation.

For this reason, the surrender value corresponding to variable insurance policies fell substantially short of initial projections and the amount of paid premiums.

At the time variable insurance was being sold, few people anticipated that share prices would drop so significantly and the sales method that was employed was inadequate as a method for selling risky products by today's standards given that policies were effectively being sold bundled together with bank loans. It was questionable as to whether policyholders were properly informed of the risks involved and lawsuits consequently ensued.

2 Products for old-age protection

(1) Fixed-amount individual annuity insurance

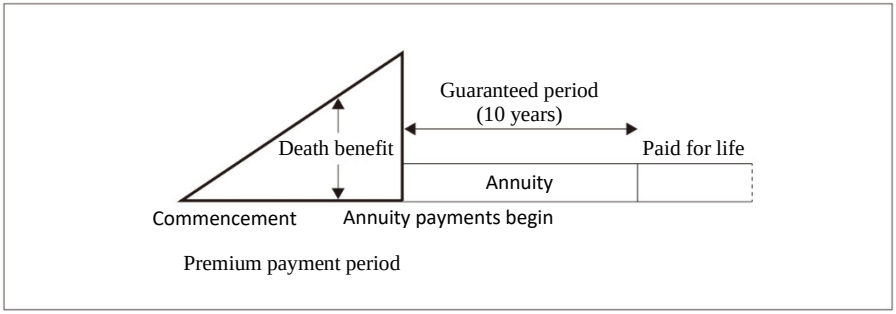
When it comes to individual annuity insurance policies, when premiums are paid and the policyholder reaches a prescribed age – such as sixty-five, the funds that have been paid in and invested up to that point in time constitute the pension

resource. Annuity payments are made based on this pension resource. If the insured dies during the premium payment period, the premiums that have been paid up to that point in time (or a slightly higher amount) will be paid as a death benefit.

There are several ways that an annuity can be paid, including the following: defined payments, fixed-term payments, fixed-term payments with a guaranteed period, and whole life payments. If defined payments are to be made for five years, then they will be made for five years after the start of annuity payments regardless of whether the insured is dead or alive. With fixed-term payments, if the insured dies during – for example – the ten-year annuity payment period, annuity payments will be terminated upon the death of the insured even if ten years have not elapsed. Since the policyholder suffers a loss if the insured dies early with this approach to making annuity payments, some policies set forth a guaranteed period within the fixed-term period. For example, a policy might have a fixed term for payment of ten years with a guaranteed period of five years. This way, even if the insured dies three years after the start of annuity payments, five years' worth of annuity payments will still be issued.

With whole life payments, an annuity will be paid until the insured dies. Since it is not possible to know the age up to which any given individual will survive, premiums are higher. Figure 11 sets forth an example of whole life annuity payments with a guaranteed period of ten years.

Figure 11 **Illustration of whole life annuity payments with a 10-year guaranteed period**



Tontine annuities **Column 10**

In a world with ultra-low interest rates, it has become difficult to obtain sufficient yields on annuities and other savings-type products. Developed in response to this state of affairs were tontine annuities. With this product, a portion of the savings of an enrollee is left in place in the event of an early cancelation or death and utilized to provide annuity benefits to others. Under this scheme, the older a member gets, the greater the annuity amount he or she will be entitled to receive. This scheme was devised by Italian Lorenzo de Tonti and is known as a tontine.

Tontine annuities specifically sold in Japan include those that increase the annuity benefit amount at the expense of a reduction in the surrender value.

(2) Variable individual annuity insurance

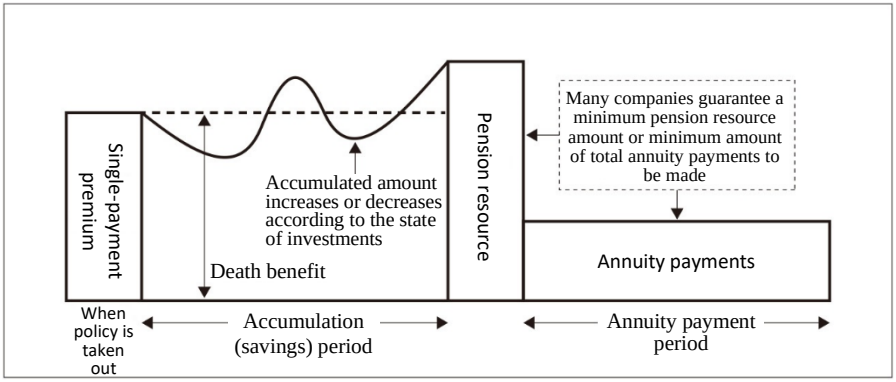
Given the ultra-low interest rates of recent years, it is not possible to obtain sufficient interest earnings on national government and company bonds that constitute investment vehicles for fixed-amount annuity insurance funds. Variable individual annuity insurance was developed in response. With this type of product, paid premiums are invested in stocks and other financial instruments. If favorable investment performance is achieved, the pension resource will grow and make it possible to increase annuity amounts.

Many policies of this type of product were sold over the counter at banks. For a time, single-premium variable individual annuity insurance policies were very popular.

Incidentally, financial instruments that serve as investment targets for variable individual annuity insurance policies generate losses from time to time. In such a case, the annuity amount may decrease. However, many insurance companies guarantee the payment amount to ensure that the pension resource or total amount to be paid out as an annuity does not fall below the amount of single-payment premiums that have been paid (Figure 12 on the following page).

If the insured dies during the investment period, the amount that was paid on a single-premium basis will be paid out as a death benefit (benefit amount). Even if this sort of minimum guaranteed amount is attached to a policy, no minimum guarantee will apply to the surrender value prior to the expiration of the insurance term. You will need to enroll in such a policy after you come to a full understanding of the distinct nature of such a pension as an investment product.

Figure 12 **Illustration of variable, single-premium individual annuity insurance**



(3) Foreign currency-denominated individual annuity insurance

The structure of a foreign currency-denominated individual annuity insurance policy is more or less the same as that of a fixed-amount individual annuity insurance policy. As a foreign currency-denominated individual annuity insurance policy allows for investments in foreign national government bonds and other bonds with higher interest rates than Japanese national government bonds, this kind of insurance is advantageous in that a higher yield can be expected.

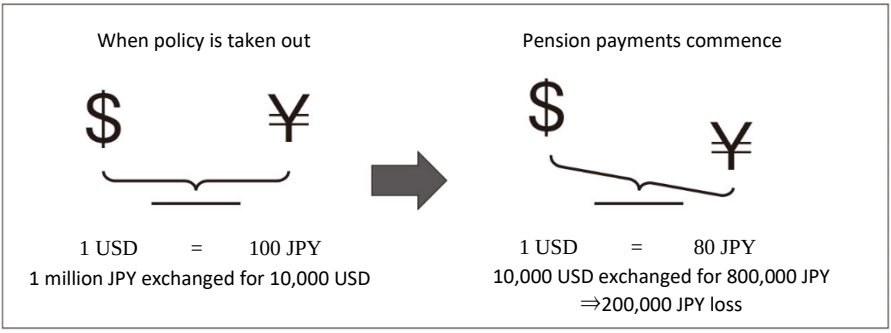
However, a foreign currency-denominated individual annuity insurance policy entails the payment of premiums after converting yen into the applicable foreign currency. In addition, since annuity payments are received in a foreign currency, payments need to be converted from the foreign currency into yen before they can be used as funds for living. If the yen appreciates between the time the policy is taken out and the time annuity payments are received, the annuity payment amounts that you will receive will be reduced in yen terms. You can select from among the different options for foreign currency as set by the insurance company, such as US dollars, euros, or Australian dollars.

Figure 13 on the following page outlines a scenario in which the exchange rate was 1 dollar = 100 yen at the time the policy was taken out but then became 1 dollar = 80 yen at the time annuity payments began. If we assume an investment yield of zero, this means that you will have sustained a loss of 20 yen on the dollar, such that you will have lost 200,000 yen if 1 million yen in premiums had been paid to date. Thus, even if your policy has earned a slight

investment yield over time, an appreciation of the yen against the foreign currency you selected from the outset may incur a loss.

Since knowledge of currencies is required, this type of product should be purchased by someone with a certain level of financial knowledge or someone who has received a careful explanation from an insurance solicitor.

Figure 13 Currency risks



3 Third-sector products (accident and sickness insurance)

(1) Medical insurance

There are various types of medical insurance available. Obvious options will pay out benefits for hospitalization or surgeries due to an injury or illness. Many policies pay out a fixed amount, such as 10,000 yen, per day for hospitalization. With some policies, the surgical benefit is set at ten or twenty times the daily hospitalization benefit depending on the type of surgery in question. For example, with a product that pays out 10,000 yen per day of hospitalization, a benefit of 100,000 yen or 200,000 yen will be paid for a surgical procedure. While the types of surgery for which a surgical benefit is payable used to be limited, a surgical benefit is paid out these days for all surgical procedures covered by public medical insurance.

Other policies pay out a benefit for post-hospitalization outpatient visits or a benefit upon being discharged from the hospital.

As mentioned in Chapter 1, enrolment in the public health insurance scheme in Japan is compulsory but one normally needs to pay thirty percent of the medical costs incurred. There are also costs that lie outside the scope of insurance that must be borne by the individual, such as the cost to upgrade a hospital room.

Medical insurance differs from life insurance in that a life insurance policy will be extinguished upon the payment of a benefit, such as a death benefit or maturity benefit. Even if a hospitalization benefit or surgical benefit is paid under a medical insurance policy, the policy is not extinguished. Benefits will continue to be paid to an insured each time he or she is hospitalized or undergoes a surgical procedure, subject to certain restrictions.

While medical insurance has been around for a long time, products have undergone significant changes over the years. Older products were designed to provide coverage for longer-term hospitalizations, such that they might not have paid a hospitalization benefit for a certain period after the date of hospitalization (such as five days). These days, as more and more people find themselves being discharged after a short period of time in the hospital, newer products pay a hospitalization benefit from day one or a lump-sum payment at the time of hospitalization, such as 300,000 yen.

Advanced medical procedures insurance (rider) **Column 11**

Under the public health insurance scheme, medical procedures for which insurance benefits are paid are defined. Advanced medical procedures consist of medical procedures that utilize advanced technology and that have been approved by the Minister of Health, Labour and Welfare. Advanced medical procedures can be received as treatment at a designated hospital. However, they are not covered by public health insurance.

Typical examples of advanced medical procedures are proton therapy and heavy particle beam therapy, which are used to combat cancer.

What must be kept in mind is that, in receiving an advanced medical procedure, it is not just the costs incurred for the advanced medical procedure itself that are not covered by insurance; medical examinations, tests, and medication associated with the advanced medical procedure are also not covered.

Some procedures can be very expensive and are not covered by the reimbursement system for high-cost medical care that is provided if treatment costs exceed a certain amount per month. Advanced medical procedures insurance (rider) was developed to cover such costs.

When a treatment method for an advanced medical procedure becomes commonplace, it can sometimes come to be covered by public health insurance. In addition, you should note that new treatment methods are sometimes developed and change with each revision of the public health insurance system.

(2) Cancer insurance

Cancer insurance is normally designed to provide coverage if you develop cancer. Once a diagnosis of cancer is confirmed, you will be given a one-time payment or benefit payments like a hospitalization benefit, surgical benefits, or hospital visit benefits. Some policies pay out a death benefit while others do not. More recently, policies that pay out a death benefit appear to be less common than before.

A feature of cancer insurance is that there is typically an exclusion period of 90 days. Regardless of what facts were disclosed by the insured from the outset, a confirmation of a diagnosis of cancer within 90 days of the day on which a policy is taken out will mean that the cancer insurance policy will be treated as having been null and void from the beginning. In such a case, no cancer insurance benefit will be paid out by the policy. However, as the policy is also null and void, all premium payments that have been made will be refunded.

When it comes to cancer insurance, you need to pay attention to whether or not coverage extends to epithelial cancer. As this type of cancer rarely metastasizes, it is not covered by some cancer insurance policies.

Sometimes, a doctor will declare that a patient has cancer but, in a way that is perhaps difficult to understand, no benefit payment is made by the cancer insurance policy that was taken out by the patient. In light of this point, there appear to be more and more products these days that offer benefit payments to cover epithelial cancer.

(3) Critical illness insurance

A typical example of critical illness insurance is known as three-major-disease insurance. Such a policy pays out a lump-sum amount when the insured comes to suffer from a certain condition as a result of becoming affected by one of three illnesses – cancer, cerebral stroke, or acute myocardial infarction. This type of insurance pays out far more in benefits than the hospitalization benefit or surgical benefit that is offered by a typical medical insurance policy.

This type of insurance is offered to address the fact that these illnesses incur substantial costs for medical treatment and post-discharge recuperation.

(4) Long-term care insurance

A long-term care insurance policy pays out a certain amount of benefits when the insured comes to need a prescribed level of long-term care. As mentioned in Chapter 1, a public long-term care insurance scheme exists in Japan, but individuals and families sometimes want to receive more extensive services, such as four day-service visits a week instead of just two. At such times, benefits offered by a private long-term care insurance policy can be used. See Chapter 5-I for more information on long-term care insurance policies as well as dementia insurance, for which a number of new policies have been introduced in recent years.

(5) Disability income insurance

This type of insurance pays out a lump-sum payment or annuity if the insured is hospitalized for a long period of time and is certified as having a certain disabling condition. It is intended to cover the loss of income that results from becoming no longer able to engage in work. The coverage period is normally a fixed term.

This type of product has been garnering significant attention in recent years as insurance that is designed to help the insured by way of coverage that serves as an alternative to death coverage.

Reviewing your coverage **Column 12**

Insurance products evolve from year to year. Products that were not available when a policyholder first took out his or her policy are constantly emerging, such as by way of the development of long-term care insurance and dementia insurance and the upgrading of medical insurance coverage. In addition, the needs of a client often change over time. For example, a client may have taken out a life insurance policy with substantial death coverage in the beginning but, given that his or her children have left the nest, he or she would now like to pivot away from death coverage and instead enhance his or her medical coverage.

Policy conversion schemes exist to address such changing client needs. Simply put, the savings component of an insurance policy still in force is used to pay some of the premiums of a new insurance policy. This process is also known as an insurance trade-in. While this process can only be carried out within the same insurance company, you should note that it cannot be applied in some cases depending on the products in question. This process is advantageous in that premiums are lower than

they would be if you were to cancel your current policy and enroll in a new one.

If you simply want to bolster your coverage amount, you can either increase the amount of insurance money under your current policy or take out a new stand-alone policy. Consult with an insurance solicitor to figure out which approach is better for you.

IV. Group products

In this section, I will discuss group insurance. With group insurance, a company or organization is the policyholder and a contract for insurance is concluded with the group of people to be covered, such as the employees or members thereof.

Group insurance can be broadly divided into group life insurance and company pensions. Group life insurance plans primarily provide a death benefit, but some also cover medical costs (Figure 14).

On the other hand, company pensions include defined benefit company pension plans, defined contribution company pension plans, and employees' pension fund insurance plans (Figure 15).

Figure 14 **Group life insurance**

Name	Policyholder	Premiums paid by	Purpose
Group term insurance	Company or organization	Employee	Low-premium death coverage for employees
Comprehensive welfare group term insurance	Company or organization	Company or organization	Allocated to death retirement bonus payments and condolence money payable by the company or organization
Group credit insurance	Bank or financial institution	Borrower	Repayment of loan in the event of the death of a borrower
Medical coverage insurance (group type)	Company or organization	Company or organization or employee	Low-premium medical coverage for employees

Figure 15 **Company pension plans**

Name	Contribution	Pension amount	Comment
Defined benefit pension plan	Reviewed at regular intervals	Fixed	Company assumes investment risks (decreasing trend)
Defined contribution pension plan	Fixed	Depends on investment performance	Employees assume investment risks
Employees' pension fund plan	Reviewed at regular intervals	Fixed	Scheme that functions in place of the welfare and pension system in part

1 Group life insurance

(1) Group term insurance

Group term insurance provides death coverage to employees. This type of group insurance is voluntary in that, while the company or organization is the policyholder, the employee or member, as the insured, can choose whether or not to enroll and how much he or she wishes to contribute. Premiums are also deducted from the employee's pay and paid to the life insurance company.

Death benefits are paid out not to the company but to the employee's surviving family members.

(2) Comprehensive welfare group term insurance

Contracts for comprehensive welfare group term insurance are concluded with life insurance companies for the purpose of providing funds to a company to pay its own death retirement bonuses and condolence money. The consent of the insured is collectively obtained from employees. While this type of product is predicated on enrollment by all employees, individual employees are entitled to refuse to provide the consent of the insured (in other words, refuse to become enrolled).

While the death benefit is paid to the company or organization, this money is to be allocated to the death retirement bonus and condolence money and will ultimately be paid to surviving family members.

If a company takes out a policy for a death benefit amount that exceeds what is stipulated in provisions governing its death retirement bonus, it must take out a human value rider and obtain the consent of individual employees. The human value rider is added where substantial funds will be needed to recruit and train someone to replace an employee upon his or her death.

(3) Group credit life insurance

Group credit life insurance is insurance that covers against the death of the insured and for which a bank or other financial institution is the policyholder. The insured is a mortgagor or otherwise a borrower of money lent to the borrower by the financial institution. The amount of the death benefit is equivalent to the outstanding balance of the loan. The amount of the benefit declines as the loan is repaid and the outstanding balance of the loan decreases. If the insured dies, an amount equivalent to the outstanding balance of the loan is paid and allocated in full against the outstanding balance of the loan.

This type of insurance is designed to ensure that, in the event that the

borrower of a loan dies, his or her surviving family members will not be burdened by any residual debt tied to the loan in question.

(4) Group medical insurance

This is the medical version of group term insurance. A company or organization is the policyholder and employees or members are the insured. It is a voluntary enrolment scheme whereby each employee or member can decide whether or not to enroll and the extent to which he or she wishes to be covered. Medical insurance can be obtained at lower premiums than would be charged with enrolment by an individual in a medical insurance plan.

2 Company pensions

(1) Defined benefit company pension

A defined benefit company pension scheme is a scheme that sets forth a predetermined future amount of company pension benefits for retired persons (called "defined benefit" since the amount of the benefit is fixed). Contributions needed to cover the amount of the defined benefit are calculated according to actuarial calculations based on assumed interest rates, average life expectancy, and other pertinent variables and contributed by the company to the insurance company or trust bank.

The management of pension assets is outsourced by the company to the life insurance company or trust bank. If there are insufficient funds to pay for benefits as defined by the company pension scheme, the company will be required to make up the shortfall with an additional contribution. A company pension scheme's finances are also regularly subject to re-calculation in order to adjust the contribution amount. Since the burden on a company can increase depending on economic conditions and other factors given that it is tasked with guaranteeing pension benefits to be paid to retired persons, there is an ongoing shift to defined contribution company pension schemes as described below.

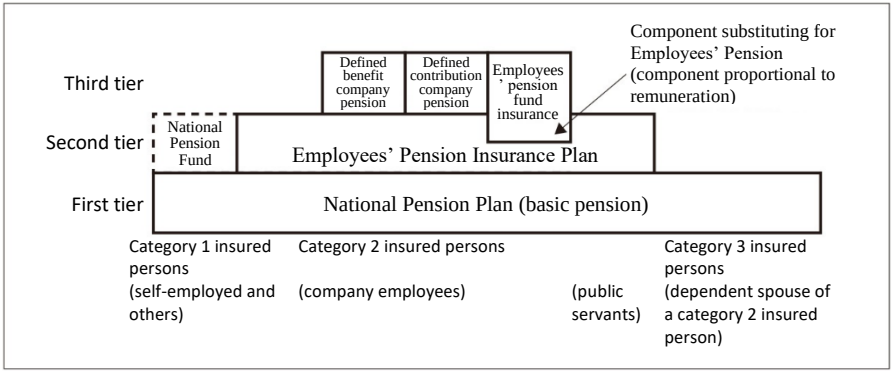
Company pensions provide benefits to supplement public pensions as a third-tier component of the pension system. Companies introduce this scheme as part of the benefit package they offer to employees. Figure 16 on the following page shows the relationship between public pensions and company pensions.

(2) Defined contribution company pension

A defined contribution company pension scheme is a scheme under which the contribution amount (premium) is predetermined, and future benefit amounts

are determined according to the amount of contributions made and the investment performance corresponding to this amount (called "defined contribution" since the amount of contributions is fixed). Pension assets are invested by the enrollees (employees) themselves by selecting the investment products and investment ratio from among financial instruments set up by an asset-managing institution. Since the investment results belong to the employees, the investment risk is shouldered by the employees.

Figure 16 **Public pension system and company pensions**



This type of scheme was introduced in 2001 with the enactment of the Defined Contribution Pension Act. It has also been referred to as a 401k pension as provided for by provisions of the US tax code that authorize defined contribution pension schemes.

While investments that perform well will enable large pensions to be received, those that go south will yield less.

In other words, future benefit amounts vary as a function of investment performance. The pension that an employee can receive is not defined. A defined contribution pension scheme also constitutes a third-stage component of the pension system.

iDeCo (individual defined contribution pension) **Column 13**

A defined contribution company pension as mentioned in this text is a scheme set up by a company for enrolment by employees. Such a pension scheme set up for individuals is known as an iDeCo (individual defined contribution pension) scheme.

An iDeCo scheme is an asset-building scheme that anyone between the ages of 20 and under 60 years can join. Contributions are paid in until one turns 60 years of age, whereupon money can be received thereafter as a lump-sum amount or pension. There is a ceiling to the contribution amount; for example, the maximum monthly amount that can be contributed by a company employee working for a company with no defined contribution company pension scheme is 23,000 yen. Certain tax benefits can be obtained when paying in contributions and when receiving pension payments.

Company pension rules need to stipulate that an individual enrolled in a defined contribution company pension scheme can also enroll in an iDeCo scheme. The upper contribution limit also varies depending on what kind of scheme the company has adopted.

(3) Employees' pension fund insurance

An employees' pension fund scheme is a scheme that provides pension benefits by substituting for and augmenting some of the benefits provided by the state-run Employees' Pension (proportional to remuneration). Large companies set up and run a fund on their own while small to medium-sized companies do the same depending on the sector to which they belong. A fund will outsource the management of contributions to a life insurance company or other such enterprise and the product for which this outsourcing occurs is an employees' pension fund insurance plan.

An employees' pension fund substitutes for part of the second-tier component and provides the third-tier component of the public pension system (see Figure 16).

During the period of high economic growth, management performance was good, which meant that employees' pension funds could provide benefits to employees that added substantially to the amount that the state was required to provide. Since the collapse of the bubble economy, however, investment performance has not been very good and many employees' pension funds have gone under due to the difficulties in managing the benefits that are supposed to substitute for what the state provides.

The dissolution of an employees' pension fund and the cessation of efforts to substitute for the state's Employees' Pension is known as the return of the substituted component. In April 2002, the system was revised to allow for the return of the substituted component and a transition thereof to a regular defined benefit company pension scheme.

V. Taxation on life insurance

Life insurance is a product designed to facilitate efforts on the part of policyholders to help themselves prepare for life risks. For this reason, life insurance premiums and life insurance money are subject to special treatment for tax purposes. Since life insurance can be seen in terms of an exchange of current premiums for future insurance money, we cannot think of life insurance without the impact of tax on the money concerned. In this connection, I will explain taxation matters with respect to premiums and benefits in this section.

1 Treatment of life insurance premiums

The way life insurance premiums are subject to income tax treatment was changed in 2011.

The treatment of policies prior to 2011 (referred to as "old policies") under the Income Tax Act differs from the treatment of policies after 2011 (referred to as "new policies"). In addition, the calculation of income tax for an individual with both an old policy and a new policy is set forth.

Since this book is meant to serve as an introductory guide, I will be looking only at tax on new policies to avoid getting into a complicated discussion.

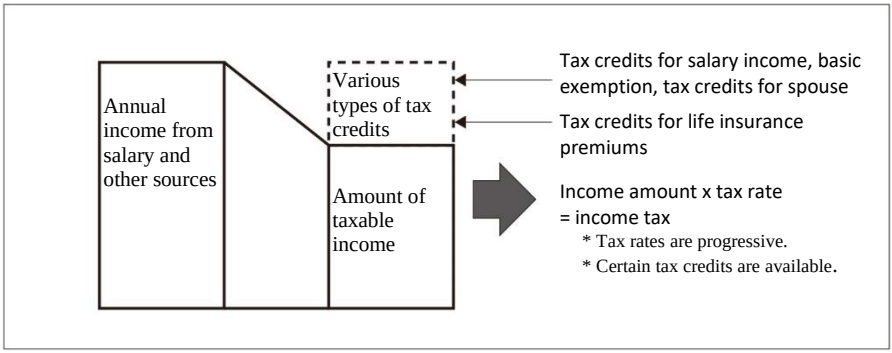
Incidentally, as I will explain below, there are three types of tax credits tied to life insurance: tax credits for common life insurance premiums, tax credits for long-term care and medical insurance premiums, and tax credits for individual annuity premiums. In this section, I will collectively refer to these tax credits as tax credits for life insurance premiums except when I refer to them as individual tax credits.

(1) Income tax and residents' tax

Before I explain the way tax credits for life insurance premiums are treated, I will briefly go over income tax and residents' tax in this section for the sake of understanding. What is important to note is that tax is not imposed on the individual's income per se when it comes to either income tax or residents' tax. Rather, tax is imposed on income net of prescribed tax credits (taxable income).

Take a look at Figure 17 on the following page.

Figure 17 How income tax is calculated



The amount of income tax owing is determined by subtracting tax credits for salary income, the basic personal exemption, tax credits for the individual's spouse, and other income tax credits from the individual's annual salary income (nominal rather than take-home pay) and then multiplying the resulting net income amount by the tax rate. Tax credits for life insurance premiums are an example of an income tax credit and can be subtracted from annual income.

In addition, tax rates are structured in such a way that it progressively increases as taxable income goes up (known as progressive tax rates).

Residents' tax is collected as a combination of prefectural and municipal taxes. It comprises an income-based levy and a per-capita levy; the former is calculated similarly to the aforementioned income tax.

Tax credits for life insurance premiums are permitted as a type of income tax credit to be deducted from income in calculating taxation on an income basis.

(2) Tax credits for life insurance premiums that are available in connection with income tax

As mentioned above, there are three types of life insurance tax credits:

(i) Tax credits for common life insurance premiums
(ii) Tax credits for long-term care and medical insurance premiums
(iii) Tax credits for individual annuity premiums

(i) Tax credits for common life insurance premiums

Tax credits for common life insurance premiums apply to premiums corresponding to insurance policies that pay out a certain amount of insurance money based on the survival or death of the insured. Life insurance policies

offering a death benefit and/or a maturity benefit are eligible.

The following amounts are allowed as income tax deductions as described in (1) above.

- Annual premiums of up to 20,000 yen: Full amount of paid premiums
- Annual premiums exceeding 20,000 yen but not exceeding 40,000 yen: Paid premiums x 1/2 + 10,000 yen
- Annual premiums exceeding 40,000 yen but not exceeding 80,000 yen: Paid premiums x 1/4 + 20,000 yen
- Annual premiums exceeding 80,000 yen: 40,000 yen

(ii) Tax credits for long-term care and medical insurance premiums

Policies that are subject to tax credits for long-term care and medical insurance premiums are insurance policies that pay out insurance money for an illness or physical injury that corresponds to a reason for the payment of medical expenses. In other words, medical insurance and long-term care insurance are eligible. However, beneficiaries of insurance money in all cases must be the person who pays the premiums for such a policy or his or her spouse or other relatives. Since the policyholder is the one who typically receives benefits with a medical insurance policy, this requirement is probably met with most such products.

Tax credits for long-term care and medical insurance premiums are calculated the same way as they are for common life insurance premiums.

(iii) Tax credits for individual annuity premiums

Policies eligible for a tax credit for individual annuity premiums are those that satisfy the following requirements:

- The beneficiary of the annuity is the person who pays the premiums or his or her spouse.
- The policy is one for which premiums are regularly paid over a period of at least ten years until such time that annuity payments are received.
- Annuity payments are to be made for a fixed term of at least ten years or the remainder of the annuity beneficiary's life with annuity payments to begin once the annuity beneficiary turns, in principle, at least sixty years of age.

Eligible for a tax credit for individual annuity premiums is any policy for an individual annuity or any annuity benefit rider attached to a life insurance policy. Tax credits for individual annuity premiums are calculated the same way as they

are for common life insurance premiums.

These three types of tax credits for life insurance premiums can all be used in full. Thus, if you have paid premiums of at least 80,000 yen each, you would be entitled to receive an income tax credit of 40,000 yen each for a total of 120,000 yen.

(3) Tax credits for life insurance premiums that are available in connection with residents' tax

As in the case of income tax, there are three types of income tax credits that are available in connection with residents' tax: tax credits for common life insurance premiums, tax credits for long-term care and medical insurance premiums, and tax credits for individual annuity premiums. The requirements for applying tax credits for each policy are also the same as they are for income tax.

However, the way tax credit amounts are calculated and the way we should think about the total amount of tax credits differ.

These tax credits are calculated as follows:

- Annual premiums of up to 12,000 yen: Full amount of paid premiums
- Annual premiums exceeding 12,000 yen but not exceeding 32,000 yen:

  Paid premiums x $1/2$ + 6,000 yen
- Annual premiums exceeding 32,000 yen but not exceeding 56,000 yen:

  Paid premiums x $1/4$ + 14,000 yen
- Annual premiums exceeding 56,000 yen: 28,000 yen

If you were to make full use of all three tax credits for life insurance premiums that are available in connection with residents' tax, you could use 28,000 yen in tax credits each for a total of 84,000 yen. However, the amount of tax credits for all three of these tax credits for life insurance premiums that can be used is capped at 70,000 yen.

2 Treatment of life insurance money

The taxation of life insurance money is a complex matter. In this section, I will discuss this topic with a primary focus on typical examples involving death benefits, maturity benefits, and individual annuities.

(1) Death benefits

A typical example of a case involving a death benefit is probably one in which the policyholder takes out a life insurance policy with himself or herself as the insured and with his or her spouse as the intended beneficiary of the death benefit. In such a case, the death benefit will be subject to inheritance tax.

A death benefit will, aggregated together with other inherited assets, be subject to inheritance tax; a certain amount, however, is exempt. The aggregated amount is as follows:

Death benefit (taxable) = death benefit amount — (the number of successors x 5 million yen each)

For example, let us say that the successors consist of a spouse and two children for a total of three successors. In this case, up to 15 million yen (3 persons x 5 million yen each) is tax exempt. Other taxation matters related to death benefits are as outlined in Figure 18. Taxation varies depending on the relationships among the policyholder, insured, and beneficiary. In Figure 18, it is assumed that the policyholder is the one who pays the premiums.

Figure 18 Taxation of death benefits

Policyholder	Insured	Beneficiary	Tax	Calculation method
Given individual	Given individual	Spouse	Inheritance tax	Benefit — (number of successors x 5 million yen) ⇒ Subject to inheritance tax together with other inherited taxes
Given individual	Spouse	Given individual	Income tax	[(Benefit — paid-in premiums) – 500,000 yen] x 1/2 ⇒ Subject to income tax together with salary and other income
Given individual	Spouse	Child	Gift tax	Benefit — 1.10 million yen ⇒ Subject to gift tax together with other gifted assets

(2) Maturity benefit

The taxation of maturity benefits is determined by the relationship between the policyholder and beneficiary. In a typical example, the policyholder designates himself or herself the beneficiary and receives the maturity benefit at

the end of the day. In such a case, the following amount, as temporary income, is aggregated with salary and other income and subject to taxation.

Maturity benefit (taxable) = (maturity benefit amount — paid-in premiums — 500,000 yen) x 1/2

The maturity benefit constitutes a one-time source of income because it is not taxed at the time interest is accrued each year as is the case with interest on deposits; instead, it is received in a lump-sum payment as insurance money at maturity.

The pattern of taxation applicable to maturity benefits is as show in Figure 19.

Figure 19 Taxation of maturity benefits

Policyholder	Insured	Beneficiary	Tax	Calculation method
Given individual	—	Given individual	Income tax (one-time income)	[(Benefit — paid-in premiums) — 500,000 yen] x 1/2 ⇒ Subject to income tax together with salary and other income
Given individual	—	Spouse	Gift tax	Benefit — 1.1 million yen ⇒ Subject to gift tax together with other gifted assets

For single-premium endowment insurance policies with an insurance term of no more than five years or single-premium endowment insurance policies that may have an insurance term of more than five years but that are canceled within five years, tax is withheld at source on gains and tax payment processing is completed internally by the life insurance company. The tax rate at present is 20.315%. Originally, the rate on tax withheld at source was 20%, which represents the sum of income tax (15%) and residents' tax (5%), but 0.315% will remain tacked on as a special income tax for reconstruction in response to the Great East Japan Earthquake until 2037.

(3) Individual annuity

According to the typical pattern for an individual annuity, the policyholder designates himself or herself as the annuity beneficiary with himself or herself

as the insured. We can also assume that the policyholder is the person paying the premiums in such a case. The taxation of annuities also depends on the relationship between the policyholder and beneficiary.

Where an annuity is paid in the event that the policyholder and the beneficiary are the same person, income tax is levied each year on the annuity as miscellaneous income. The amount of the miscellaneous income is as follows:

Miscellaneous income (taxable)
= annuity amount received in the given year — the paid-in premium amount corresponding thereto

The paid-in premium amount corresponding to the annuity amount received in the given year is, in an example involving a ten-year defined annuity, the total premium amount paid divided by ten. For a whole-life insurance policy, the amount is calculated by dividing the total premium amount paid by the average number of years of remaining life expectancy as of the start of the annuity.

However, if the annual amount of an annuity less the premium amount for the given year is 250,000 yen or more, income tax and the special income tax for reconstruction is withheld at source in advance when the annuity is paid. The amount withheld at source is calculated as follows:

Amount withheld at source
= (Annuity amount − premium or contribution amount corresponding to the annuity amount) x 10.21%

Figure 20 on the following page outlines the taxation of individual annuities. If the policyholder (= person paying premium amounts) differs from the beneficiary, a gift tax is levied at the time the annuity commences and income tax is thereafter levied each year that annuity benefits are received.

Figure 20 Taxation of individual annuities

Policyholder	Insured	Beneficiary	Tax	Calculation method
Given individual	—	Given individual	Income tax (miscellaneous income)	Annuity amount — paid-in premium amount corresponding to the annuity amount ⇒ Subject to income tax together with salary and other income
Given individual	—	Spouse	Gift tax + income tax (miscellaneous income)	Gift tax is levied when the right to receive the annuity arises and tax on miscellaneous income is levied when annuity benefits are paid

Chapter 3: Life insurance solicitation

Life insurance solicitation is one of the major pillars of the life insurance industry. Life insurance companies and agencies compete on the basis of life insurance product offerings and seek to figure out ways to gain access to clients and sell life insurance policies to them.

In Chapter 3, you will learn about the definition of life insurance solicitation and the process by which life insurance solicitation is undertaken.

Next, I will touch on the evolution and diversification of solicitation channels before shedding light on the specific forms of the different types of solicitation channels in existence.

I will then discuss rules governing insurance solicitation.

I. What is life insurance solicitation?

What is life insurance solicitation? There are all sorts of possible examples, including abstract forms such as television commercials and Internet ads, as well as specific proposals made by insurance solicitors. What we exactly mean when we talk about life insurance solicitation is what I will be explaining in this section.

1 Definition of life insurance solicitation

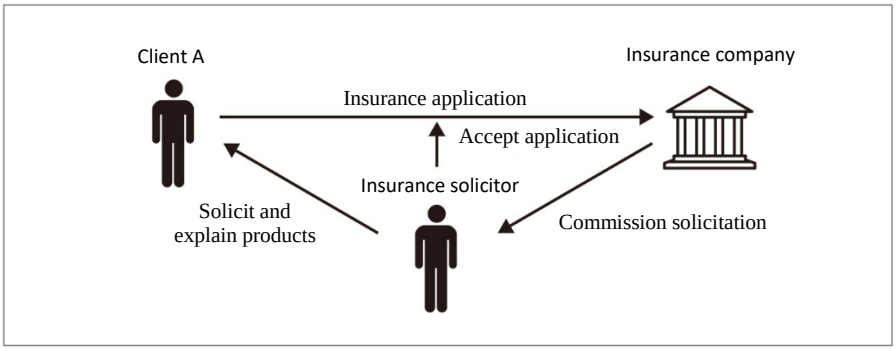
I mentioned in Chapter 1 that solicitation is the act of mediating between a life insurance company and the person who will apply for an insurance policy. To engage in insurance solicitation, you are required to be certified as an insurance solicitor (as explained in more detail in V-1 below). Incidentally, you might have seen newspaper ads and television commercials placed by newspaper companies and television networks. These actions constitute advertising rather than solicitation, which means that they can even be carried out by parties that are not certified as a solicitor.

While solicitation and advertising are both acts that aim to promote the selling of insurance, what is the definitive difference between the two?

First, someone who engages in life insurance solicitation is acting as an agent or intermediary in order to have life insurance policies concluded. Specifically, his or her duties will include attempting to sell insurance, explaining the contents of insurance products, and receiving applications for insurance policies. In other words, solicitation encompasses a wide range of actions beginning with actions undertaken to specifically urge someone to take out an insurance product and ending with the acceptance of an application (Figure 1 on the following page).

In contrast, examples of actions that do not fall within the scope of insurance solicitation include the simple distribution of an insurance company's fliers or promotional tissue packs, the provisions of administrative information by a call center operator, a brief introduction of the structure of an insurance product at a session held to explain financial instruments, and the placement of ads in a newspaper or magazine. This is because such actions do not involve any action to specifically recommend an insurance product or accept an application for an insurance policy.

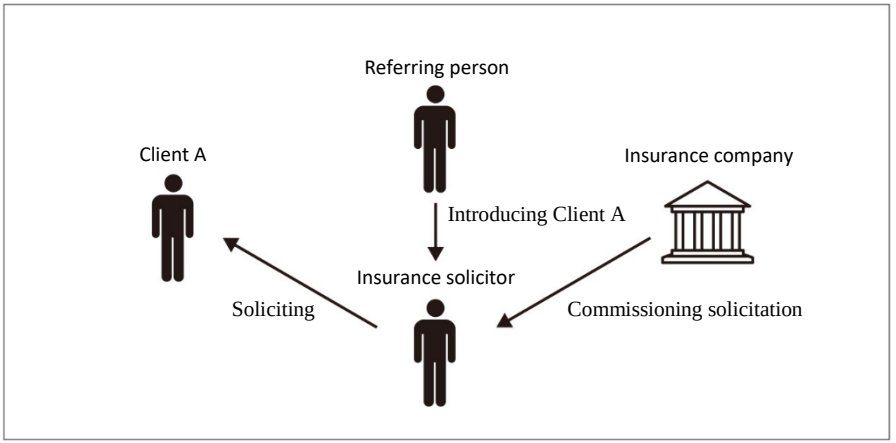
Figure 1 **Solicitation actions of an insurance solicitor**



2 Referral agency

The scope of solicitation actions became an issue in this way because of the existence of referral agencies. One effective way to solicit insurance in the life insurance industry consists of asking an existing policyholder to provide the solicitor with the contact information of potential new clients from among his or her acquaintances. It is argued that as long as the referring person is doing nothing but referring an acquaintance and is not specifically recommending an insurance product to other potential clients, his or her actions will not satisfy the definition of solicitation as set forth above and he or she will not need to register as a solicitor (Figure 2).

Figure 2 **Referral actions for which you do not need to be certified as a solicitor**



However, what if the referring party receives some kind of referral fee or other form of remuneration and does not simply refer an acquaintance but strongly urges his or acquaintance to purchase an insurance product from a specific insurance solicitor? If the referring party acts like this in concert with an insurance solicitor, the actions will constitute insurance solicitation. Moreover, if referral actions that encompass specific product details are also carried out, the referring party will need to be certified as an insurance solicitor given that these actions constitute insurance solicitation as well.

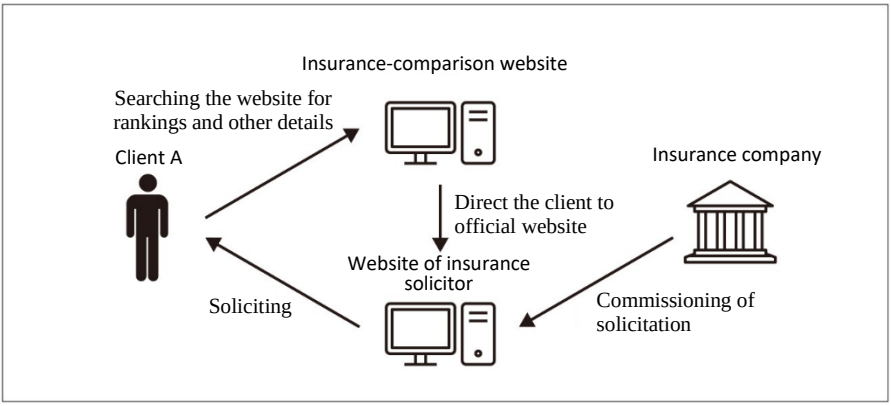
A corporation is banned from serving as a referral agency (can only become a solicitation agency upon registration).

3 Insurance-comparison websites

This issue has recently come back into the spotlight. This is because the growing popularity of the Internet has made it possible to use insurance-comparison websites in recent years. Questions have been raised as to whether these websites constitute insurance solicitation.

Specifically speaking, insurance-comparison websites show the details of each product and even examples of premiums that might be paid for different age brackets. Products are sometimes ranked by popularity and recommended products are highlighted. Clicking the product field can bring you to the website of the underwriting life insurance company or insurance agency (Figure 3).

Figure 3 **Referral actions of insurance-comparison websites**



The relationship between insurance-comparison websites and life insurance companies or insurance agencies can vary. For example, a company or agency

may be paying an advertising fee whose amount is determined as a function of the number of clicks recorded or paying a certain fee per policy taken out.

Actions that are not unambiguously insurance-solicitation actions and that are carried out on or through such a website are referred to as solicitation-related actions. The mere reproduction of information provided by insurance companies on an insurance-comparison website is a solicitation-related action. One who carries out a solicitation-related action does not need to be certified as an insurance solicitor. However, a life insurance company or insurance agency that engages in transactions with a website that carries out solicitation-related actions is obligated to oversee the website operator to ensure that the website is being properly operated.

Incidentally, recommending only the products of specific companies from which compensation is obtained, such as by indicating that these products are recommended, and explaining insurance products in detail on a compensated basis constitute solicitation actions, which means that certification as an insurance solicitor would be required in such a situation.

II. The process of life insurance solicitation

In this section, I will begin by exploring why life insurance solicitation is needed but I will be primarily explaining the process of life insurance solicitation. This process is mainly predicated on the use of sales agents.

1 Why are actions to solicit life insurance necessary?

Let us look at things from the perspective of a life insurance company. As a general rule of thumb, all companies regardless of industry seek to grow. Thus, it is natural that a life insurance company too will focus on selling life insurance in hopes of achieving growth. And life insurance policies will rapidly diminish in number as life insurance policies mature, death benefits are paid out, and fewer new policies are taken out.

That said, a life insurance company is unique in that the system of life insurance per se, as mentioned in Chapter 1, is one that is based on the law of large numbers. In other words, a life insurance company will need to sell many policies in order to ensure that changes in the amount of death benefits that it disburses are soundly consistent with initial expectations.

Next, let us look at things from the perspective of clients. In particular, a client will not always be clearly cognizant of the need for life insurance. Moreover, as life insurance policies are not tangible goods, it is not possible to intuitively figure out if one is needed or not and if one is a good product or bad product.

Since needs are latent, one is generally not inclined to take actions to purchase insurance products unless one is encouraged to do so by someone else or something happens to trigger such actions. With non-life insurance, for example, it is generally understood that the acquisition of a car makes it necessary to take out automotive insurance. With death insurance, however, you are called upon to imagine what would happen in the event of your own death; it is rather difficult to try and imagine what might transpire after you are gone. Even if this were possible to do with ease, few people know how much money needs to be set aside to prepare for their own death. For this reason, someone who can sit down with a client and work together to identify the client's needs in terms of life insurance is indispensable.

2 Why life insurance solicitation needs to be regulated

Allow me to expound a bit on what I mentioned in 1 above. This may sound a little complicated but it is said that there is an information gap (or asymmetry) in the area of life insurance solicitation. You might be able to grasp what an information gap is by thinking about the relationship between a doctor and his or her patient. Imagine that a patient, worried about his or her physical condition, goes to visit his or her doctor. The doctor proceeds to diagnose what ails the patient. The doctor is also the one who knows what course of treatment to apply and which pharmaceutical drugs to administer for the ailment in question.

It is the doctor, not the patient, who possesses information on the illness affecting the patient and its treatment. In this way, there is an information gap here in which the possession of information is skewed as between these two parties.

When it comes to life insurance solicitation as well, an information gap can be seen in the way a client's own needs are clarified through the advice provided by an insurance solicitor and in the way that an insurance solicitor is more knowledgeable about the contents of insurance products than any client.

When such an information gap exists, the interests of the party not in possession of information will be harmed and the market will no longer function effectively. Thus, initiatives to eliminate this gap and measures to prevent harm caused by this gap are taken. To this end, certain regulations govern activities carried out to sell life insurance.

Enrolment in unnecessarily expensive insurance and continued enrolment in insurance that is no longer needed are nothing but examples of wasteful spending.

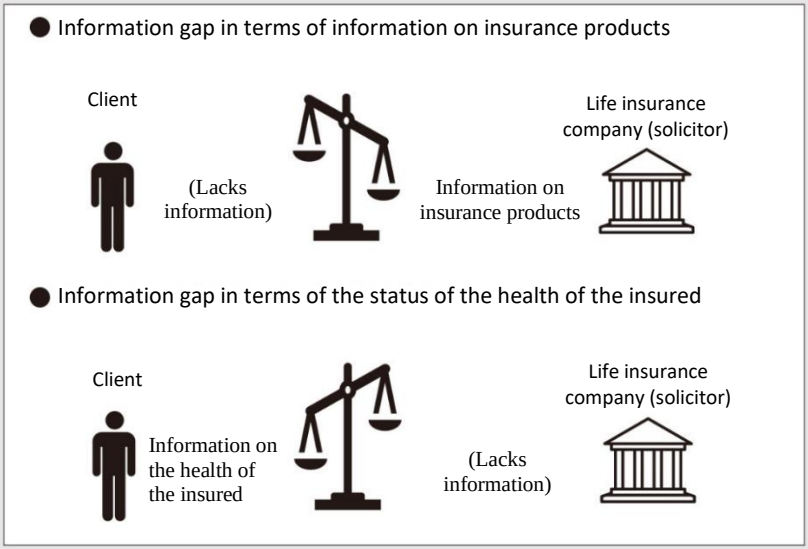
On the other hand, life insurance is notable for the need to measure a person's risks in order to ensure fairness within the group being insured. Even if you were sold a life insurance policy, the insurance company may ultimately reject your application. In other words, even if you find out later that you had taken out a different insurance policy than you intended or if you seek to switch to a different policy, the fact that you are now older or may be afflicted with an illness could mean that you will be forced to pay higher premiums or outright denied. This is known as the difficulty of re-enrolling in life insurance.

Regulations as discussed in V of this chapter exist to address the need to ensure that solicitation is properly undertaken. That said, however, the enrolment in insurance plans by clients who fully understand and accept what they are purchasing is essential for the sustainable growth of life insurance companies in

the first place. Life insurance companies engage in all sorts of initiatives to this end for this reason.

Information gap **Column 14**

The existence of an information gap in the context of life insurance refers to one of two situations: one in which the client lacks information on insurance products or insurance needs (insurance company > client) and one in which the insurance company lacks information on the health of the insured when underwriting insurance (insurance company < client) (see the Figure).



With respect to the former, legal regulations are imposed on solicitation actions. The latter emerges as an issue concerning the duty to disclose. It is said that the duty to disclose is based on the maximum good faith of an insurance policy. Maximum good faith means that, since a large sum of money is supposed to be paid out in the event that a contingency comes to pass, the policyholder is required to be rigorously honest with the insurance company. See Chapter 2-II for more information on the duty to disclose.

3 Finding clients

Beginning in this section, I will describe the process by which insurance is sold by sales agents, a traditional sales channel used for life insurance. In IV, I will explain specifically what a sales agent is.

When you turn on the television, you might see a commercial for a life insurance company. Ads for life insurance are posted on the Internet. However, commercials and ads are not enough on their own to enable life insurance to be easily sold to clients.

First, you must *find clients* in order to sell insurance. This means that you need to find *potential clients* who have a need for insurance. Since a sales agent is assigned geographical areas and company workplaces, he or she will work to find potential clients by engaging in familiarization activities, such as by distributing flyers in these areas or obtaining referrals from existing clients.

In addition, a sales agent will also solicit products upon obtaining information to the effect that a family member of an existing client has found a new job or gotten married.

By issuing regular publications containing information on life insurance and other matters concerning life in general to potential clients, a sales agent will make themselves more familiar to these potential clients and raise awareness of the need for insurance.

4 Getting clients to recognize their needs

When efforts to solicit life insurance are commenced, you first need to ascertain the life insurance needs of a potential client. The way this is done varies from one company to the next and in accordance with the way a sales agent engages in work. One possible approach that can be taken to ascertain needs involves the administration of a questionnaire to the potential client. Just remember that one's needs at this time are subject to change since they are needs at a stage when the potential client is probably not yet aware of what his or her own life plan is like or familiar with life insurance products.

Where the needs of a potential client lie with the security of survivors after his or her own death, financial planning based on the use of death insurance is undertaken. For example, the security of survivors is the first thing you would think about for a young person with a small child.

Most tablets used by sales agents belonging to life insurance companies and computers operated by salespersons who provide advice and consultation services out of so-called insurance shops contain software that can automatically calculate an estimated amount needed for protection. The required amount of coverage is calculated by plugging in the required numbers obtained through a process of talking with the client.

Financial planning to provide security for survivors — Column 15

I will now present a simple illustration of financial planning for the security of survivors. Imagine a household with two parents and two children. The husband is thinking about taking out death insurance with himself as the insured. The basic notion is that, if future expenses are greater than future income, then life insurance money can be used to make up the difference.

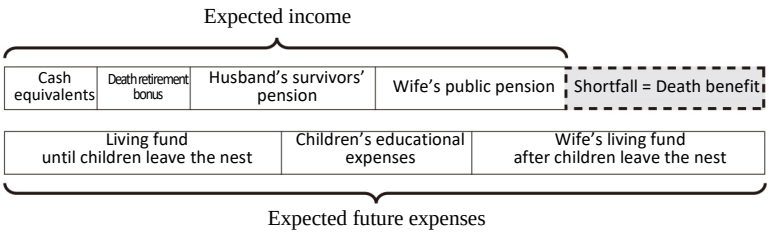
First, we calculate income by adding up the savings accumulated to date, death retirement bonus from the company, the estimated amount of the survivors' pension, the wife's total income, and the estimated amount of the wife's old-age welfare pension subsequent to her own retirement. See Chapter 1-II for the estimated amount of the survivors' pension and the estimated amount of the old-age welfare pension.

At the same time, future expenses should be calculated. First, calculate current living expenses. Think of living expenses as salary minus the portion that goes into savings. Next, assume that family living expenses after the death of the husband will be reduced to 70% of current levels and that family living expenses after the children leave the nest will be reduced to 50% of current levels. Living expenses of the wife are calculated with reference to the average life expectancy for women and by assuming that she will live to that age. In addition, if the children are thinking about studying liberal arts at a private university, you can add another 5 million yen for university expenses alone.

Set the amount of the death benefit to equal the extent to which calculated future income falls short of future expenses. The figure below illustrates how the amount of necessary coverage is calculated.

The wife's future income has not been incorporated into the calculation. The income of the wife, if she is working or plans on working, also needs to be included in the calculation.

● Illustration of financial planning to provide security for survivors



What needs to be kept in mind is that the amount of death protection is larger

for families with more substantial current living expenses. An insurance policy is to be designed while taking into account the amount of premiums that can be paid and the extent to which living expenses can be curtailed when necessary.

In your late forties and fifties, you will need to also prepare a retirement fund. Financial planning to set up a retirement fund is carried out for such individuals.

Financial planning for retirement funding **Column 16**

Financial planning for retirement funding first entails estimating the extent to which public pensions will be provided.

As explained in Chapter 1-II, a husband and wife couple receiving benefits from the employees' pension fund scheme are paid approximately 230,000 yen a month on average. On the other hand, a survey conducted by the Japan Institute of Life Insurance (JILI) revealed that living funds needed to live comfortably in retirement significantly exceed the public pension amounts that are received.

In this connection, if we assume here that 300,000 yen a month will be needed, we must ask ourselves the following: how can a couple secure 70,000 yen a month? If you have a retirement allowance or company pension, add that amount to your income. The rest of the shortfall can be covered by savings or you can think about enrolling in a savings-type individual annuity insurance plan.

● Illustration of Financial planning for retirement funding

(Yen)

Husband	→			81 years of age	
	65 years	70 years	76 years	80 years	Husband dies
Wife	→				87 years
	60 years	65 years	71 years	75 years	76 years	Wife dies
Public pension	170,000	230,000	230,000		110,000	
Company pension	100,000	100,000				
Sub-total	270,000	330,000	230,000		110,000	
Monthly difference	-30,000	+30,000	-70,000		-90,000	

In the above figure, it is assumed that there is a five-year age gap between husband and wife and that both will live to about the average life expectancy. The numbers written in the bottom half of the figure are the expected employees' pension amounts to be received by the husband and National Pension Plan amounts to be received by the wife on average. In addition, it is assumed that the husband's

corporate pension of 100,000 yen a month as of his retirement will be received for a period of ten years.

It is also assumed, for example, that 300,000 yen a month will be needed to cover living expenses when both husband and wife are still alive and that 200,000 yen a month will be needed to cover living expenses when the wife is widowed.

The numbers written on the bottom row denote the excess or shortfall of funds each month. This figure reveals that there would be a shortfall of funds if we were to rely only on public pension payments. You can prepare a retirement fund with a retirement allowance, savings, a company pension, and other such options, but you will likely require money from an individual annuity to address shortfalls in funds.

In addition, when it comes to the question of how to set benefit amounts for medical insurance, it should be noted that the average amount for currently enrolled people is around 10,000 yen a day. On the other hand, as mentioned in Chapter 1-II, a survey revealed that hospitalization can cost 23,300 yen a day. It is probably a good idea to think about such data points when determining benefit amounts.

These days, a growing percentage of the population are single for life. For such individuals, it may be advisable to limit death coverage to the cost of a funeral while enhancing critical illness insurance, medical insurance, long-term care insurance, and individual annuity insurance instead.

5 Proposing insurance products

Once the needs of a potential client have taken shape to a certain extent, you can design a specific product and propose it in the form of a design document known as a policy outline. In many cases, needs are gradually consolidated while both sides look at the product design document. For this reason, step 4 above ("Getting clients to recognize their needs") and the presentation of a design document are carried out in a back-and-forth manner. In addition, the particulars of an insurance policy are explained by issuing the potential client with a document outlining matters that should be kept in mind with respect to the policy, which are collectively referred to as alert information.

Once the orientation of the application is determined, you should once again ascertain what the potential client would like to do. Finally, confirm that the insurance product is in line with the needs of the client with the use of a written confirmation of intent. This process is legally required to fulfill the obligation to provide information and obligation to ascertain intent in the context of the selling

of life insurance (to be explained in V-3 below).

6 Applying for an insurance policy

For the process of applying for an insurance policy, you first get the policyholder-to-be to fill out an application form for the insurance policy. This form includes the name of the policyholder, name of the insured, name of the beneficiary, premium amount, coverage details, and other pertinent information. This form is typically pre-printed and only needs to be signed. Some companies even operate digitally in this area, such as by having a signature affixed to a document presented on a tablet screen.

The insured shall also inform the life insurance company of his or her physical condition and medical history in accordance with matters to be disclosed as required by a disclosure form. The disclosure form shall be completed and sealed by the insured before being kept by the sales agent or sent by post directly to the life insurance company.

Incidentally, since no insurance solicitor is ever granted the right to receive disclosed information from a potential client, a potential client cannot argue that he or she does not need to fill out a disclosure form if he or she has already conveyed the necessary information to the insurance solicitor.

In addition, if the death benefit amount is high, a professional life insurance interviewer who assists the insured with the task of disclosing matters may also be involved. A life insurance interviewer is certified by the Life Insurance Association of Japan. No life insurance interviewer is granted the right to receive disclosed information from a potential client either.

If the insured at the time of enrolment is older or the amount of the insurance money is large, the insured will be interviewed by a physician appointed by the insurance company and asked to inform the physician of certain matters.

Finally, let me talk about the payment of premium amounts. It used to be that an amount equivalent to a single premium payment would be obtained in cash at the time an application for an insurance policy was made. These days, however, administrative tasks that are predicated on a cashless approach are carried out. In many cases, payments by way of credit card payments or the withdrawal of amounts from the bank account of the policyholder are actually undertaken after a contract is concluded.

Primary risk selection

Column 17

A sales agent is tasked with soliciting insurance but is, at the same time, the only person on the company side who meets in person with policyholders and insured persons. A sales agent takes on the role of observing each policyholder and insured person, asking pertinent questions as appropriate, and reporting on what is found to the life insurance company.

Tasks to be carried out by a person in charge of solicitation are as follows:

(i) Interview

To interview the policyholder and insured is the responsibility of the insurance solicitor. An insurance solicitor must not proceed with a policy without first directly meeting the policyholder and insured. A physician will conduct an interview for an insurance policy with a medical exam but, since only the insurance solicitor directly interviews the policyholder and insured when it comes to an insurance policy without a medical exam, this step cannot be omitted. In extreme cases, the policyholder may try to enroll in an insurance plan while the insured is physically in the hospital. This can be prevented by interviewing the insured.

(ii) Observe

Observe facts related to health, such as complexion, facial expression, attitude, and language, and also observe with care anything that might relate to housing, living conditions, and more.

(iii) Question

Questions shall be posed to confirm certain circumstances in such cases as where someone is taking out insurance that is too expensive based on living conditions that could be observed or where the beneficiary is not a parent, child, or spouse but instead a nephew or niece or otherwise a person that is not commonly related to someone for insurance purposes.

This is known as *primary risk selection.* For example, a sales agent must report circumstances that he or she feels is suspicious to the life insurance company via a written report (sub-application). Each sales agent bears the responsibility for ensuring that enrolment in insurance is being done properly.

Incidentally, life insurance is also sold via mail order or online channels these days. Since primary risk selection cannot be carried out with these methods of selling policies, it is believed that companies need to cap the amount of coverage one can obtain with an insurance policy and strengthen checks when paying out benefits.

When being informed of health-related matters, an insurance solicitor shall explain only matters in response to questions received from the insured. Imagine, for example, that the insured asks whether or not he or she should indicate that he or she has seen a doctor for a cough and the insurance solicitor replies that it is not

necessary given that it is a trivial matter. This could give rise to problems at a later date since there is a risk that this might constitute a breach of the duty to disclose if the cough turns out to be a symptom of pneumonia.

7 Formation of insurance policies and the cooling-off system

An insurance policy application and disclosure form shall be sent to the life insurance company. If the life insurance company decides to accept the application, an insurance certificate and notice of acceptance will then be sent to the policyholder. See Chapter 4 for more information.

Traditionally, a sales agent would engage in the solicitation of life insurance by visiting the home or workplace of the client and personally picking up an insurance application. In such cases, the client would often apply for insurance as proposed by the sales agent before being given a chance to think about it. In this connection, the law now allows the policyholder to unilaterally withdraw an application or cancel the policy with or without cause at any point in the first eight days from and inclusive of the date of the application or date of the issuance of a document notifying the policyholder that he or she can take advantage of a cooling-off period, whichever is later.

However, the cooling-off system cannot be used if the insured undergoes a medical exam for a product requiring a medical exam, the policyholder personally visits the sales office of the insurance company at a specified time on a specified date, or if a premium payment has been made by way of a bank transfer. This is because, in any such case, it is believed that there is no need to allow a withdrawal or cancelation since the intent of the policyholder to enroll in a policy is clear.

III. Life insurance solicitation channels undergo change and diversification

Individuals and organizations engaged in the solicitation of life insurance are collectively referred to as solicitation channels. In this section, we will take a brief look at the history and current state of solicitation channels. The specific contents of each channel are described in IV below.

1 Establishment of traditional channels

When life insurance first emerged in Japan, solicitation activities were primarily carried out by sales agents employed by life insurance companies and local persons of note and influential persons operating as agencies. This system underwent a wholesale change after the Second World War.

After the war, women who lost husbands in the war began to be hired as life insurance sales agents. This was partly due to the limited opportunities to work that were available to women at the time.

On the other hand, the Act on the Regulation of Insurance Solicitation was enacted and put into force in July 1948 in response to inappropriate solicitation activities carried out during the chaotic postwar years and criticism lodged against what was known as *special new policies*, a type of transfer contract.

From around the middle of the 1950s, when the period of rapid economic growth began, life insurance sales expanded greatly through the large-scale recruitment of female sales agents. At that time, women who had finished raising children were seeking employment. At the same time, there was a need for death insurance for husbands since husbands were primary breadwinners and since social security was inadequate. Against this backdrop, the industry grew through the selling of death insurance by female sales agents.

2 Entry of foreign-affiliated life insurance companies and the diversification of channels

In 1969, foreign-affiliated companies were allowed to operate in the Japanese life insurance industry through subsidiaries or branch offices. In the beginning, American Life Insurance Company (now Metropolitan Life Insurance Company) and American Family Life Insurance Company made their foray into the Japanese market by setting up branch offices in the country in February 1973 and November 1974, respectively. American Family Life Insurance Company

was incorporated in Japan in 2018 and now goes by the name Aflac Life Insurance. From its establishment, Aflac has been demonstrating its strength in the area of sales via company-affiliated agencies with a focus on banks, newspaper companies, television networks, power companies, and other large enterprises.

In 1987, Prudential Life Insurance Company made its foray into the industry and grew primarily on the backs of consulting sales carried out by insurance solicitors known as life planners.

A turning point came with amendments made to the Insurance Business Act in 1995. This revised statute allowed products offered by multiple life insurance companies to be sold by agencies, each of which had previously been exclusively affiliated with just one life insurance company at a time.

The above amended statute also made it possible for non-life insurance companies to enter the life insurance business through subsidiaries. Twelve non-life insurance companies (among which eleven were newly established) entered the market through subsidiaries though this was done mainly by having conventional non-life insurance agencies who were also certified as solicitors of life insurance sell both life and non-life insurance products as a channel for both.

3 The emergence of new channels and the intensification of competition

While insurance solicitation by banks (over-the-counter sales at banks) began in 2001, products were initially limited to credit life insurance. The ban on the selling of individual annuities and other such products on an over-the-counter basis by banks was lifted in October 2002, after which sales of variable individual annuities in particular increased.

It was subsequently set forth that there would be a full lifting of the ban in 2005 after a monitoring period. In December of that year, the ban on the sale of single-premium whole life insurance, single-premium endowment insurance, and level-premium endowment insurance policies of 10 years or less was lifted. After a two-year monitoring period, banks were able to sell all products beginning in December 2007.

We also saw the development of large-scale agencies, particularly since the latter half of the first decade of this century. Large-scale agencies are commissioned by a large number of life insurance companies and present a wide range of product options to clients. Insurance is sold on an over-the-counter basis at insurance shops in town and by door-to-door insurance solicitors.

Life insurance companies that mostly conclude insurance contracts online via the Internet have also emerged.

In this way, sales channels for the solicitation of insurance have diversified to allow clients to choose the channel through which they can enroll in an insurance policy.

4 Trends in insurance solicitation channels

(1) Number of registrants

According to materials released by the Life Insurance Association of Japan (Figure 4), registered sales agents increased in number for the fifth year in a row to 236,987 in fiscal year 2019 (101.2% of the number for the preceding fiscal year). This number grew from 220,000 to 250,000 over the course of a decade with no significant fluctuations recorded along the way.

The number of corporate agencies declined slightly to 33,948 in fiscal year 2019 (97.9% of the number for the preceding fiscal year). Individual agencies decreased in number for the fifth year in a row to 49,631 (97.0% of the number for the preceding fiscal year). The number of agency employees employed by corporate agencies or sole proprietors decreased for the second year in a row to 999,121 (99.0% of the number for the preceding fiscal year).

Figure 4 **Changes in the number of sales agents, the number of agencies, and the number of agency's employees**

	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019
Number of registered sales agents	227,724	229,668	232,006	232,942	234,286	236,987
Number of corporate agencies	35,218	35,199	35,306	35,113	34,693	33,948
Number of individual agencies	59,700	57,786	55,805	53,537	51,169	49,631
Number of agency employees	992,266	999,218	1,003,507	1,012,385	1,009,058	999,121

Source: "2020 Life Insurance Trends", The Life Insurance Association of Japan

(2) Through what channels do policyholders take out insurance policies?

For a survey conducted by the Japan Institute of Life Insurance (JILI) in fiscal year 2018 (Figure 5), households that took out private life insurance policies (other than policies offered by Japan Post Insurance) over the last five years – in other words, since 2013 – were asked to identify the channel through which they took out these policies (enrolment channel). The response that accounted for the highest percentage of responses was "Sales agent working for a life insurance company" at 53.7% (compared with 59.4% in the previous survey). While "sales agent" was found to have declined by 12.6 percentage points over the 2006 survey, it remained a major channel. Note that the question concerned the enrolment channel and not the premium or policy amount.

Figure 5 **State of enrolments by most recent enrolment channel**

(Unit: %)

Most recent enrolment channel (last 5 years)		FY 2006	FY 2009	FY 2012	FY 2015	FY 2018
Sales agents with life insurance companies		66.3	68.1	68.2	59.4	53.7
Mail order sales		9.1	8.7	8.8	5.6	6.5
	Internet	1.8	2.9	4.5	2.2	3.3
	TV, newspapers, other	7.3	5.7	4.3	3.4	3.3
Life insurance company contact		2.1	1.9	2.5	3.1	2.9
Post office contact or sales agent		—	2.9	2.1	3.0	4.2
Bank or securities company		3.3	2.6	4.3	5.5	5.4
	Bank	3.1	2.6	4.2	5.3	4.9
	Securities	0.2	0.0	0.1	0.2	0.5
Insurance agency contact or sales agent		7.0	6.4	6.9	13.7	17.8
Workplace or labor union		5.2	3.0	3.2	4.8	3.4
Other/unknown		7.0	5.2	4.0	4.8	6.2

Source: Produced based on "National Survey on Life Insurance" (2018), Japan Institute of Life Insurance (JILI)

This was followed by "Insurance agency contact or sales agent", at 17.8%

(compared with 13.7% in the previous survey). Insurance agencies increased sharply from the 6.9% figure that was obtained in the FY 2012 survey, which could account for the increase in the volume of sales attributed to large-scale agencies.

"Mail-order sales" accounted for 6.5% (compared with 5.6% in the previous survey). As part of this category, Internet sales accounted for 3.3%, an increase over the 2.2% figure obtained in the previous survey but still less than the 4.5% obtained in FY 2012, such that it does not appear to have increased substantially.

(3) Information pipelines and comparisons

Through what channel does a policyholder obtain information? Figure 6 presents the results of a survey that was conducted to determine the channels through which information had been obtained.

First, the "From a life insurance company with human intervention" specifically refers to a channel consisting of sales agents belonging to life insurance companies and sales agents and point-of-sales contacts belonging to insurance agencies and any other entity or person whose primary business is life insurance. Over 60% of information is acquired through this channel, which remains the top channel for obtaining information despite a slight downturn in terms of percentage over the last decade.

Figure 6 **Information and enrolment channels related to policies that have been taken out in recent years**

(Multiple responses) (Unit: %)

Information pipeline	FY 2009	FY 2012	FY 2015	FY 2018
From a life insurance company w/ human intervention	64.1	63.0	61.4	62.7
From a source other than a life insurance company w/ human intervention	34.2	37.7	37.6	37.8
From a life insurance company w/o human intervention	11.7	11.6	8.6	10.8
From a source other than a life insurance company w/o human intervention	10.5	8.8	7.6	8.9
Other	2.6	2.1	2.5	2.4
Unknown	1.0	0.7	0.8	0.6

Source: Same as for Figure 5.

This was followed by “From a source rather than a life insurance company w/ human intervention”, which accounted for a little under than 40%. Information was found to have been obtained from friends, acquaintances, family, and relatives, which accounted for half of all cases of information acquisition through this channel, or about 20% of all cases of information acquisition. In addition, point-of-sales contacts at banks and securities companies as well as financial planners accounted for around 5 to 6 percent of all cases of information acquisition.

Third was “From a life insurance company without human intervention”, which accounted for approximately 10%. This response corresponds mostly to pamphlets as well as the websites of insurance companies and insurance agencies.

The least used channel was “From a source other than a life insurance company without human intervention”, which accounted for less than 10%. This response corresponds to such sources as television commercials, newspapers, magazines, and general websites.

Figure 7 on the following pageexamines whether a product comparison was undertaken and, if so, with what was a product comparison undertaken. In looking at this figure, we see that “No particular comparison was made” was indicated by two-thirds of respondents, such that we see that those who compare before enrolling in a policy remain part of a minority. The largest proportion of those who undertake a product comparison do so with products offered by a private life insurance company; those who responded accordingly accounted for approximately 27% of all respondents.

Those who enroll in a policy offered by an agency that deals with products offered by multiple insurance companies do so after comparing multiple products and others enroll after obtaining quotes from several sales agents working with different life insurance companies. Measures have also been taken to encourage people to compare different products before enrolling (see Chapter 5).

Figure 7 **Products that were compared at the time of the most recent enrollment**

(Unit: %)

Information pipeline	FY 2009	FY 2012	FY 2015	FY 2018
Other private life insurance (*1)	25.0	27.1	24.7	26.9
Life mutual aid from prefectural mutual aid or cooperative	5.7	6.8	4.6	3.9
Japan Post Insurance	2.9	2.9	3.6	3.8
Life mutual aid from JA	2.4	1.5	1.3	1.5
Financial instrument other than life insurance	0.9	0.7	0.9	0.8
Did not compare in particular	67.7	66.4	69.6	66.7
Unknown	1.1	0.9	1.1	1.2

*1: Other than Japan Post Insurance.

Source: Same as for Figure 5.

IV. Structure of each channel through which life insurance solicitation is carried out

In this section, I will provide an outline of each channel through which life insurance solicitation is carried out. There are primarily three sales channels as follows:

(i) Sales by the employees of a life insurance company
(ii) Sales by an agency commissioned by a life insurance company
(iii) Direct sales by a life insurance company

First, (i) sales by the employees of a life insurance company refer to the sales agent channel. Major life insurance companies have traditionally employed many sales agents to engage in the selling of life insurance.

For (ii) sales by an agency, we see that small to medium-sized life insurance companies and foreign-affiliated life insurance companies have used agencies to sell insurance. Agencies operate independently of life insurance companies and sell insurance as individuals or corporations in their own right. These were originally small agencies.

With independent agencies finally allowed to operate under the amended Insurance Business Act of 1995, life insurance agencies proceeded to grow bigger in scale. Large independent agencies are a type of agency.

Sales by banks and securities companies are also a type of agency sales. However, banks in particular are subject to specific sales limits and restrictions because they belong to a regulated industry with a license system and provide loans to clients.

Finally, (iii) direct sales by a life insurance company would include direct sales of life insurance products, such as mail-order sales or Internet sales triggered by newspaper ads.

1 Sales agents

(1) Organizational structure of sales agents in a life insurance company

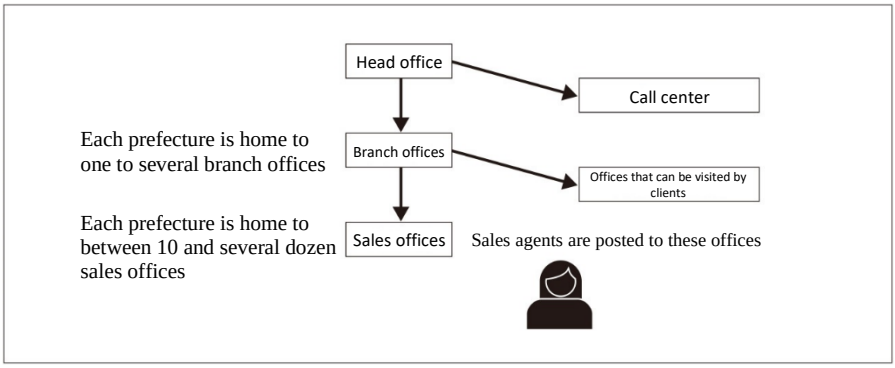
As was mentioned in the section on the history of insurance, female sales agents have traditionally been hired in large numbers by major life insurance companies. These days, there are even specialized organizations that hire women

with advanced educational backgrounds to fortify consulting sales in the companies assigned to each.

There are also examples of foreign-affiliated life insurance companies that aim to implement a consulting sales strategy with an organization of sales agents, many of whom are men.

Figure 8 outlines the organizational structure of a traditional life insurance company. Life insurance companies set up branch offices for each prefecture. Larger prefectures are divided among several branch offices while smaller prefectures are sometimes grouped together to be served by a single branch office. In the three large metropolitan areas of the country, a regional head office may be established to oversee branch offices.

Figure 8 **Structure of life insurance companies and sales agents (illustration)**



A branch office will have jurisdiction over several to dozens of sales offices (sites). A sales agent will be assigned to a sales office and be placed in charge of a geographical or job-related area that has been allocated to the sales office.

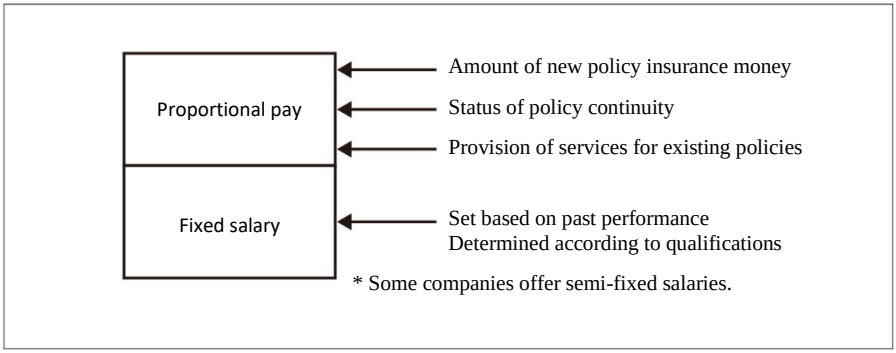
As noted above, a sales agent works to get a client to become enrolled in a life insurance policy through the provisions of all sorts of advice in face-to-face interactions.

(2) Sales agents' work environment

The salary structure for sales agents comprises a fixed component and a performance-based component. For the fixed component, a fixed salary based on qualifications set upon taking into account such factors as performance over the last year is paid monthly in accordance with these qualifications. Proportional pay is based on insurance sales performance but is determined after

a comprehensive assessment is made by also taking into account the continuity of insurance policies sold and service activities provided for existing policies (Figure 9).

Figure 9 Illustration of the salary structure for sales agents



Incidentally, it is said that the situation with sales agents is negatively affected by turnover. Turnover refers to a repetitive cycle whereby high numbers of new sales agents are hired, many of whom go on to quit after a short period of time.

For example, let us say that a sales agent at a life insurance company is guaranteed a minimum level of fixed salary regardless of performance for the first two years after getting hired. After two years, however, his or her performance-linked proportional pay will account for a greater percentage of salary earned. Under such a system, some sales agents quit due to inadequate performance results. In particular, a sales agent will often start out by selling policies to relatives and neighbors but might then be unable to subsequently improve his or her performance when the well, based on local and blood ties, runs dry.

In this connection, life insurance companies designated geographical areas where sales agent were assigned to work and developed education and training programs to enable them to work productively in geographically and occupationally defined areas with which they have no local or blood ties by giving them the skills needed to be effective rather than compelling them to sell insurance policies to their own relatives and neighbors. In addition, they transitioned from a focus on obtaining new policies to a salary structure that also places a value on providing services to existing policyholders. Moreover,

companies extended their minimum guaranteed fixed salary period from two years to three to five years and implemented various other initiatives along this line.

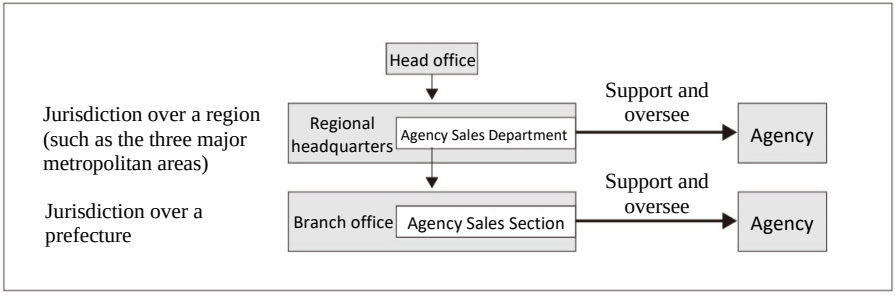
The sales agent system is one that has been subject to criticism, but it cannot be denied that there are many female sales agents who continue to actively engage in their work even at an older age. Such sales agents are regarded as trustworthy and reliable in their communities. Sales agents will likely continue to be seen as one, if not the only, major sales channel used by life insurance companies.

2 Agencies

In this section, I will talk about agencies, such as specialized agencies and professional agencies. A specialized agency is an agency with one or more members of staff who engage in actions to sell life insurance at the behest of a life insurance company. Traditionally, they have been used as a sales channel by small to medium-sized life insurance companies.

Agencies differ from sales agents in that, whereas a sales agent is normally an employee of a life insurance company, an agency operates independently of life insurance companies. A sales agent comes in to work at a sales office, but an agency works out of the agency's own office. An agency sales department or agency sales section will be set up within a life insurance company to serve as a link between life insurance companies and agencies. A staff member known as an agency manager who is assigned to the agency sales department will support and oversee agencies (Figure 10).

Figure 10 **A life insurance company's organization for the management of agencies (example)**



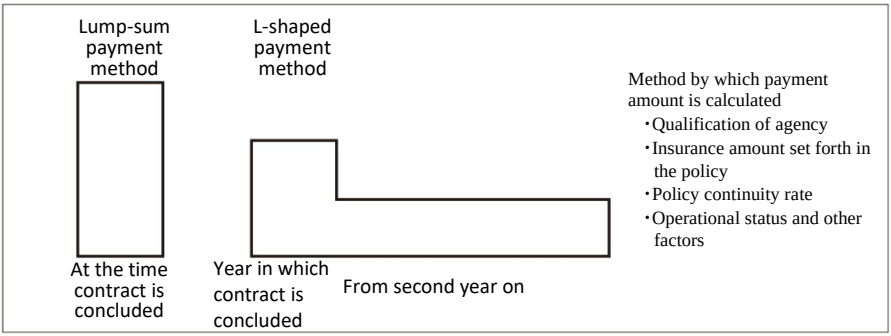
Pursuant to the amended Insurance Business Act of 1995, many entities that

used to be agencies working for non-life insurance companies came to sell insurance offered by life insurance companies affiliated with those non-life insurance companies. While the remuneration system for agencies varies, we can point to examples in which the qualification of an agency is determined as a function of sales performance over a certain period of time, such as one that spans three or four months. Sales performance is then evaluated in accordance with the agency's qualification to determine the remuneration to be paid.

In other words, the more insurance that is sold, the higher an agency's qualification and the greater the commission per sale.

Payment methods include one-time payments of the commission at the time a contract is concluded and L-shaped payments of the commission at the time a contract is concluded and over a prescribed number of years during the ongoing term of the policy (Figure 11).

Figure 11 **How agency commission payments are made**



There are agencies known as professional agencies. A primary example of a professional agency is the licensed tax accountant agency. As a tax accountant is familiar with the conditions of a client company, he or she can propose a life insurance plan that is suitable for the situation in which the company and its officers find themselves.

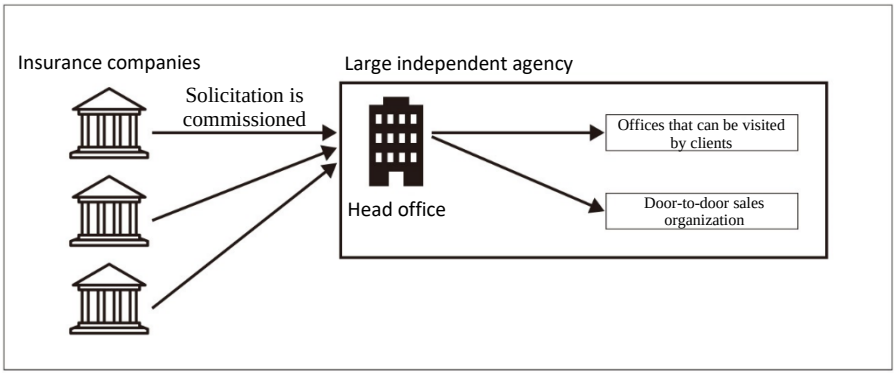
3 Large independent agencies and insurance shops

Enjoying a high profile these days as a sales channel for life insurance are large independent agencies. A large independent agency concludes agency contracts with many life insurance companies. Many such agencies are commissioned to sell insurance not just by life insurance companies but also

many non-life insurance companies.

Some large independent agencies have divisions that engage in door-to-door sales. Others operate sales outlets in urban locations to sell life insurance to visitors. Sites known as insurance shops include those that are set up by life insurance companies and those that are set up by large independent agencies (Figure 12).

Figure 12 **Structure of large independent agencies**



These parties have been selling products to clients by asserting that they propose products that best meet the needs of a client from among a wide range of choices offered by different life insurance companies. However, concerns have been expressed to the effect that independent agencies do not propose products that are the most suitable for a client but instead propose products that generate the highest commissions for them. Regulations have been enacted to address this concern. Specific details on this point are discussed in V-3(4) hereof.

4 Over-the-counter sales at banks

As mentioned earlier, the ban on over-the-counter sales at banks was completely lifted in December 2007. Banks derive their strength from the fact that they have deposit accounts into which salary, pensions, retirement allowance payments, and other items are transferred. If there is a large balance in a deposit account, a bank can earn a sales commission by recommending an insurance policy, investment trust, or other such product to the holder of the account. Given that low interest rates mean that a bank cannot expect to earn substantial income from lending operations, the growth of commission-based

services is a matter of great urgency for banks.

Banks enjoy a greater competitive advantage with savings-type products that are more investment-oriented than with products that provide coverage. Banks promote themselves as places where investment trusts, investment-oriented insurance, and other financial instruments can be purchased on a one-stop basis. On the other hand, they are less capable of selling coverage-oriented products. This may be because front-line staff members dealing with clients may be able to talk about asset management matters but find it more difficult to explain topics pertaining to coverage.

As banks have had such a strong presence in the Japanese economy, they are subject to a number of regulations. First, they are restricted from selling insurance to their own loan clients. This has the effect of restricting them from selling insurance by threatening such clients with their loan approval. A loan officer in a bank is not allowed to be involved in the selling of insurance.

In addition, the prior consent of the client is needed when using information obtained through banking operations for insurance solicitation purposes. Conversely, the consent of the client is also needed to use information obtained through insurance solicitation activities for banking operations.

Furthermore, banks are also prohibited from exerting pressure on life insurance companies in such a way that life insurance companies would offer banks more discounts on premiums than those of regular agencies.

The commission issues that I talked about in connection with large independent agencies also apply to over-the-counter sales at banks. In particular, commissions are sometimes disclosed for investment trusts, which are similar to products that are highly investment oriented. Commissions are disclosed when variable annuities and other investment-oriented products are sold by a bank.

5 Post office

As mentioned in Chapter 1-VI, Japan Post Insurance Company, Ltd., was originally a department of the Ministry of Posts and Communications. The Ministry of Posts and Communications created a simple life insurance product for the masses for which no examination was needed and for which premiums were paid monthly. The operations of this simple insurance product continued to be subsequently expanded regardless of criticism from life insurance companies, who argued that they were being squeezed by this kind of insurance.

With the enactment of the Postal Services Privatization Act in 2005, Japan

Post Insurance was established and later began operations as a joint-stock company in 2007. In the same year, the post office was broken up into Japan Post Network Co., Ltd., which carries out over-the-counter operations, and Japan Post Service, Limited, which performs logistics operations. In 2012, Japan Post Network Co., Ltd., and Japan Post Service, Limited, were merged to form Japan Post Co., Ltd.

The post office handles postal operations for such items as postcards and parcels as well as insurance solicitation activities for Japan Post Insurance and deposits for Japan Post Bank.

The post office sells not just life insurance offered by Japan Post Insurance but also cancer insurance, products for corporate clients, and non-life insurance products underwritten by common private life insurance companies.

Japan Post Co., Ltd., is obligated to provide universal services (services not divided by region) due to the fact that it provides postal services constituting a set of basic national services. For this reason, it needs to maintain post offices even in depopulated areas where postal services are invariably unprofitable. From this perspective, commissions earned from selling life insurance can be seen as a valuable source of revenue to support the core of postal services.

In 2019, Japan Post Insurance and Japan Post Co., Ltd., were subject to a business suspension order in connection with insurance solicitation due to cases of improper sales, such as where a large number of policies that were not needed by the elderly were sold. Sales later resumed in October 2020.

6 Mail-order sales

In a typical example of mail-order sales, a newspaper ad is used to present relatively simple insurance products, such as medical insurance and term insurance plans. A client seeing such an ad would call the call center to apply for insurance. Actual enrolment is processed through the conclusion of an insurance contract by way of exchanging an application form and disclosure form by post.

In some cases, a credit card company acts as the agency and solicits clients by enclosing brochures that introduce insurance products together with credit card invoices that are sent out to credit card holders.

Since explanations cannot be given on a face-to-face basis, products tend to be simple; many consist of simple disclosure-type, non-disclosure-type, or simple risk selection-type policies. Such products may also be subject to

restrictions; for example, the amount of insurance money may be kept low, or coverage may not be available for a certain period of time after enrolment.

7 Internet sales

In 2008, two companies specializing in Internet sales began operations. These companies started by launching a system to complete disclosure and application procedures online with the exception of the sending of personal identification documents. While only the Lifenet Insurance Company and AXA Direct Life Insurance initially engaged in Internet sales, Rakuten Life Insurance joined this segment in 2013. In addition, more and more life insurance companies that do not specialize in Internet sales allow clients to enroll via the Internet.

While Internet sales are expected to grow in line with increased digitalization in society, it does not account for as great a share of the market as initially expected. The selling of complex products over the Internet alone appears to be difficult. This is likely due to the fact that a client who wants to enroll in a complex policy will want to receive advice from someone.

Internet sales are appealing for the low premiums that are made possible because the insurance company has no need for human resources to facilitate the enrolment process and does not spend on advertising. Since a high enough profile cannot be obtained through just the Internet, however, some Internet-based life insurance companies run television commercials to gain name recognition.

8 Independent financial planners

Independent financial planners – who are usually referred to as independent FPs in Japan – normally receive an advisory fee from clients as compensation by providing advice on life insurance to clients. Advice is provided not just with respect to life insurance but also with respect to investment trusts and other financial instruments in general. Independent financial planners do not conclude solicitation commissioning agreements with specific life insurance companies.

While the notion of paying compensation for advice is not yet generally recognized in Japan, there is, in the United Kingdom for example, a sales channel occupied by independent financial advisors (IFAs) who provide advice on insurance from a neutral standpoint and receive a fee only from clients.

9 Insurance brokers

An insurance broker is someone who engages in the solicitation of insurance without receiving a commission from an insurance company. Generally speaking, a broker will be commissioned by a client to negotiate with life insurance companies and conclude the most suitable insurance policy. Operational tie-up agreements are concluded with life insurance companies and affairs are carried out in accordance with these agreements.

Since there is normally not much room for negotiating contractual terms in a life insurance agreement, it is unlikely that the advantages of brokers, which are characterized by the ability of brokers to extract favorable provisions through negotiations with insurance companies, can be harnessed for life insurance. For this reason, insurance brokers are a sales channel primarily used in the area of non-life insurance.

V. Life insurance solicitation rules

I have already mentioned that the solicitation of life insurance is subject to rules. This section will outline these rules in specific detail.

First, a life insurance solicitor has an obligation to register. Certain actions are obligatory while inappropriate actions are prohibited. Large agencies have an obligation to put in place certain systems.

1 Certification as a life insurance solicitor

At the beginning of this chapter, I explained that certification as a life insurance solicitor is required for sales agents and other life insurance company employees as well as agencies who are commissioned by life insurance companies to engage in the solicitation of life insurance. To become a life insurance solicitor, you need to be registered with the Prime Minister. In practice, you would register with your local finance bureau or local finance office.

While someone engaging in insurance solicitation without being commissioned by an insurance company needs to be certified as an insurance broker, this matter will not be explored in this book.

An application to register a life insurance solicitor is made by a life insurance company. A life insurance solicitor who is an employee of an insurance agency, which is a separate entity from any life insurance company, is also registered by the commissioning life insurance company. A life insurance company that registers a life insurance solicitor in this way is referred to as a proxy application company.

In registering as a life insurance solicitor, certain knowledge of life insurance is required. For this reason, the Life Insurance Association of Japan administers exams for insurance solicitors. By passing this exam, you will be recognized as possessing the knowledge required for registration. A life insurance company will provide education concerning proper sales activities before and after registration in order to facilitate the recruitment of prospective insurance solicitors and ensure that they pass this exam and are capable of effectively explaining the company's own products to clients.

The Life Insurance Association of Japan administers not only the minimal knowledge exams required for registration but also more advanced exams, such as the specialty course exam. Moreover, it also administers an exam for selling

variable insurance and variable annuities and an exam for selling foreign currency-denominated insurance and annuity plans. Life insurance companies allow only those who have passed these exams to sell variable annuities and foreign currency-denominated insurance. A system for registering persons who are certified to sell foreign currency-denominated insurance with the Life Insurance Association of Japan is set to begin in 2022.

An insurance solicitor needs to receive ongoing education each year in order to maintain his or her skills and specialized knowledge.

2 One-company exclusive affiliation system and independence

As mentioned above, a life insurance solicitor is, in principle, supposed to be exclusively affiliated with one company under the law; independent agencies are set forth as an exception to this rule.

(1) One-company exclusive affiliation system

The one-company exclusive affiliation rule is set forth as a rule that is applicable to both life insurance companies and life insurance solicitors. First, a life insurance company is prohibited from commissioning the solicitation of insurance to a life insurance solicitor affiliated with another life insurance company. On the other hand, a life insurance solicitor is prohibited from engaging in the solicitation of insurance on behalf of another life insurance company.

Under the Insurance Business Act, an insurance company with which an insurance solicitor is affiliated shall be liable to compensate for any damage caused to a policyholder in connection with the solicitation of insurance by the insurance solicitor. This clarifies which life insurance company will be held liable for an action carried out by a life insurance solicitor.

A life insurance company must educate life insurance solicitors to ensure that proper solicitation activities are undertaken. In addition, the implementation of a one-company exclusive affiliation system will facilitate the ongoing and efficient provisions of consulting sales and after-sales services by a life insurance company.

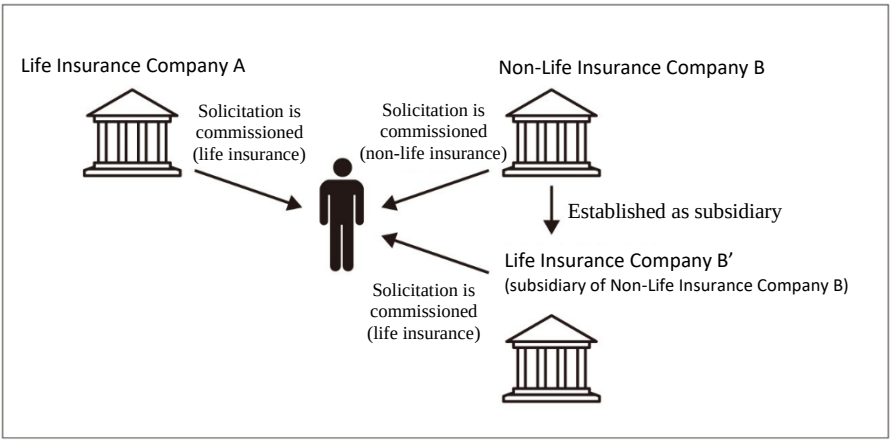
(2) Independence

If you have read this far into the book, you might be wondering why independent agencies are allowed to operate. Yet, a new life insurance company that enters the market and seeks to utilize a channel consisting of agencies will find it impossible to do so while operating under the one-company exclusive affiliation system. In response, the Insurance Business Act permits independent operations as long as an agency is able to ensure a certain level of solicitation quality.

Two types of independent agencies are allowed as exceptions to the one-company exclusive affiliation system.

The first is allowed by way of a rule for non-life insurance agencies that previously sold the products of life insurance companies before the entry of life and non-life insurance companies into each other's sector through subsidiaries came to be permitted. When a non-life insurance company to which such an agency belongs sets up a new life insurance company as a subsidiary, the non-life insurance agency is also able to sell life insurance underwritten by the subsidiary of the non-life insurance company to which it belongs (independent approach by non-life insurance agencies (Figure 13)).

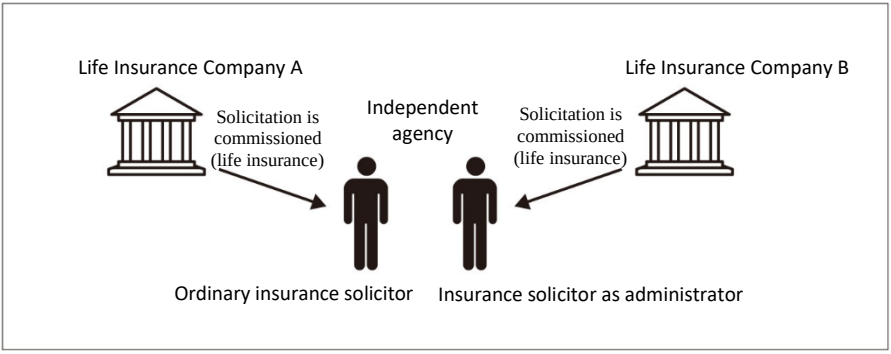
Figure 13 **Independent approach based on the use of a non-life insurance agency**



The other involves cases in which a life insurance solicitor and his or her employees have acquired prescribed knowledge or is capable of engaging in the appropriate management of operations in order to accurately and fairly perform

operations pertaining to insurance solicitation carried out on behalf of two or more affiliated insurance companies. Specifically, there need to be at least two life insurance solicitors in total: at least one who has passed a general course run by the Life Insurance Association of Japan and at least one who has passed the specialized course run by the same organization (Figure 14 on the following page).

Figure 14 **Independent approach by way of the appointment of an administrator**



Prohibition against re-commissioning solicitation **Column 18**

In principle, an agency commissioned to engage in the solicitation of life insurance is prohibited from commissioning the solicitation of life insurance to another agency or party (re-commissioning). This is because doing so would make it less likely for oversight and control to be exercised by the life insurance company and would also make the responsibilities become unclear.

The only permitted exception would be the re-commissioning of solicitation by a life insurance company commissioned to engage in solicitation to one of its own agencies in the event that solicitation is commissioned between life insurance companies within the same corporate group. In such a case, the situation is considered to be less harmful since the life insurance company is commissioning operations to an agency over which it has direct control.

3 Rules governing insurance solicitation

In engaging in the solicitation of insurance, the insurance company or

insurance solicitor (hereinafter referred to as "Insurance Solicitor") shall have a positive obligation to ascertain the intent of the client and provide information. It shall also be subject to a negative obligation in that it will be prohibited from engaging in improper sales. Furthermore, the amendments made to the Insurance Business Act in 2014 set forth an obligation to develop a system for insurance solicitors. This obligation will be explained later in 4 while the positive and negative obligations mentioned above will be explained here in this section.

(1) Obligation to ascertain the intent of the client

As mentioned above, the Insurance Solicitor is required to sell insurance products that are consistent with the intent of the client. While this is carried out as a service in the course of engaging in the solicitation of insurance in that products are to be sold in accordance with client needs, it is also a legal obligation. Requirements along this line include the following:

(i) Ascertain the intent of the client when engaging in the solicitation of insurance

This is to propose products that are consistent with the intent of the client.

(ii) Ascertain the intent of the client before accepting an application for a specific product

Through this requirement, the insurance solicitor confirms how the intent of the client has changed from the outset to the time of application, the intent of the client at the time of application, and how the characteristics of the product for which an application is ultimately made have changed.

(iii) Verify that the product is consistent with the client's own intent at the time of the application for an insurance policy

This is to provide an opportunity to the client to verify before applying that the product for which he or she wishes to apply matches his or her own needs.

Obligation to ascertain the intent of the client and the principle of suitability — **Column 19**

As will be explained later, the principle of suitability applies to life insurance with investment characteristics. There have long been discussions as to whether or not the principle of suitability should also apply to life insurance without investment

characteristics. However, the principle of suitability is a principle to determine whether or not a given investment product is suitable for a given person in light of his or her investment experience, the state of his or her assets, his or her investment objectives, and other factors. Simply put, it is a principle for assessing whether it is appropriate to have the client shoulder the risk of a decline in the value of the investment product in question, which means that it is hard to see how it might apply to general life insurance products.

As a result of discussions held by the Financial System Council and other bodies, the issue when it comes to general life insurance is not suitability but whether an insurance product meets the needs of a client. Yet, it is difficult for anyone other than the client himself or herself to ultimately determine whether or not needs are being met. Thus, as outlined here, an Insurance Solicitor is obligated to ascertain the intent of the client, propose a product accordingly, and ultimately provide the client with an opportunity to confirm that the insurance product is in line with his or her own intent.

(2) Obligation to provide information

The obligation to provide information is the obligation on the part of the Insurance Solicitor to provide the policyholder with information that would be helpful when the Insurance Solicitor is engaging in the solicitation of insurance. Specifically, the Insurance Solicitor is obligated to ensure that the client understands the characteristics of and matters to be noted as concerns the life insurance product in question.

(i) Policy summary

The policy summary is a document that is used to explain the characteristics of a life insurance policy. It is a document that explains, among other details, the contents of coverage provided by the life insurance policy.

When selling life insurance, an outline of the insurance product, such as one for medical insurance or term insurance, should first be provided in a brochure. If the client is interested, ask him or her questions to glean his or her date of birth, desired insurance amount and term, desired premium amount, and other pertinent information and then propose a specific insurance policy that satisfies his or her conditions. This written proposal is generally known as a policy illustration. Since the policy summary explains the specific contents of coverage designed for that person, it is often integrated with the policy illustration.

(ii) Advisory information

Advisory information that alerts the insured to matters that should be noted is also provided together with the policy summary. It contains matters to be noted when an application is made for an insurance policy. For example, it might state that you might not be refunded premiums paid in the event of an early cancelation, that you might not be paid insurance money if you breach the duty to disclose, and that you are entitled to a cooling-off period.

(iii) Obligation to explain

Based on these documents, matters need to be carefully explained in accordance with the client's knowledge.

At the same time, you will need to explain important matters by issuing the client with the policy provisions and a policy booklet, which should contain excerpts of important points in the policy provisions, before receiving an insurance policy application form.

This obligation to explain is imposed as a supervisory regulation, the breach of which will be met with the implementation of administrative measures. In addition, the obligation to compensate for damages is sometimes imposed on a life insurance company when a life insurance product is sold through a serious failure to comply with the obligation to explain.

(3) Prohibition against improper sales

Examples of improper sales that are prohibited include sales for which important matters are not explained and sales for which an incorrect explanation of important matters is provided. While this appears to overlap with the obligation to explain as described in (2) above, the Insurance Business Act had not, until recently, set forth a positive obligation to explain as described above. It was on the basis of this prohibition against improper sales that insurance solicitors came to be required to comply with the obligation to explain.

Also prohibited are actions to impede any attempt on the part of the insured to properly fulfill the duty to disclose and the imposition of any requirement on the insured to give a fraudulent disclosure. If there has been a breach of the duty to disclose, the insurance policy may be canceled without any payment of insurance money forthcoming. However, if the insurance solicitor was involved in an improper disclosure, the insurance company will be unable to cancel the policy. If there has been any action taken to impede disclosure, the insurance solicitor will be subject to criminal punishment and other penalties.

Unauthorized contract switching is also banned. If done properly, contract switching is not problematic. Since commissions are earned by an insurance solicitor by acquiring new policies, however, one might come up with the idea of extinguishing an existing policy and having a new contract concluded even though there is no need to carry out such actions.

In order to prevent such actions, a life insurance company will not recognize that a case in which an existing policy is canceled and a new policy is taken out within a short period of time counts towards the performance of the insurance solicitor and will, if anything, draw attention to such a case as one that is problematic.

(4) Rules pertaining to comparative sales

An independent agency handles similar products offered by multiple life insurance companies. Regulations have been enacted to ensure that products sold by an independent agency to clients are compared with other similarly handled products and are more in line with client needs.

First, an independent agency is required to present an outline of comparable (similar) products that it handles. When products are narrowed down as requested by the client (such as in terms of desired premium amount and coverage) after this outline has been presented, the criteria and reasons for this narrowing-down process need to be indicated. The client will then select a product suitable for himself or herself from among the narrowed-down products and submit an application accordingly.

There is also another method by which a product recommended by an independent agency is presented while taking the client's intent into account. In such a case, objective reasons for recommending this product, such as reasons that are framed in terms of product characteristics and insurance premium level, will need to be indicated by the independent agency to the client.

4 Rules of solicitation concerning insurance with investment characteristics

Life insurance with investment characteristics, such as variable insurance, variable annuity insurance, foreign currency-denominated insurance, and foreign currency-denominated annuity insurance, are defined under the Insurance Business Act as "specified insurance" in the form of insurance with investment characteristics.

Regulations as provided for in the Financial Instruments and Exchange Act, which regulates the sale of investment trusts and other financial instruments, apply mutatis mutandis to investment-oriented insurance (specified insurance). Key rules include the following: (i) principle of suitability, (ii) the obligation to issue documents prior to and at the time of the conclusion of a contract, and (iii) a prohibition against false disclosures and other forms of improper conduct.

(1) Principle of suitability

The principle of suitability is a regulation under the Financial Instruments and Exchange Act that prohibits solicitation that is improper in light of the client's knowledge, experience, asset situation, and purpose of concluding a contract for a financial instruments transaction.

Like investment trusts, an investment-oriented insurance policy is also subject to price fluctuations in the market, as can be seen with share prices and foreign currency exchange rates. In this connection, the Financial Instruments and Exchange Act applies mutatis mutandis as a set of rules applicable to anyone selling investment-oriented insurance given that he or she needs to appropriately engage in solicitation activities upon learning of the client's background.

These rules proclaim, for example, that an explanation tailored to the attributes of the person who wishes to take out investment-oriented insurance must be given and that no product with excessively high risks may be sold to an elderly person lacking investment experience.

(2) Issuance of documents prior to and at the time of the conclusion of a contract

Documents issued prior to the conclusion of a contract are documents that must be issued in advance in order to allow the client to assess the investment in question in accordance with the Financial Instruments and Exchange Act. They shall, for the protection of the client, state important matters, such as an outline of the policy, costs, and main risks. In order to have risks associated with the transaction correctly understood, these documents should be reviewed prior to the transaction. These documents shall be provided to the client as an integral part of the policy summary and advisory information, which must be provided under the Insurance Business Act.

Where a contract has been concluded, the contents of the transaction undertaken by the client need to be presented to the client without delay as part

of the issuance of documents at the time of the conclusion of the contract. For investment-oriented insurance policies, it is believed that an insurance certificate is commonly issued in lieu of these documents.

(3) Prohibition against false disclosures and other forms of improper conduct

The following are examples of conduct that is prohibited: making a false statement concerning an important matter and making a statement informing the client of important matters or matters related to important matters that would be in the client's interest while deliberately failing to disclose facts concerning such important matters that would be detrimental to the client.

5 Obligation to develop a system for insurance solicitors

(1) General discussion

Rules governing the selling of insurance as provided for in the Insurance Business Act have thus far required that insurance companies enact client-protection rules and be responsible for ensuring compliance therewith by affiliated sales agents and agencies. Insurance companies are also to be held liable for improper sales and insufficient explanations.

However, insurance solicitors with larger operations than smaller insurance companies, such as large insurance agencies, banks, and securities companies, have emerged. In addition, these large insurance agencies usually operate independently and sell insurance as commissioned by large numbers of insurance companies. Thus, a life insurance company may seek to have its rules observed but may find it impossible to do so any time these rules differ from rules enacted by an independent agency.

In this connection, the obligation to develop a system for insurance solicitors came to be introduced through the 2014 amendment to the Insurance Business Act. In talking about insurance solicitors in this context, it is sufficient for agencies operating with sales agents or on an individual basis to comply with this obligation by complying with the obligation to develop a system as imposed by life insurance companies. Thus, the term *insurance solicitor* in this context refers mainly to large insurance agencies.

The term *employee* refers to anyone who is employed by an insurance solicitor and who is actually involved in the solicitation of insurance.

(2) Contents of the obligation to develop a system

(i) Ensuring the eligibility of officers and employees

An insurance solicitor is required to possess appropriate knowledge for the solicitation of life insurance in order to be registered as a solicitor. Therefore, a check first needs to be conducted to ensure that no board member or employee engaged in the business of an insurance solicitor are in contravention of the eligibility conditions for registration under the law. In addition, education needs to be provided to ensure that knowledge on insurance solicitation sufficient for registration is possessed and maintained.

As mentioned above, the commissioning of solicitation by an insurance solicitor to someone else in a life insurance business is, in principle, prohibited. For this reason, an employee must be in an employment relationship with an insurance solicitor and someone who follows directions and orders issued by the insurance solicitor. Solicitation cannot be commissioned to an independent third party.

(ii) Education, management, and guidance pertaining to compliance with laws and regulations

First, an insurance solicitor is required, by internal rules, to set forth compliance with laws and regulations concerning insurance solicitation, knowledge concerning insurance policies, the development of an internal office control system (including the proper management of client information), and other matters.

These internal rules should provide for appropriate education, management, and guidance, such as by way of the implementation of measures to educate and improve the qualifications of officers and employees engaged in insurance solicitation.

When it comes to internal rules, it is not enough to simply enact them; the audit department and other sections need to engage in monitoring to ensure compliance with these rules. However, if an audit department cannot be set up due to the size of an insurance solicitor, alternative measures can be put in place, such as by appointing a person in charge of audits.

(iii) Managing client information

An insurance solicitor or external party to whom administrative office work is outsourced needs to develop a system suitable for the size and operational

characteristics of the insurance solicitor and take appropriate measures in accordance with the Act on the Protection of Personal Information to ensure that client information is appropriately managed.

The Act on the Protection of Personal Information requires that information be appropriately acquired, used, stored, and disposed of. In appropriately acquiring information, the purpose to which the information will be used needs to be expressly indicated.

In particular, the express consent of the individual is required when acquiring such sensitive personal information as information on the individual's ethnicity, creed, social status, and medical history.

Safety control measures pertaining to personal client information need to be implemented to prevent the leakage or loss of or damage caused to such information irrespective of the size or operational characteristics of the insurance solicitor.

Personal information is required to be used within the scope of the purpose of use as initially indicated and its provisions to a third party, in principle, requires the consent of the individual to whom such information pertains. The provisions by an insurance solicitor of information for the purpose of outsourcing office administration does not constitute the provisions of personal information to a third party as long as the information is used for the operations of the insurance solicitor.

Client information can also in some cases constitute inside information under the Financial Instruments and Exchange Act. In such a case, the use of inside information to trade shares or securities would be a violation of rules governing insider trading.

In these ways, a solicitation agency is required to develop a system for and shoulder the costs of compliance with laws and regulations.

Chapter 4: Operations of life insurance companies

We have to this point learned about the basics of life insurance (Chapter 1), life insurance products (Chapter 2), and the solicitation of life insurance (Chapter 3).

In Chapter 4, I would like to look at an outline of the operations of life insurance companies.

First, I will explain everything from the establishment and acquisition of a license for a life insurance company to the way a life insurance company is managed. At the same time, I will also talk about life insurance companies forming corporate groups.

Next, I will explain how the financial soundness of a life insurance company, which is integral to its management, is ensured.

I will then talk about life insurance underwriting, a core operation of a life insurance company, followed by another core operation in asset management.

I. Management of a life insurance company

In this section, I will start by going over the process by which a life insurance company is established and is then granted a license. I will then explain the form of governance by which a life insurance company operates and the appointment of its officers.

1 Life insurance business operations that are subject to a license

As the life insurance business is a licensed business, the operations of a life insurance company require the granting of a license by the Prime Minister.

It is then necessary to start by clarifying what the business of life insurance is. According to the Insurance Business Act, the life insurance business is defined as a business that underwrites insurance through which it promises to pay out a certain amount of insurance money in connection with the survival or death of a person (including a physical condition, as determined by a medical doctor, by which life expectancy is found to be no greater than a certain length of time) and collects premiums. In other words, a life insurance business underwrites insurance policies in connection with the survival (such as in terms of policies with maturity benefits or annuities) or death (policies that pay out death benefits) of a person as a business.

However, small-amount, short-term insurance providers and insurance and mutual-aid businesses that provide mutual aid are businesses that have a different legal basis and thus engage in business in accordance with other laws. See Chapter 1-VI for more information on small-amount, short-term insurance providers and mutual aid. Incidentally, the definition of a life insurance business as set forth above includes a part in parentheses; this part can correspond to a rider designed to meet what is known as living needs and which pays out insurance money when the insured has a life expectancy of, for example, six months. This part in parentheses has been incorporated into the definition.

Operating a life insurance business without a license granted by the Prime Minister is subject to criminal punishment.

2 Applying for a license

Since a life insurance business is conducted not by an individual but by a company, a preparatory company is to be established first in the process of

applying for a license. A preparatory company is established either as a joint-stock company or a mutual company.

The following points are examined when granting a license to a preparatory company:

(i) The company has a sufficient financial basis and its income and expenditure projections are favorable (sufficient economic basis);
(ii) The persons operating the company have the knowledge, experience, and sufficient social credibility (appropriate basis in terms of human resources);
(iii) The statement of business procedures and policy provisions are appropriate (proper policy provisions);
(iv) The statement of methodology for making premium and policy reserve calculations is appropriate (proper actuarial principles).

In addition to the above, a company applying for a license needs to have capital for a joint-stock company or a fund for a mutual company of at least 1 billion yen. Moreover, a board of directors and board of auditors (or an audit committee or nominating committee) must be established as bodies within the company. The board of auditors and other such bodies shall be explained in 4 below. An accounting auditor to audit financial documents of the company also needs to be appointed.

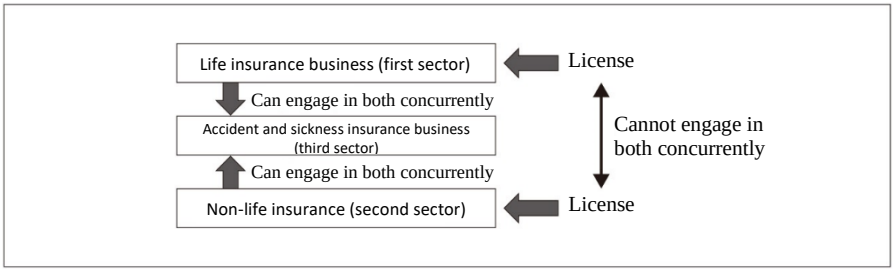
A life insurance company that is granted a license needs to promptly commence its business.

3 Business operations that can be carried out by a life insurance company

A life insurance company can engage in the underwriting of accident and sickness insurance, such as medical insurance and long-term care insurance (third-sector insurance) at the same time as it runs a life insurance business. The underwriting of third-sector insurance can be done concurrently by either a life insurance company or a non-life insurance company. Conversely, no insurance company specializing in the underwriting of third-sector insurance is assumed to exist.

No company is allowed to concurrently operate both a life insurance business and a non-life insurance business. A summary of the above points is presented in Figure 1 on the following page.

Figure 1 **Life insurance business, non-life insurance business, and accident and sickness insurance business**



The core businesses of a life insurance company are thought to be insurance underwriting and asset management (inherent operations). In principle, a life insurance company is restricted from engaging in any other business (restriction against engaging in other businesses). However, a life insurance company is able to engage in operations that are incidental to an inherent operation and that are allowed under the Insurance Business Act (incidental operations) and in any business that is specifically allowed by law (other businesses that are statutorily allowed). A summary of operations that a life insurance company is allowed to run is presented below:

(i) Inherent operations (underwriting of insurance, asset management)
(ii) Incidental operations (acting as an agency for operations pertaining to a financial business, performing administrative work for another party, guaranteeing debts, and more)
(iii) Other businesses that are statutorily allowed (operations for the solicitation and administration of corporate bonds on a commissioned basis, insurance trust operations, and more)

4 Management of a life insurance company

As mentioned in Chapter 1, life insurance companies consist of joint-stock companies and mutual companies. In principle, directors and other officers are elected, financial statements are approved, and shareholder dividends are determined at general meetings of shareholders in a joint-stock company. In a mutual company, delegates representing employees are normally elected by employees. Meetings of delegates play the same role as general meetings of shareholders in a joint-stock company. In a mutual company, share dividends are not paid; dividends are only paid on insurance policies.

For both joint-stock companies and mutual companies, the board of directors, whose members comprise elected directors, make decisions with respect to important management matters. Specifically, the important functions carried out by a board of directors consist of determining management strategies, appointing and dismissing the president and other executive directors, and monitoring and overseeing the execution of management.

In a company that has set up a board of auditors, auditors are appointed separately from directors to audit management. Some general operating companies appoint auditors but do not set up a board of auditors. A life insurance company, however, is required to set up a board of auditors consisting of at least three auditors. In a company that has set up a nominating committee or a company that has set up an audit committee, auditors are not appointed; instead, management is audited by the audit committee in a company that has set up a nominating committee or directors who comprise the audit committee in a company that has set up an audit committee.

Company with a board of auditors, company with a nominating committee, and company with an audit committee **Column 20**

Originally, large companies like life insurance companies were thought to take the form of companies with a board of auditors as permitted under Japan's Companies Act (formerly set forth in the Commercial Code of Japan). However, the system of auditors who audit the duties performed by directors is unique to Japan and was rather difficult to understand as seen from the perspective of non-Japanese observers. In response, the Anglo-American system of companies with a nominating committee came to be allowed. A company with a nominating committee is required to set up three committees: a nominating committee, remuneration committee, and audit committee, each of which is composed of directors. On the other hand, operating officers who are appointed separately from directors are charged with executing the management of the company. At a company with a nominating committee, audits are conducted by an audit committee composed of directors, which means that auditors are not appointed.

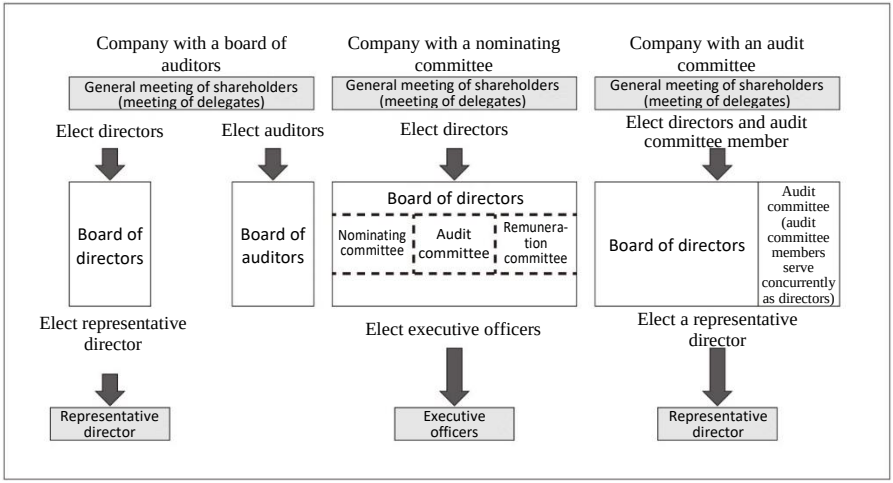
In companies with a nominating committee, the system was too strict and its usage did not spread due, for example, to the fact that matters determined by the nominating committee could not be modified by the board of directors.

Subsequently, the system corresponding to a company with an audit committee under which an audit committee is the only body to be established along with the board of directors came to be permitted. Companies with an audit committee also

do not appoint auditors.

Joint-stock companies and mutual companies that operate as life insurance companies are allowed to assume one of three forms: company with a board of auditors, company with a nominating committee, and company with an audit committee. For example, the Nippon Life Insurance Company is a company with a board of auditors but the Meiji Yasuda Life Insurance Company and Sumitomo Life Insurance Company are companies with a nominating committee. The Dai-ichi Life Insurance Company is a company with an audit committee. (See Figure 2.)

Figure 2 **Three different company forms (joint-stock companies and mutual companies)**



5 Election of officers

Directors, executive officers, and auditors engaged in the management of a life insurance company are required to be eligible as officers under the Insurance Business Act. This eligibility rule is modeled after the fit-and-proper principle applicable in the United Kingdom. By ensuring the knowledge and suitability of officers engaged in the management of a life insurance company, the appropriate operations of the company can be ensured. This is analogous to the right to elect officers at a general meeting of shareholders, the exercise of which is a key means of ensuring that a company is appropriately compliant, subject to risk management, and effectively and efficiently managed.

Directors and executive officers engaged in management duties are required

by law to possess the knowledge and experience to be able to precisely, fairly, and efficiently carry out the management of an insurance company. These days, the election of outside directors or independent outside directors has come to be required not just of life insurance companies but also of general operating companies.

See Column 21 for more information.

Likewise, auditors are required by law to possess the knowledge and experience to be able to precisely, fairly, and efficiently audit the execution of duties by directors and executive officers.

Outside directors and independent outside directors **Column 21**

It is difficult to distinguish between outside directors and independent outside directors, but the former are required by the Companies Act while the latter are required by stock exchange listing rules.

They are both the same in that each is required to express opinions from an independent standpoint to the roster of executive officers as headed by the president of the company. Since, in principle, the Companies Act applies regardless of whether or not an entity is listed, outside directors are needed as part of the corporate structure. Outside directors must be appointed in both companies with a nominating committee and companies with an audit committee. In addition, outside directors are also now required to be appointed at companies with auditors, although this is, in principle, limited to listed companies (Companies Act amended in 2019). Statutory requirements applicable to an outside director include not being now and not having been at any time in the last ten years an officer or employee of the company or subsidiary of the company.

On the other hand, listing rules that require an independent outside director are a system that applies only to listed joint-stock companies. The requirement for an independent outside director is one that is prescribed by stock exchanges. In addition to being required to be outside the company in terms of status, an independent outside director is strictly required to be independent, such as by not having any conflict of interest with a general shareholder. Originally, a company, under listing rules, had to have at least one independent officer among its directors and auditors. An independent officer is an outside director or outside auditor who is not at risk of having a conflict of interest with a general shareholder. While there are certain guidelines, it is ultimately the company itself that determines whether or not someone is independent.

With the adoption of the Corporate Governance Code of June 2015 by the Tokyo

Stock Exchange (to be explained in VI-2(2) below), each listed company came to be required to elect at least two independent outside directors or explain the reasoning behind any failure to do so ("comply or explain"). This point is explained in VI-2(2) below.

II. Insurance company group

Life insurance companies form corporate groups to develop their operations. There are all sorts of variations in this respect that can be seen. In some cases, an operating company will form a group to place a life insurance company under its umbrella. In other cases, a group will be formed by a life insurance company to place an overseas insurance company under its umbrella. Keep in mind, however, that life insurance companies are subject to regulations that must be observed when a group is formed. This is what I will be primarily looking at in this section.

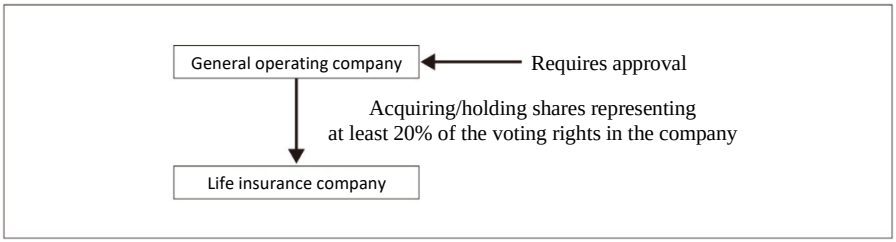
1 Major shareholder regulations

The shares of a listed life insurance company can be acquired by anyone.

In principle, however, the approval of the Prime Minister is needed if you wish to acquire at least 20% of the outstanding voting rights of a life insurance company. For a mutual company, policyholders become 'employees' and part owners of the company, which means that nobody other than policyholders have an ownership stake in the company.

The purpose of regulations as outlined in Figure 3 is tied to the fact that, whereas a life insurance company may be restricted from engaging in other industries, a major shareholder owning shares of the life insurance company in question is not subject to any operational restrictions.

Figure 3 **Regulations governing major shareholders**



For example, a life insurance company cannot make an automobile manufacturer into its own subsidiary, but an automobile manufacturer is entitled to make a life insurance company into its subsidiary. In such a case, the life

insurance company is not engaging in another business. However, there is some concern that if the automobile manufacturer, as a major shareholder, were to become mired by financial difficulties, the risks involved could negatively affect the life insurance company. For this reason, regulations to ensure that such a situation does not transpire are needed.

In this connection, the Insurance Business Act requires the granting of approval to anyone wishing to become a major shareholder in accordance with the following rules:

(i) There is no risk of a loss of the sound and proper running of the insurance company's operations in light of the funds to be acquired and the purpose of the acquisition thereof;
(ii) There is no risk of a loss of the sound and proper running of the insurance company's operations in light of the state of the assets, income, and expenses of the company that will constitute a major shareholder (including any subsidiary thereof);
(iii) The person is someone with sufficient understanding of the public nature of the insurance business and sufficient social credibility in light of the personnel structure of major shareholders.

This requirement for approval and the ability to obtain at least 20% of the voting rights of the company if this requirement is met are because such an outcome would be acceptable as long as no major shareholder imposes its own business risks onto the life insurance company.

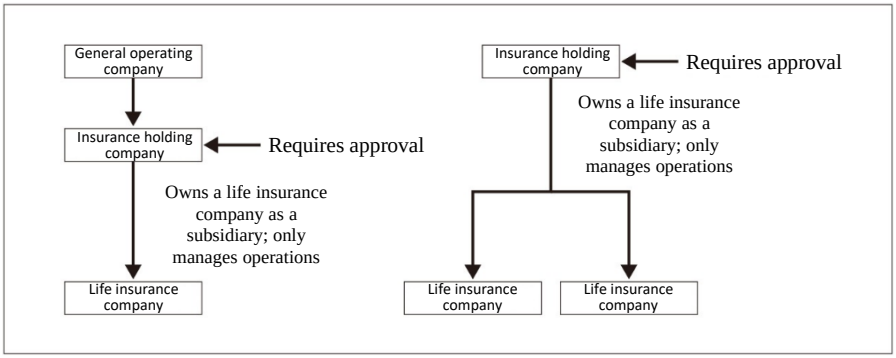
In contrast, any attempt by a life insurance company to expand into another business as a parent company would be strictly controlled since the risks associated with the other business could become risks that directly affect the life insurance company (to be explained in 3 below).

2 Insurance holding companies

A life insurance holding company refers to a company that has a life insurance company as a subsidiary and that has been granted approval by the Prime Minister. In the earlier example of an automobile manufacturer, a company can directly own a life insurance company as a subsidiary. In another scenario, a holding company can be established as a subsidiary and made to run a life insurance company as a subsidiary of a subsidiary. An example of this can be seen in Sony Group company (a parent company) Sony Financial Holdings (a subsidiary) and Sony Life Insurance (a subsidiary's subsidiary).

In addition, there have been examples in recent years – like the Daido Life Insurance Company, Taiyo Life Insurance Company, and Dai-ichi Life Insurance Company – in which a life insurance company sets up a holding company and arranges to become a subsidiary of this holding company (Figure 4).

Figure 4 **Example of an operating company establishing an intermediate holding company downstream and example of multiple insurance companies establishing a holding company**



One of the advantages of establishing such a holding company is that if, for example, a company wishes to make an overseas life insurance company into one of its subsidiaries, the procurement of funds for acquiring this company can be flexibly undertaken. Moreover, the target company is not made into a subsidiary of a Japanese life insurance company; rather, it is made into a group company of the same rank under the holding company.

However, you will often get a case in which there is only one major life insurance company operating under an insurance holding company. In such a case, the task of reconciling differences between what the management of the life insurance company intends and what the management of the insurance holding company intends is a challenge. Thus, management executives belonging to the insurance holding company sometime serve concurrently as management executives for the major life insurance company.

The operations of the insurance holding company are limited to holding insurance companies and other entities as subsidiaries and managing their operations.

3 Subsidiaries

A life insurance company is restricted from engaging in other businesses. While the direct undertaking of actions by life insurance companies themselves has already been discussed in I above, it should be noted that regulations are also imposed on the effective expansion of life insurance companies into other businesses through subsidiaries.

An insurance company may not make a company other than a company listed below a subsidiary:

(i)	Life insurance company; non-life insurance company; small-amount, short-term insurance provider
(ii)	Bank, long-term credit bank
(iii)	Company specializing in fund transfers
(iv)	Company specializing in securities, company specializing in securities intermediary services
(v)	Company specializing in trusts
(vi)	Foreign company engaged in the insurance business
(vii)	Foreign company engaged in the banking business, foreign company engaged in the negotiable securities-related business, foreign company engaged in the trust business
(viii)	Company exclusively engaged in a subordinate business or finance-related business
(ix)	Company cultivating a new business field (venture business company)
(x)	Holding company whose subsidiaries consist only of companies coming under any of (i) through (ix) above

A few characteristic points will be mentioned here. Amendments made to the Insurance Business Act in 1995 allowed for the entry of life and non-life insurance companies into each other's sector through subsidiaries (related to (i) and (vi)). In addition, amendments made in 1998 made it possible for life insurance companies to expand into other domains of the financial industry, namely the banking, securities, and trust sectors (related too (ii), (iv), (v), and (vii)). The fund transfer business in (iii) is a business that has recently come to be permitted and consists of operations whereby ICT technologies are used to enable individuals to settle payments with one another.

The entry of life and non-life insurance companies into each other's domain in the financial industry involves entry by the main company or entry by a subsidiary. In the case of entry by a subsidiary, any business failure by the

subsidiary will result in nothing more than the loss of the subsidiary's capital (wherein the value of shares owned by the parent insurance company becomes zero). For this reason, it is believed that this approach limits risks more effectively than entry by the main company.

A subordinate business in (viii) is one that involves the outsourcing of the administrative work of a life insurance company itself. A company that engages in a dependent business could be, for example, one that buys and sells goods used for solicitation by sales agents (such as calendars and folding fans) or one that undertakes the development and operations of a system for a life insurance company. While such a company would constitute a general operating company, they are permitted since they can be owned as subsidiaries without taking on any new risks.

There are regulations that require that a minimum percentage of revenue earned by a dependent company is derived from a parent life insurance company or a group insurance company.

A finance-related business in (viii) is permitted for life insurance companies, including companies that engage in the solicitation of insurance or conduct investigations of insurance incidents. More recently, the operations of daycare centers and other such entities have come to be allowed in the interests of supporting dual-earner families.

III. Ensuring financial soundness

A core element of the life insurance business is ensuring financial soundness. In this section, I will explain the ways by which the financial soundness of life insurance companies is ensured, including the method by which premiums are set, the accumulation of policy reserves, and regulations governing the solvency margin ratio.

1 General discussion

With life insurance policies, premiums are normally paid in advance by the policyholder while insurance money to be paid by the life insurance company is paid out at a later date. From the perspective of the policyholder, nothing is of greater importance than the eventual return of insurance money as paid consideration.

In order to make certain that insurance money will be paid, it is important that the financial soundness of the life insurance company is ensured on an ongoing basis.

Measures to ensure financial soundness in a manner that is specific to life insurance companies generally comprise the following three pillars:

(i) Accumulation of a standard policy reserve
(ii) Regulations governing the solvency margin ratio
(iii) Having an actuary verify the sufficiency of the policy reserve, fairness of dividends, and continuity of management

Before I explain each of these in greater detail, allow me to provide an outline in brief. First, a policy reserve is money set aside within a life insurance company in anticipation of paying claims in the future, and is accumulated for the purpose of covering the normal range of insurance payments for which claims are made. The standard policy reserve system regulates the level of the policy reserve to be accumulated.

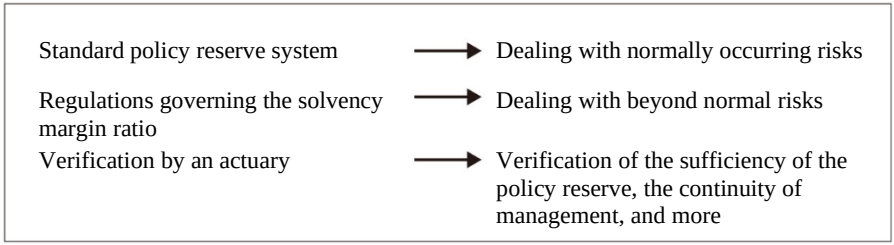
The solvency margin ratio is the ratio of a life insurance company's money (which the company is not obligated to return to anyone else), which includes capital and retained earnings, to the risks that are assumed by the life insurance company.

Thus, the solvency margin ratio indicates the extent to which money is available to cover "beyond normal" level events should they occur.

An actuary is an actuarial specialist that should be appointed by a life insurance company to ensure financial soundness by confirming the appropriateness of actuarial calculations, including the calculation of premiums charged by the life insurance company. A summary of these three pillars is presented in Figure 5.

While I will begin by explaining matters related to standard policy reserves, I should note that an understanding of the process by which life insurance premiums are designed is first necessary to understand the system of policy reserves. In this connection, I will start by first talking about the way premiums are calculated.

Figure 5 **3 pillars for confirming the financial soundness of a life insurance company**



2 Natural premiums and level premiums

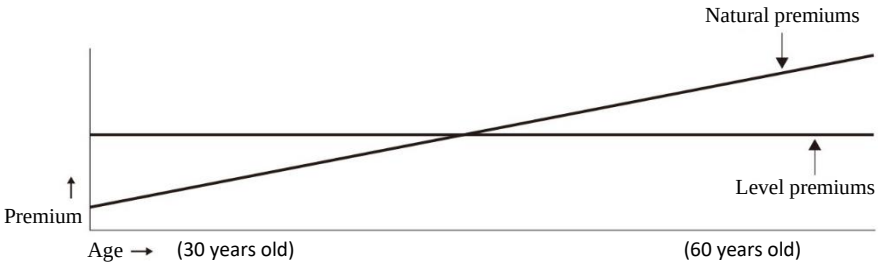
Natural premium refers to a premium that is calculated in such a way that a break-even state is achieved from year to year based on mortality rates by age. Premium amounts are calculated based on the mortality rate at age 30 years for an insured person who is 30 years old and the mortality rate at age 60 years for an insured person who is 60 years old.

Generally, since the mortality rate rises with age, the natural premium also rises in line with the mortality rate. The premium for a 60-year-old person is higher than it is for a 30-year-old person. This is disadvantageous in that the premium amount increases as a policyholder ages, which makes it increasingly difficult to continue the policy.

With level premiums, the premium is calculated in such a way that a break-even state is achieved over the entire insurance term – from the beginning to the end of the policy – with the same premium amount to be paid each time in order

to encourage a continuation of the policy even into old age. (Figure 6.)

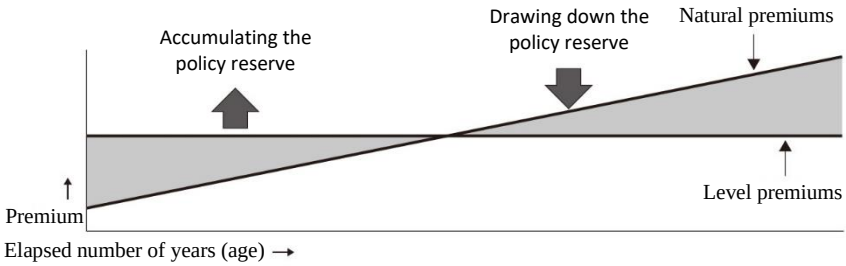
Figure 6 **Natural premiums and level premiums**



Today, most life insurance products sold by life insurance companies are tied to level premiums.

When the level-premium method is used, the amount of premiums not allocated to paying out death benefits in a given year will be accumulated to cover future payments of claims. The accumulated amount is the policy reserve (Figure 7). In the latter part of an insurance term, the difference between the growing natural premium amount and the level premium amount will be reversed.

Figure 7 **Accumulating and drawing down a policy reserve**



3 Net and additional premiums

The actual premium consists of a portion that is allocated to the payment of claims and a portion that is used to cover costs incurred by the life insurance company. The portion of paid-in premiums that will be allocated to the payment

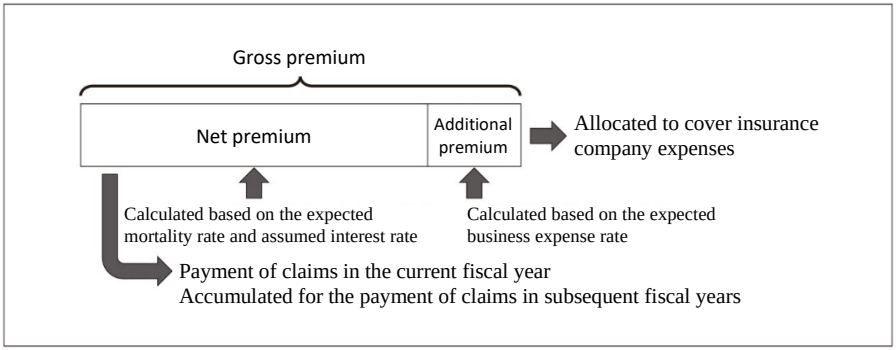
of insurance money in the current and subsequent fiscal years is known as *net premium.* This net premium is generally calculated for death insurance based on the expected mortality rate and the assumed interest rate. The expected mortality rate is the rate at which it is assumed people will die when the insured is at a given age.

In addition, reserves accumulated for the payment of claims in subsequent fiscal years are expected to earn a certain rate of return that is invested by the life insurance company and that will help to reduce premium amounts going forward. This yield is known as the assumed interest rate.

An additional premium is the portion of the premium that is used to cover costs incurred by the life insurance company and is calculated based on the expected business expense rate for which the extent to which expenses will be incurred is estimated.

The sum of the net and additional premiums is the gross premium, which constitutes the premium that the policyholder will actually pay (Figure 8).

Figure 8 **Net premium, additional premium, and gross premium**



4 Accumulating a policy reserve

As explained above, a certain portion of paid premiums is accumulated in the first half of an insurance term. While the money accumulated from premium payments is known as *policy reserve*, the level at which the policy reserve is accumulated is determined based on the following two factors:

(i) Accumulation method
(ii) Basic computation rate

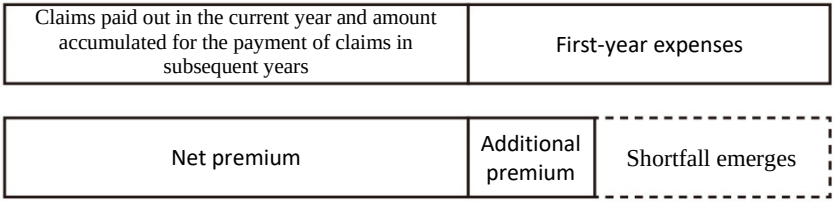
(1) Accumulation method

First, there are, broadly speaking, two types of accumulation methods: the Zillmerization method and net premium method.

There are two methods because the amount of the additional premium that is included in the premium amounts received each time and that is allocated to the life insurance company's expenses is the same throughout the premium payment period. On the other hand, expenses pertaining to a life insurance premium are higher in the first year of an insurance policy due to the costs of procedures for processing a new policy and the remuneration payable to the solicitor.

In other words, expenses are incurred by a life insurance company that cannot be covered by the additional premium in the first year of a policy. However, the net premium portion needs to be allocated to pay claims in the current year as well as accumulated for the payment of claims in subsequent years. For this reason, premium amounts in the first year of a policy are invariably insufficient (Figure 9).

Figure 9 **Relationship between reserves and first-year expenses and premiums (illustration)**

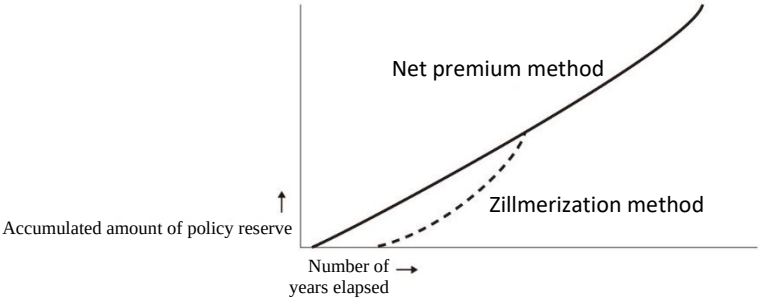


In the first year of a policy, amounts to cover necessary expenses are procured from other sources and a policy reserve is built up in accordance with the premium-calculation rules under what is known as the net premium method.

On the other hand, the Zillmerization method is a method that reduces the policy reserve by diverting part of the first year's net premium to expenses that are initially incurred. With the Zillmerization method, the initial shortfall in the reserve relative to what the rule mandates is eliminated through the accumulation of additional premium amounts over a five- or ten-year period (Figure 10 on the following page).

The elimination of a shortfall in five years is referred to as five-year Zillmerization and the elimination of a shortfall in ten years is referred to as ten-year Zillmerization.

Figure 10 **Policy reserves under the net premium method and the Zillmerization method (example of level-premium endowment insurance policy)**



(2) Basic computation rate

Next, the basic computation rate calculates the extent to which a policy reserve must be built up now based on the assumed interest rate and expected mortality rate as explained in the premium-calculation section above. When the assumed interest rate is high or the expected mortality rate is low, the policy reserve can be low. Conversely, if the assumed interest rate is low or the expected mortality rate is high, the policy reserve must be increased in amount.

The amended Insurance Business Act of 1995 introduced the standard policy reserve system. Under the standard policy reserve system, a policy reserve must be accumulated with (i) the method of accumulating a policy reserve and (ii) the basic computation rate being in accordance with the rules as set forth by the government.

In other words, for a standard policy reserve, a standard level must be accumulated after being set by the regulating authority from the standpoints of maintaining the soundness of the insurance company and protecting policyholders, irrespective of the insurance premium level set by the insurance company.

In principle, the method of accumulation is the level net premium method. However, the adoption of the five-year Zillmerization method is allowed for companies that have recently been established.

The other basic computation rate varies according to when the contract was concluded.

In principle, the expected mortality rate is based on the 1996 life insurance standard life table for policies concluded in or after April 1996, the 2007 life

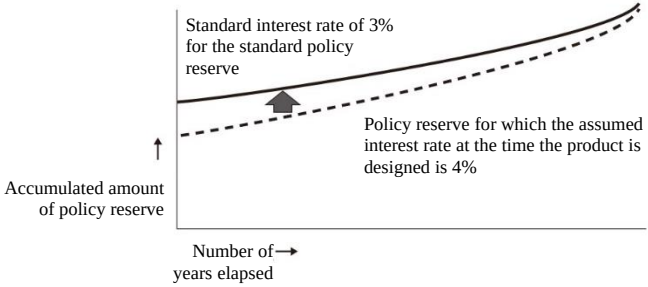
insurance standard life table for policies concluded in or after April 2007, and the 2018 life insurance standard life table for policies concluded in or after April 2018.

The standard interest rate was reduced to 2.75% for policies concluded in or after April 1996, 2.0% for policies concluded in or after April 1999, 1.5% for policies concluded in or after April 2001, 1.0% for policies concluded in or after April 2013, and 0.25% for policies concluded in or after April 2017. Most recently, they have been reduced to 0% for single-premium whole life insurance policies in April 2020.

Planned basic rate of premiums and planned basic rate of policy reserves **Column 22**

Take a look at the figure below. It shows the extent to which the policy reserve is built up when a single-premium endowment insurance policy is designed and sold with an assumed interest rate of 4% on premiums at a time when the assumed interest rate for the standard policy reserve (referred to as the standard interest rate) is 3%.

● Case in which a single-premium endowment insurance policy is designed with an assumed interest rate of 4% and the standard policy reserve builds up at a rate of 3%



Since the assumed interest rate is 4% for the designing of this product, only premium amounts based on the assumption that the reserve will be built up along the dotted line will be paid (assumed interest rate is high → premium amounts from the policyholder are low). However, since the standard interest rate for the standard policy reserve is 3%, an amount greater than the dotted line as indicated by the solid line in the graph needs to be accumulated.

In other words, since a high assumed interest rate for a product would mean that you can expect to invest at a high level for the future, you should be able to correspondingly lower the policy reserve to be built up and require lower premium amounts to be paid.

However, if the standard interest rate for a standard policy reserve is low as shown in the figure, the low premium amounts must be invested to the fullest extent possible to somehow build up the reserve to the standard policy reserve amount. If the expected investment results are not achieved and the amount actually accumulated falls short of the standard policy reserve amount, the company will need to secure funds from somewhere to accumulate what is required.

Thus, while it is possible to set premium amounts at a higher interest rate than the standard interest rate for the standard policy reserve, significant management issues could arise if there is a failure to achieve a high level of investment performance.

Basic profits and dividends — Column 23

As described to this point in the text, premiums are calculated based on the assumed interest rate, expected mortality rate, expected business expense rate, and other factors and built up into a policy reserve to cover future claims payments.

Even if the required reserve is built up, such as where investment performance is favorable enough to generate a return greater than the assumed interest rate (known as interest gain), where deaths do not occur as much as what is reflected in the expected mortality rate (known as mortality gain), or where business expenses incurred by the insurance company are not as great as what is reflected in the expected business expense rate (known as expense savings), a surplus may still result.

I will spare you the details, but the sum of these different surplus amounts is called basic profit. It is conceptually similar to operating profits earned by general operating companies. Since basic profit does not include capital gains and losses (such as valuation gains or losses on shares), it is used to evaluate the performance of a life insurance company as an indicator of a life insurance company's pure earnings.

Where a surplus is generated, a dividend will be paid to policyholders of insurance policies with policyholder (employee) dividends.

After the collapse of the bubble economy, life insurance companies struggled to invest policy reserves for policies with high assumed interest rates that were promised during the bubble economy. A negative spread refers to negative investment yields caused by an inability to generate investment earnings exceeding assumed interest rates (known as interest loss).

In recent years, it is believed that the problem of negative spread has been mostly eliminated with the disappearance of policies from the bubble era.

5 Solvency margin ratio

The solvency margin ratio is a measure of the solvency of a life insurance company in the event that a large-scale disaster or financial market crash occurs.

Whereas normal risks are covered by the standard policy reserve, the solvency margin ratio is intended to ensure an ability to cope with the occurrence of risks exceeding normal levels.

For example, a bank is subject to regulations that require it to meet a certain ratio of owned capital to total assets that depends on the scope of its operations; this ratio is known as the capital adequacy ratio. The solvency margin ratio is the insurance industry's version of this measure.

The formula for calculating the solvency margin ratio is as shown in Figure 11.

Figure 11 **Solvency margin ratio**

$$200\ \% \leq \frac{\text{Solvency margin}}{\text{Risk amount} \times 1/2}$$

The solvency margin ratio is, simply put, a ratio that indicates the extent to which the life insurance company's own money for covering risks is sufficient to cover risks.

The risks in the denominator of the formula include insurance risks, assumed interest rate risks, asset management risks, and operational management risks, the amount of each of which is calculated according to a certain formula. The sum of these risk amounts is called the capital requirement.

The solvency margin, which is the numerator in the formula, equals the net assets of the life insurance company (assets minus liabilities) minus the appropriation of retained earnings plus the life insurance company's own reserves, such as a reserve for price fluctuations. The solvency margin ratio is a measure of the extent to which solvency has been built up relative to the capital requirement.

If you look at the formula in Figure 11, you will see that the risk amount in the denominator is multiplied by 1/2 (in other words, the numerator, which represents the solvency margin, is doubled), such that if the solvency margin ratio exceeds 200%, it will mean that the life insurance company is capable of

sufficiently covering the occurrence of greater-than-normal risks with its own funds.

If the solvency margin ratio falls below a certain level, the life insurance company would be subject to an early-warning system that is designed to enable the supervisory authority to require management improvement.

If the solvency margin ratio falls below 200%, an operational improvement order for improved profitability and an improved method of coping with various types of risks will be issued by the supervisory authority. A more severe improvement order will be issued if the solvency margin ratio falls below 100% and the company will be ordered to suspend operations if the solvency margin ratio falls below 0%.

In 2025, the current regulations will be revised and regulations for an economic value-based solvency margin ratio are slated to be introduced. Under regulations for an economic value-based solvency margin ratio, the ratio will be calculated after revaluating both the assets and liabilities of the life insurance company based on the interest rate level in effect at the time of valuation and other values that can be measured at that time.

6 Actuary

Actuarial functions by which premiums and policy reserves are calculated are exceedingly important for an insurance company. Thus, the Insurance Business Act stipulates that "an insurance company… must appoint a responsible actuary to take part in the… actuarial particulars involving, among others, the method of calculating insurance premiums and method of calculating policy reserves." The duties of an actuary are to check (i) through (iii) below and submit a written opinion in which the results of this process are stated to the board of directors:

(i) Sufficient policy reserves have been built up to cover future claims payments from the standpoint of the soundness of the insurance company;
(ii) The distribution of policyholder dividends and surplus funds is done in a fair and equitable manner;
(iii) The insurance company can continue to operate.

An actuary is required to meet several conditions, among which are that he or she must be a full-fledged member of the Institute of Actuaries of Japan and that he or she must have engaged in actuarial duties for at least five years at an

insurance company. In these ways, an actuary is required to possess specialized knowledge and a wealth of professional experience.

Actuaries **Column 24**

An actuary is a full-fledged member of the Institute of Actuaries of Japan. The emergence of actuaries can be traced back to the emergence in the United Kingdom of insurance policies for which premiums were set forth according to the age of the enrollee and the number of years of enrolment. The design of such insurance requires the calculation of premiums and reserves based on the theory of probability and statistics. Those who were involved in making such calculations can be regarded as the first actuaries.

To become an actuary these days in Japan requires that you pass an examination in five basic subjects and two specialized subjects (from among a life insurance course, non-life insurance course, and pension course). Examinations are held once a year and are normally sat while the test-taker is working for a life insurance company. Some people take their first examination while still enrolled at a university.

An actuary does not just help design life insurance products and engage in duties related to actuarial matters for a life insurance company. They are also active across a wide range of different areas, including planning and corporate sales. A university student who is majoring in science and who wishes to work in the insurance industry might want to consider becoming an actuary as an option.

7 ERM

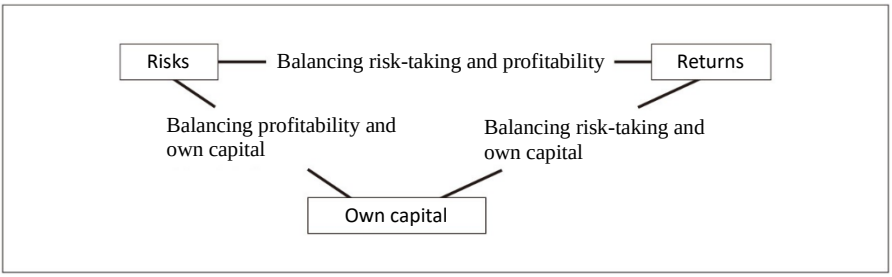
These days, life insurance companies are required to develop an enterprise risk management (ERM) system to undertake what is known as company-wide risk management or integrated risk management.

Risk management to date had been carried out from the perspective of avoiding and controlling risk but ERM thinking aims to increase the value of the company in accordance with a policy of proactively taking certain risks. In other words, risks are not meant to be simply avoided or controlled under an ERM system. Instead, a company should strike a proper balance based on its own capital in order to obtain a return. (Figure 12 on the following page)

In an ERM system, risk management and management strategies are formulated on an integrated basis. Internal controls, corporate governance, or routine operational policies are also formulated based on a risk management policy. Officers and employees are required to make operational decisions and

carry out executive functions as risk managers.

Figure 12 Conceptual diagram depicting an ERM system



Source: Excerpted from "Summary of ERM evaluation results based on a report concerning self-assessments of risk and solvency in insurance companies (ORSA Report) and hearings on enterprise risk management (ERM) systems", Financial Services Agency (September 15, 2014)

Risks should be rendered visible, and the state of their occurrence need to be reported.

Specific elements of ERM are listed in the Comprehensive Supervisory Guidelines for Interpreting Insurance, as set forth by the Financial Services Agency, and include the following:

Elements of integrated risk management (ERM)

- Risk identification and profiles
- Operational continuity preparedness
- Risk measurements
- Comprehensive management of assets and liabilities
- Enactment of a risk management policy
- System for managing underwriting risks
- Self-assessment of risks and solvency
- Risk management for reinsurance
- Group-based integrated risk management
- System for managing liquidity risks
- Reporting system
- System for managing operational risks

IV. Underwriting operations

In this section, I will be talking about underwriting operations, one of the major pillars of the main business of a life insurance company. These operations consist of the development of products to be underwritten, underwriting, preservation functions, and the payment of claims.

1 Planning and designing insurance

(1) Law and principles underlying the design of insurance products

As explained in Chapter 1-III, life insurance products are based on the law of large numbers, the principle of equivalence between proceeds and disbursements, and the individual equivalence principle. Allow me to briefly review these concepts.

First, there is the law of large numbers, which can be explained by talking about dice. If you were to roll a die enough times, the probability of rolling a given number will approach one in six. When it comes to the death of individuals, you can likewise determine probabilistically how many people in a large cohort of persons in the same age bracket will die in a one-year period. A life table (mortality table) outlines the results of efforts to ascertain these values. You can look up a life table to see what the mortality rate is by sex and for a specific age.

Premiums needed to pay claims are determined in accordance with the principle of equivalence between proceeds and disbursements. In other words, premiums to be paid are set so that they are equivalent to the total amount of claims to be paid by a life insurance company.

Finally, the extent to which an individual policyholder shall pay premiums is determined in accordance with the individual equivalence principle. In other words, premiums that are in accordance with the degree of risk corresponding to the policyholder (the insured in the context of a life insurance policy) should be levied.

(2) Statement of the calculation of the basic computation rate, insurance premium, and policy reserve

As touched on in III above, a policyholder pays a gross premium, which is the sum of the net premium, as calculated according to the assumed interest rate and expected mortality rate for a life insurance policy, and the additional

premium, as calculated according to the expected business expense rate. In calculating the net premium for a low surrender value-type policy for which the surrender value has been reduced, a life insurance company might also calculate the expected surrender rate.

Any calculation of the net premium or accumulation of a policy reserve requires the approval of the Prime Minister at the time a calculation or change is made.

(3) Policy provisions

As also touched on in Chapter 2, documents stating promises made between a life insurance company and a policyholder are known as policy provisions. Major clauses in these policy provisions set forth the types of cases in which claims will be paid, the point in time from which responsibility for the provisions of coverage will be assumed, how premiums should be paid, what will happen if there is a failure to pay premium amounts, how a claim should be made in the event of a death or other event for which a claim will be paid, and the types of cases in which a claim will not be paid.

Policy provisions need to be approved. As stated in Chapter 3, they also need to be issued to the policyholder before an application for a policy is made.

(4) Statement of business procedures For the specific method by which an insurance policy is to be handled, such as in terms of the age from which a policy can be taken out, a legal document known as a Statement of business procedures needs to be drafted and approved. This plan should include the age at which someone can enroll, the method by which the consent of the insured shall be obtained, and the method by which the surrender value is to be calculated and disclosed.

Any change to a statement of business procedures likewise requires approval.

Basic documents **Column 25**

As indicated in this book, insurance oversight in Japan involves looking into and supervising the business of life insurance companies in detail. One aspect of this is the approval of basic documents, which consist of the following four types of documents:

(i) An insurance company's articles of association
(ii) Statement of business procedures

(iii) Policy provisions
(iv) The statement of methodology for making premium and policy reserve calculations

The articles of association constitute the most fundamental document for a life insurance company, one that sets forth the purpose of the company and its organizational structure, among other points. A company needs to be registered when it is established as a company. The other basic documents listed herein have been explained previously in this book. The approval of the Prime Minister is needed whenever these documents are produced or revised.

(5) Summary of the planning and development of insurance

In developing an insurance product, an insurance company will, as would anyone in any other business, conduct a market survey to, in part, determine the extent to which there is demand for the intended product. Since the marketing of a product would incur costs, the insurance company will need to determine whether the product can cover these costs and still generate an appropriate level of profit. The insurance company will also be called upon to figure out which customer groups to target, the way marketing activities should be carried out, what the market environment is like, and what trends pertaining to other companies can be considered pertinent.

While the framework of a product is put together in this way, actuarial design and legal design work will be carried out. Such work will need to be granted government approval as stated above.

In addition, a system for managing the conclusion of insurance contracts, preservation functions, and payments will need to be developed. Application forms, solicitation materials, and other documents for the selling of insurance will also need to be produced.

Furthermore, it is important that insurance solicitors be educated. Since sales agents are staff members belonging to a life insurance company, sales departments and branch offices organize educational courses. In some cases, the employees of an independent agency are educated when an employee of a life insurance company is dispatched to the independent agency or bank for this purpose. In other cases, an employee in charge of education at an agency receives information from a life insurance company and uses it to educate fellow employees.

In this way, cross-departmental work is performed until a new insurance product is released for sale.

2 New insurance underwriting operations

(1) Risk selection

Life insurance will not be made available for everyone who applies for it. Given that life insurance brings together many people with similar risk profiles, coverage is provided by receiving premiums according to the level of risk associated with a given person in such terms as age and health condition.

Someone with a medical history and a higher level of risk than healthy people can sometimes receive coverage for what is known as a special premium, which is a higher premium than what might be charged to a healthy individual. A company may also be able to underwrite a policy for a person with an illness affecting a specific part of his or her body by withholding coverage for just the specific body part in question. If the risk level for an individual is too high given that he or she is currently in the hospital or has just been treated for cancer, his or her application for life insurance will be rejected.

The process by which the risk level associated with a policyholder or insured is assessed in order to determine whether or not insurance can be underwritten for that individual, such as by way of considering his or her health condition and occupation, is known as *risk selection.* This is derived from the individual equivalence principle as described earlier in Chapter 1-III.

As explained in Chapter 2-II, the attempt by a person associated with a high level of risk, such as where an illness has been diagnosed in the course of a medical checkup, to take out life insurance is known as an *adverse selection* or *moral risk.* A life insurance company conducts underwriting assessments in order to prevent such moral risks and otherwise for risk selection purposes.

Handling genetic information **Column 26**

In recent years, services that analyze genetic information just by sending saliva samples have been launched to make it possible to know, to some extent, what diseases you are susceptible to contracting at some point in the future if you wish.

Whether a life insurance company can demand to be informed of such genetic information when it is in the possession of a policyholder or insured is an open question.

Taking out life insurance after you find out that you are susceptible to contracting a specific illness is arguably an example of an adverse selection. On the other hand, genetic information also constitutes sensitive information that could lead to discrimination.

Some jurisdictions abroad ban the use of genetic information or allow for its disclosure to be requested in limited cases.

Presently, life insurance companies in Japan do not ask to be informed of genetic information but I believe that it will become necessary to determine what should be done when the acquisition of genetic information becomes commonplace.

(2) Disclosure of information

Comprising a core element of the risk selection process is the disclosure of information by the insured. See Chapter 2-II to review details concerning this topic. The disclosure of information requires the provisions by the insured of accurate answers to questions concerning important matters as asked by the insurance company.

A policy shall be canceled by the insurance company if the insured deliberately fails to disclose a matter that should be disclosed or that the insured, with minimal thought, should have known is required to be disclosed. In addition, no claim will be paid if the insured dies for the same reason as a matter that he or she failed to disclose.

(3) Risk assessments

A life insurance company will determine whether or not to underwrite a policy and the conditions under which it would be underwritten after it checks the contents of the disclosure form and other pertinent documents and, for example, assigns a score to the level of risk associated with the insured.

If a policy is to be underwritten with conditions, a contract incorporating the conditions imposed by the company is not simply concluded accordingly. Instead, conditions imposed need to be accepted by the policyholder. Even if relevant matters emerge from disclosed information, it does not necessarily mean that conditions will be imposed or that the application will be declined. In some cases, a policy may be underwritten without conditions if the level of risk is low or without conditions by having the insured undergo an additional health checkup.

(4) Underwriting decision

If a life insurance company conducts an assessment and decides that it can underwrite a policy and the policyholder agrees to any and all conditions that are imposed in the case of a conditional decision, a decision will be made to

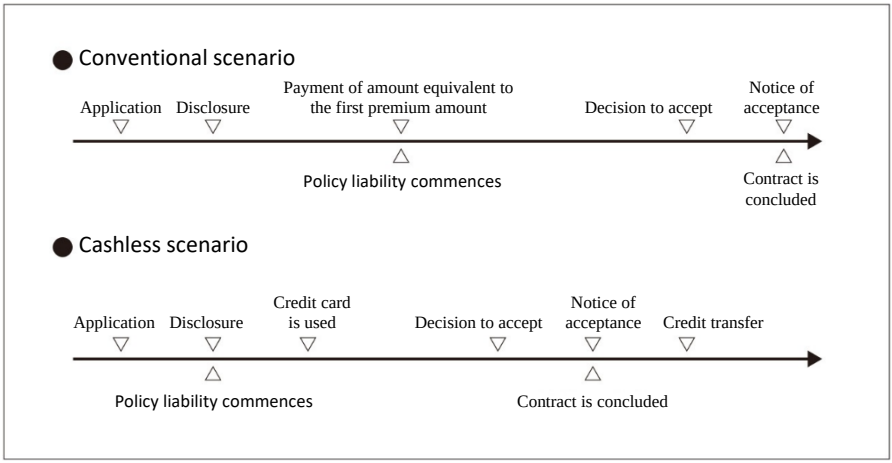
underwrite the policy as an internal decision of the life insurance company. If a decision to underwrite is made, a notice of acceptance and insurance certificate will be sent to the policyholder.

Incidentally, from what point in time is a life insurance company liable? For example, what would happen if the insured were to die after the application and disclosure forms are sent but before the application has been accepted by the life insurance company?

Historically, if an insurance application form, disclosure form, and amount equivalent to the first premium payment were all received by a life insurance company, the application was such that it could be accepted by the life insurance company, and an event for which a claim payment can be made, such as a death, were to occur prior to approval, the life insurance company would be required to pay insurance money. Thus, if, for example, a healthy person submitted an application, disclosed pertinent information, and paid an amount equivalent to the first premium payment owed before dying in an automobile accident, a death benefit would be paid.

These days, there are cases in which, in line with the development of cashless transactions, a life insurance company would be required to pay insurance money even if an amount equivalent to the first premium payment has not yet been remitted as long as the life insurance company has received an insurance application form and disclosure form and is able to accept the application (see Figure 13).

Figure 13 **Commencement of liability (in normally conceivable cases)**



3 Operations of an insurance company while a policy is in effect

(1) Management of the collection of premium amounts

The most important operation of a life insurance company after an insurance contract has been concluded is the collection of premium amounts, the payment of which enables a policy to be continued in force.

The continuation of a policy in force means that insurance money will, in the case of life insurance, be paid if the insured dies at a time when the policy is in force.These days, premiums are paid on a one-time basis for savings-type products but on a monthly basis for products designed to provide coverage. The monthly payment method requires the payment of premium amounts each month.

In the context of the practices carried out by an ordinary life insurance company, a policy will cease to be valid after a defined grace period if premium amounts fail to be paid by the policyholder. This is known as the lapsing of a policy.

If the current month's premium amount for a life insurance policy for which premiums are paid monthly is not paid and payment continues to be withheld for another full month, the policy will lapse. A life insurance company will send out notices of payment and inform the policyholder that, if no payment is received, no claim will be paid even if a death or other claim event occurs after the policy lapses.

Automatic premium loan **Column 27**

There is a system whereby, when a policy has already been in continuous force for a long period of time and a sufficient amount has been accumulated, the policyholder can be automatically lent the premium amount owing from the accumulated funds even if premiums are not paid. This is known as an automatic premium loan.

This system prevents the policyholder from being cut off from coverage due to a temporary shortage of funds. Because a loan is involved, it will be subject to a rate of interest as set forth in advance in the policy provisions.

Such a loan can be repaid at any time. On the other hand, if the transfer period is extended and the upper limit on funds that can be transferred is reached, the policy will lapse.

The automatic premium loan option is not offered by some life insurance companies or for certain products these days.

However, a policy can generally be reinstated if a request for reinstatement and the premium amounts for the period of the lapse are submitted to the life insurance company within a certain period of time (such as three years) after the policy lapses. There are cases in which, because the policyholder enrolled in a life insurance plan at a young age, it would be more favorable to him or her to use the reinstatement option rather than enroll in a separate brand-new policy.

What should be noted here is that information will need to be disclosed again at the time of reinstatement, such that, if the insured had been hospitalized during the lapse period, the life insurance company may refuse to accommodate the request for reinstatement.

(2) Policyholder loans

A policyholder sometimes needs funds while he or she is enrolled in an insurance plan. If the plan consists of a savings-type insurance policy, canceling the policy before the expiration of its term will result in the payment of a surrender value to the policyholder. However, cancelation of an insurance policy will also result in the cessation of coverage. Even if the policyholder were to attempt to once again take out insurance after the restoration of his or her financial wherewithal, it is possible that he or she would be unable to do so if his or her health has deteriorated in the meantime. In addition, as the age of enrollment would have increased, premiums would normally have gone up over what was being paid under the previous policy.

In this connection, life insurance companies offer loans to policyholders who have taken out certain savings-type insurance policies by using the accumulated portion of premiums received as collateral. Policyholder loans thus enable policyholders to obtain necessary funds without losing coverage.

A policyholder loan is subject to the accrual of interest costs. While the loan principal and interest amounts can be repaid at any time, any claim to be paid will be paid net of any outstanding loan and interest payments owing.

(3) Policy verification activities

An important activity undertaken by life insurance companies is the annual process by which policy contents are checked. For this process, sales agents and others visit the home of each client, re-explain the contents of policies currently in effect, and confirm that the insured has not been hospitalized or undergone a surgical operation and that no event for which a claim can be made has otherwise

occurred over the last year.

This is an opportunity for the policyholder to review his or her current policy to see if coverage is deemed to be insufficient or if some aspects of coverage are redundant.

Payment problems **Column 28**

Policy verification activities came to be carried out in response to payment problems in the life insurance industry. Up until then, regular visits to existing clients had been undertaken. Now, the reconfirmation of policy contents and the confirmation of whether or not the insured has been hospitalized or undergone a surgical operation for which a claim would be paid are seen as important activities.

The payment problem initially occurred when insurance companies went too far in rejecting claims by using the provisions of policy provisions to justify non-payment. However, further investigations in certain cases revealed that there might have been another reason for paying a benefit other than the benefit for which a claim was made (for example, the name of a surgical operation was written on a medical certificate attached to a claim form for hospitalization benefits, such that a surgical benefit was payable) and, despite the fact that this was written on the medical certificate, no payment was made.

While the inability to pay a benefit for which no claim has been made is unavoidable, it is possible to encourage a policyholder to make a claim if a medical certificate can be checked for confirmation purposes. The existence of this problem was what led to such actions.

(4) Policy cancelation

If a policyholder believes that a policy is no longer needed or cannot be continued, he or she can cancel the policy at any time. For a policy for which premiums are paid monthly, premium amounts corresponding to the period up to the end of the month of cancelation will be collected. In other words, if you have already paid for the current month, no refund for premiums corresponding to the rest of the current month will be received.

With a policy that has a savings component, a surrender value will be paid. With a coverage-providing policy, the provisions of death coverage and other guarantees means that the amount of the surrender value will normally be less than the sum of premium amounts paid to date. Also, cancelation will result in the provisions of no subsequent coverage. For these reasons, a life insurance

company will offer advice to make it possible to continue a policy, such as by reducing benefit amounts, reducing premiums, or extending a policyholder loan if funds are temporarily needed by the policyholder.

What should be kept in mind is that there may be variable annuity insurance plans and other such options that can be purchased. These products are sometimes sold by highlighting the fact that they offer a minimum guarantee; for example, the total annuity amount will never fall below the total amount of premiums paid provided that such a product is continued until the annuity premium payments are completed. Even for such products, cancelation of the policy before it expires will render invalid any minimum guarantee that may have been promised, such that the money you get back could fall far short of the total premiums paid if market prices were to fall.

4 Paying claims

(1) Handling claims

In order to make a claim for a death benefit, you will need to submit the death certificate and certificate of residence of the insured, an extract from the family register of the beneficiary, and other documents along with the insurance company's prescribed claim form. For a normal death insurance policy, the mere fact of death is sufficient to have the benefit paid. However, if there are grounds for nonpayment, the life insurance company will refuse to pay after looking into the matter. The process by which this investigation is conducted and a decision is made to accept or refuse payment is known as a payment assessment.

One reason for refusing to pay is a breach of the duty to disclose at the time of enrolment. If there is a connection between the matter that was not disclosed or matter that was inaccurately disclosed and the cause of death, no benefit will be paid. In addition, no claim will be paid if the insured commits suicide within three years of enrolment or where a serious event occurs. See Chapter 2-II for an explanation of these points.

(2) Payment deadline

The deadline for the payment of a claim is normally five business days after the claim form is received by the insurance company in the event that no investigation is necessary. In addition, policy provisions also stipulate that a claim should, in principle, be paid within forty-five days even in the event that an investigation is needed to determine whether payment can be made following

a breach of the duty to disclose or the cancelation of the policy due to a serious event.

Policy provisions also state that payment shall be made within 180 days where the death of the insured is investigated as a criminal matter.

In principle, insurance money is paid with interest for any delay in payment beyond the deadline for payment.

V. Asset management system

Along with underwriting, asset management is another pillar of the business of life insurance companies. In this section, I will explain matters related to the system of asset management.

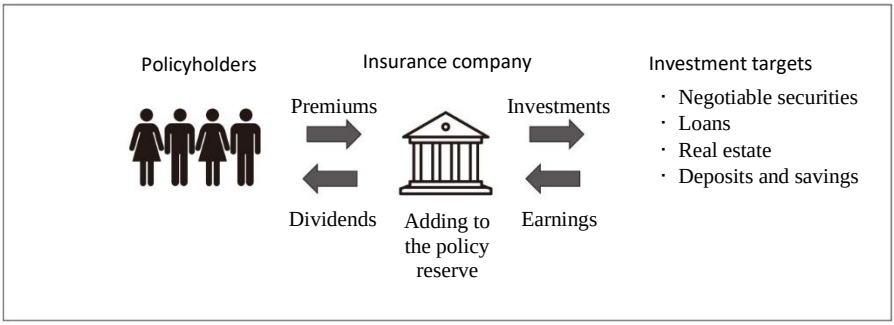
1 Why are asset-management operations necessary?

As explained earlier, a modern life insurance company that is using the level premiums method needs to accumulate a policy reserve in anticipation of paying future claims. Premiums are set forth on the assumption that the assets comprising the policy reserve are invested at a certain rate of interest. For this reason, a failure to invest assets at an assumed rate of interest will render it impossible to pay future claims.

In addition, if investments yield greater earnings than expected with the assumed interest rate for a policy that pays out dividends whenever investment performance is good, then a dividend can be paid out to the policyholder (Figure 14).

It is for these reasons that asset management is undertaken.

Figure 14 **Asset management by insurance companies**



2 An insurance company's stance on investment

A life insurance company will manage assets upon taking into account safety, profitability, liquidity, and the public interest. Asset management is undertaken by a life insurance company in order to pay future claims. For this reason,

investments with inappropriately high levels of risk should not be made. Yet, simply placing assets in a deposit account to generate sufficient investment earnings is problematic as profitability needs to be ensured. In addition, liquidity must also be achieved by ensuring that a portion of assets is invested in cash equivalents and short-term maturing assets as a way to prepare for claims that will be made.

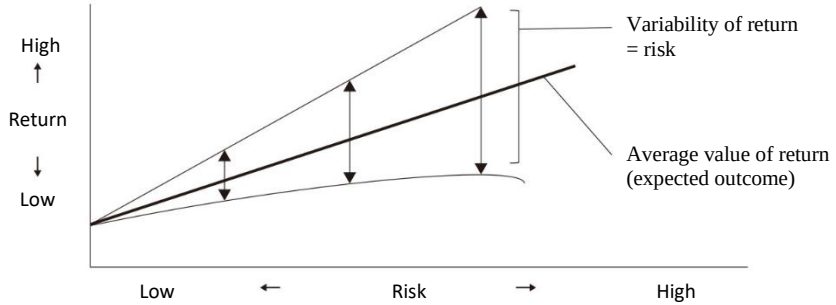
Finally, investments should be consistent with the public interest and are expected to contribute to society and industrial development. In this connection, the concept of ESG investments has emerged in recent years.

I will talk about ESG investments in Chapter 5-II.

3 Investment management system

The investment asset structure of a life insurance company is called a portfolio. When making investments, you need to consider risks and returns in light of the characteristics of the liabilities - in other words, the policy reserves – and determine how investments shall be made accordingly. *Returns* consist of the interest and dividends earned on an investment in an investment target as well as any gains obtained from an increase in the value of the investment target. As stated at the beginning of this book, *risk* is the increase or decrease in the actual return relative to the expected return. While a situation in which the actual return is greater than the expected return is also referred to as risk, risk mainly refers to a situation in which there is a failure to attain the expected return (Figure 15: reproduction of Figure 1 from Chapter 1).

Figure 15 **Risks associated with and returns on investment instruments (reproduced)**



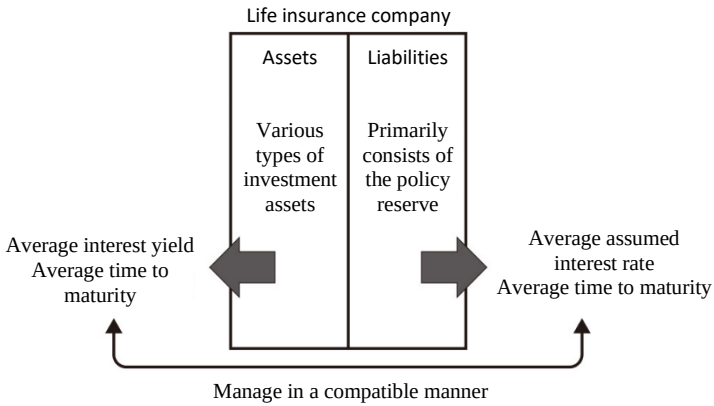
Generally speaking, investment targets with low levels of return and risk include savings accounts and national government bonds. Likewise, foreign shares are, generally speaking, an example of an investment target with high levels of return and risk.

Asset/liability management (ALM) **Column 29**

One of the concepts underlying the investment strategy followed by life insurance companies is ALM. This involves asset management based on liability-side characteristics with a focus on investment periods and returns that match these characteristics.

The liabilities of a life insurance company consist of reserves for life insurance policies – in other words, policy reserves. Assumed interest rates and fixed terms are set forth for life insurance policies included in a policy reserve. Assets should be invested to ensure that assumed interest rates and terms match (see the figure).

● Illustration of ALM



However, given that there are life insurance policies, such as whole-life insurance policies, with long residual terms as well as some past life insurance policies that have had high assumed rates of interests, ALM is not, in a nutshell, something that is easy to implement.

A life insurance company determines what investments it shall make by taking into account premium income as well as disbursements for insurance

claims and business expenses each year. The section carrying out a distribution of assets or the board of directors will decide on the amount to be invested and the investment term for each asset. The section in charge of each investment asset will then decide on specific investment targets, such as shares or bonds tied to a certain company and the amount to be invested.

4 Investment review system

The internal system of investment is one that includes a section that actually makes investment decisions (front office) and a section that engages in trading activities and administrative affairs (back office). In addition, there is also a section tasked with managing investment risks (middle office).

The middle office examines the credit risks (such as the risk that the investment target will be unable to pay interest) and market risks (such as the risk that the share price will fall) associated with each investment target.

If a loan is made, the company's financial situation will be examined to assess the ability of the company to repay the loan. A given section will examine creditworthiness for loans while a different section will examine the appropriateness of investing in marketable investment products, such as shares and company bonds. This is done since there is a possibility that the loans department will have access to inside information concerning the borrower; trading market assets like shares based on certain inside information that has not yet been publicly disclosed is banned under the Financial Instruments and Exchange Act.

5 General accounts and special accounts

Assets deposited with a life insurance company by policyholders are invested in a general account or special account. A general account is meant for the assets of all common insurance products and is an account for investing the assets of insurance products for which a certain assumed rate of interest has been guaranteed to the policyholder.

The other type of account consists of a special account, which is an account for investing the assets of insurance products for which insurance money, the surrender value to be paid, and other amounts are variable in accordance with investment performance.

For example, a variable annuity insurance plan is insurance for which the annuity amount and surrender value fluctuate depending on investment

performance. The pension resources of policyholders are invested through a special account.

In addition, the assets of company pensions with special account riders are likewise invested through a special account.

For most variable annuity insurance plans, assets are invested into investment trusts that are managed as special accounts. In other words, the portion of premiums paid by a policyholder that is allocated to resources for the payment of an annuity will be invested into investment trusts selected by the policyholder.

Generally speaking, several types of investment trusts that vary according to investment target will be made available; examples include an investment trust for investing in Japanese shares, an investment trust for investing in Japanese bonds, an investment trust for investing in overseas shares, and an investment trust for investing in overseas bonds. A policyholder will select an investment trust from among these options for the investment of his or her own pension resource. After an investment commences, a policyholder can switch special accounts (investment trusts) at his or her own discretion while keeping an eye on trends in the economy and in financial markets.

VI. Investment assets

In this section, I will explain what is entailed by asset management practices carried out by life insurance companies, including with respect to assets subject to investment.

1 Total assets

Figure 16 shows changes in the total assets of all life insurance companies over the last ten years. Figure 17 on the following page states changes in the ratio of investment assets to total assets over the same time period. These figures include figures for Japan Post Insurance, which was privatized in 2007.

In looking at these changes over a ten-year period, we see that the amount of total assets steadily increased each year with the exception of fiscal year 2015. Over the course of this ten-year period, total assets rose by approximately 70 trillion yen.

In terms of the percentage of total assets, negotiable securities accounted for 77.3% of total assets in fiscal year 2010; this figure increased to 81.9% in fiscal year 2019.

Figure 16 **Total assets of all life insurance companies and balances by type of investment asset**

(unit: x 100 million yen)

	Cash and deposits	Call loans	Monetary trusts	Negotiable securities	Loans	Tangible fixed assets	Other	Total assets
FY 2010	56,559	20,096	20,711	2,479,809	438,771	67,729	123,232	3,206,911
FY 2011	35,155	25,093	20,144	2,575,603	421,738	66,011	125,782	3,629,538
FY 2012	35,749	27,668	20,599	2,782,448	402,446	64,600	116,468	3,449,981
FY 2013	44,167	26,697	24,591	2,850,317	380,992	63,199	115,860	3,505,826
FY 2014	56,080	36,729	33,325	2,994,295	368,103	63,294	120,723	3,672,552
FY 2015	74,584	12,809	37,013	3,005,235	349,869	62,504	129,663	3,671,678
FY 2016	75,349	12,010	45,438	3,097,144	340,714	61,243	123,141	3,755,051
FY 2017	80,295	15,941	55,907	3,137,466	329,731	60,929	132,478	3,812,751
FY 2018	89,949	16,549	61,714	3,203,095	318,785	61,560	126,290	3,877,945
FY 2019	105,322	21,087	69,991	3,218,383	301,986	61,623	148,956	3,927,350

Source: “2020 Life Insurance Trends”, The Life Insurance Association of Japan

Figure 17 **Percentage of the total assets of all life insurance companies accounted for by each type of investment asset**

(unit: %)

	Cash and deposits	Call loans	Monetary trusts	Negotiable securities	Loans	Tangible fixed assets	Other	Total assets
FY 2010	1.8	0.6	0.6	77.3	13.7	2.1	3.8	100.0
FY 2011	1.1	0.8	0.6	78.8	12.9	2.0	3.8	100.0
FY 2012	1.0	0.8	0.6	80.7	11.7	1.9	3.4	100.0
FY 2013	1.3	0.8	0.7	81.3	10.9	1.8	3.3	100.0
FY 2014	1.5	1.0	0.9	81.5	10.0	1.7	3.3	100.0
FY 2015	2.0	0.3	1.0	81.8	9.5	1.7	3.5	100.0
FY 2016	2.0	0.3	1.2	82.5	9.1	1.6	3.3	100.0
FY 2017	2.1	0.4	1.5	82.3	8.6	1.6	3.5	100.0
FY 2018	2.3	0.4	1.6	82.6	8.2	1.6	3.3	100.0
FY 2019	2.7	0.5	1.8	81.9	7.7	1.6	3.8	100.0

Source: Same as for Figure 16 hereof.

On the other hand, loans, which traditionally constituted a pillar of asset management, went from accounting for 13.7% of total assets to 7.7%.

Moreover, life insurance companies might be associated with blue-chip buildings located in front of train stations but tangible fixed assets, including real estate, have fallen to account for a mere 1.6% of total assets.

2 Negotiable securities

Let us take a look at a breakdown of negotiable securities, which account for over 80% of the total assets of life insurance companies.

(1) Public and company bonds

Figure 18 on the following page reveals that national government bonds are the most common type of negotiable securities and account for nearly half of the total. A national government bond is a bond certificate that is issued by the state and that pays interest and principal. Interest is paid semiannually while the principal is redeemed at maturity. However, only discount national government bonds are issued at a price that is below face value and are redeemed at face value at maturity without any payment of interest made prior to maturity.

Figure 18 **Breakdown of negotiable securities of all life insurance companies**

(Unit: x 100 million yen)

	National government bonds		Local government bonds		Company bonds		Company shares	
	Amount	Composition ratio	Amount	Composition ratio	Amount	Composition ratio	Amount	Composition ratio
FY 2010	1,323,987	53.4	119,164	4.8	252,835	10.2	162,149	6.5
FY 2011	1,412,757	54.9	131,630	5.1	253,429	9.8	147,444	5.7
FY 2012	1,487,692	53.5	139,346	5.0	251,551	9.0	167,256	6.0
FY 2013	1,498,157	52.6	140,089	4.9	248,959	8.7	180,209	6.3
FY 2014	1,487,617	49.7	138,686	5.0	248,553	9.0	226,979	8.0
FY 2015	1,485,684	49.4	135,178	4.5	253,634	8.4	198,130	6.6
FY 2016	1,485,538	48.0	129,821	4.2	258,242	8.3	215,146	6.9
FY 2017	1,473,650	47.0	120,817	3.9	261,876	8.3	231,820	7.4
FY 2018	1,482,230	46.3	109,400	3.4	271,082	8.5	217,827	6.8
FY 2019	1,512,024	47.0	101,342	3.1	283,830	8.8	187,661	5.8

(Unit: x 100 million yen)

	Foreign securities		Other securities		Total
	Amount	Composition ratio	Amount	Composition ratio	Amount
FY 2010	457,384	18.4	164,288	6.6	2,479,809
FY 2011	469,267	18.2	161,074	6.3	2,575,603
FY 2012	559,864	20.1	176,735	6.4	2,782,448
FY 2013	614,509	21.6	168,303	5.9	2,850,317
FY 2014	732,804	24.5	159,754	5.3	2,994,295
FY 2015	786,531	26.2	146,074	4.9	3,005,235
FY 2016	851,974	27.5	156,421	5.1	3,097,144
FY 2017	889,987	28.4	159,314	5.1	3,137,466
FY 2018	965,262	30.1	157,290	4.9	3,203,095
FY 2019	981,283	30.5	152,239	4.7	3,218,383

Source: Same as for Figure 16 hereof.

A bond certificate in this context is a certificate that is issued when borrowing money (negotiable security) and can generally be sold in the market without the consent of the debtor (the national government in this case) and without having to notify the debtor.

National government bonds are the most common investment target for life insurance companies, but the amount invested in national government bonds peaked in fiscal year 2013 and has been declining ever since. The percentage of negotiable securities that they account for has also decreased to 47.0%. This is connected to the Bank of Japan's monetary easing policy known as quantitative and qualitative monetary easing, which has been in effect since 2013 and which has resulted in the purchase of national government bonds. This is believed to be because their appeal as an investment target and the quantity of national government bonds available for purchase decline as interest rates go down. Incidentally, the Bank of Japan now holds more than 500 trillion yen in national government bonds.

Local government bonds constitute debt obligations incurred by local governments to procure funds needed for financial administration from outside sources. In principle, local government bonds can only be issued to procure funds to finance the expenses of public enterprises (such as transit, gas, and waterworks) and public-sector construction projects.

The amount invested in local government bonds also peaked in fiscal year 2013 and has been declining ever since. In recent years, the percentage of negotiable securities that they account for has decreased to 3.1%.

National government bonds, local government bonds, and company bonds are collectively referred to as *public and company bonds.* For a company bond, a company issues a certificate (negotiable security) after funds are solicited from an investor in order to procure funds. The repayment date and interest rate are stated on a company bond, which serves as a written acknowledgement of debt issued by a company to an investor.

Company bonds were on the decline for a time in terms of investment amount but have rebounded in recent years.

Rather than being issued in a physical form, bonds are now issued electronically as a proof of rights, which can be transferred with the transfer of electronic data.

(2) Shares

Shares are certificates issued by a joint-stock company in exchange for funds procured from shareholders. They differ from company bonds in that shareholders, by providing funds, gain the right to obtain a portion of profit earned by the company in the form of dividends or an increase in the share price. With bonds, no matter how much profit a joint-stock company makes, you can only receive a set amount of interest and principal payments. Conversely, even if a joint-stock company fails to generate profits, a holder of company bonds will still be entitled to receive interest and principal payments.

Securities exchanges establish trading markets for shares (stock markets). Listing shares on a stock market allows them to be freely bought and sold by ordinary investors. A listed company is obligated to disclose information on the company both at the time shares are listed and on an ongoing basis.

Life insurance companies invest in listed companies and in unlisted shares that are promising in hopes of profiting from the listing of shares. Investments in shares have increased slightly over the last ten years in terms of monetary amount and declined slightly in terms of percentage.

However, considering that the Nikkei Average sank to its lowest level since the bursting of the bubble at around 7,000 yen in the fiscal year ended in March 2009, the increase in investment amount to this level means that life insurance companies have not made new investments in shares to a substantial extent.

Incidentally, life insurance companies and other institutional investors that invest in shares are required to comply with the Stewardship Code. At the same time, listed companies in which investments are made are required to comply with the Corporate Governance Code.

Corporate Governance Code and Stewardship Code (principles applicable to "responsible institutional investors") **Column 30**

The Corporate Governance Code is stipulated in the listing rules set forth by the Tokyo Stock Exchange and other stock exchanges as a set of guidelines for how listed companies should be managed.

Thus, this code is applicable to listed companies. Modeled after business administration guidelines enacted in the West, the Corporate Governance Code began to be studied in 2014 and was adopted in June 2015. More recently, it was revised in 2018.

The Corporate Governance Code requires that directors and boards of directors

endeavor to engage in dialogue with shareholders, employees, business partners, and other stakeholders in order to achieve sustainable, highly capital-efficient growth and thereby work to increase the value of the company.

An outline of basic principles in the Code is as follows:

1. A listed company shall take appropriate measures to ensure that the rights of shareholders are effectively ensured and develop an environment in which shareholders are able to properly exercise their rights. In addition, a listed company shall ensure the substantive equality of shareholders. Minority shareholders and foreign shareholders shall be granted due consideration.
2. A listed company shall endeavor to collaborate effectively with employees, clients, business partners, creditors, the local community, and other stakeholders to achieve sustainable growth for the company and generate medium- to long-term corporate value. The board of directors and management shall demonstrate leadership in cultivating a corporate culture and climate.
3. A listed company shall engage in the disclosure of financial information on the company's financial condition and operating results and other non-financial information as mandated by the laws and regulations and the provisions of other types of information. The board of directors shall ensure that information to be accordingly disclosed or provided is highly useful as information for engaging in constructive dialogue with shareholders.
4. In order to improve profitability and capital efficiency, the board of directors shall (1) broadly define the orientation of the company's corporate strategy, (2) develop an environment to support appropriate risk-taking by senior management, and (3) oversee, at a high level of effectiveness, management and directors from an independent and objective standpoint.
5. A listed company shall engage in constructive dialogue with shareholders in settings other than just general meetings of shareholders. Senior management and directors (including outside directors) shall listen to shareholders through such dialogue and explain their own management policy to shareholders clearly in an easy-to-understand manner to obtain the understanding of shareholders.

In brief, a listed company shall develop an environment that allows shareholders, as the providers of capital, to exercise their rights with ease. In particular, an environment that would allow minority shareholders and others who normally do not have much say in the affairs of management to easily exercise their rights should be maintained. On the other hand, collaboration with stakeholders who form the basis for the realization of corporate value – such as business partners, the local community, and employees – shall be promoted based on efforts to strike a balance with shareholder rights. In addition, the timely and appropriate disclosure of information shall be undertaken with a view to securing the trust of the capital markets and protecting investors. The appropriate disclosure of non-financial information, such as with information concerning risk and governance in particular and matters concerning environmental issues, is also required.

While management stands at the center of company activities carried out for the fulfilment of these principles, the board of directors should present major management strategies and carry out effective oversight of management. Finally,

dialogue with shareholders is done in response to the Stewardship Code, which will be explained below. It is a principle that a company should engage in constructive dialogue with shareholders in settings other than just general meetings of shareholders.

That each company should appoint at least two independent, outside directors, as I explained at the beginning of this chapter, is stated in this principle. With respect to this point, there are those who have suggested that a listed company that considers it to be appropriate given its size and other factors should have at least one-third of its directors consist of independent, outside directors.

These principles are to be fulfilled by way of the so-called comply-or-explain approach. In other words, appropriate basic principles will be applied based on the company's size and actual situation. Any failure to carry out what is stated in the basic principles shall be indicated and the reasons for such failure should be explained.

The Stewardship Code is a principle meant to be paired with the Corporate Governance Code and was formulated in February 2014 by a panel of experts put together by the Financial Services Agency. It was later revised in May 2017 and March 2020. It is a code that applies to life insurance companies and other institutional investors and consists of principles that are set forth to try and maximize the provisions of medium- to long-term returns to the providers of funds to institutional investors (in other words, clients) through constructive dialogue (engagement) with companies constituting investment targets from the standpoint of the sustainability of these companies and others. By endorsing the Stewardship Code, institutional investors are to implement matters stated in the Code. The Stewardship Code is also subject to a comply-or-explain approach.

The principles are as follows:

1. An institutional investor should formulate and disclose a clear policy to fulfill its stewardship responsibilities.
2. An institutional investor should formulate and disclose a clear policy on conflicts of interest to be managed in fulfilling its stewardship responsibilities.
3. An institutional investor should accurately ascertain the state of companies constituting investment targets in order to appropriately fulfill its stewardship responsibilities in connection with the sustainable growth of such companies.
4. An institutional investor should endeavor to share their awareness of matters with companies constituting investment targets and work to ameliorate issues through constructive "dialogue with a purpose" with such companies.
5. An institutional investor should have a clear policy on the exercise of voting rights and the disclosure of the results of the exercise of these rights and devise ways to promote the sustainable growth of companies constituting investment targets rather than just adhere to formal assessment criteria.
6. An institutional investor should, in principle, provide regular reports to clients and beneficiaries on how its stewardship responsibilities are being fulfilled, including with respect to the exercise of voting rights.

7. An institutional investor should be capable of appropriately making decisions in connection with carrying out dialogue with and stewardship of companies constituting investment targets based on a deep understanding of such companies and their business environment and sustainability considerations that are in line with investment strategies in order to contribute to the sustainable growth of such companies.
8. A provider of services to institutional investors should endeavor to appropriately provide services and help improve the functionality of the entire investment chain as these institutional investors fulfill their stewardship responsibilities.

An outline is as set forth below:

An institutional investor shall decide on an investment policy in maximizing returns to clients. It is on the basis of this policy that it will engage in constructive dialogue with companies constituting investment targets in accordance with an understanding of the business environment in which such companies operate and its thinking on ESG investments (see Chapter 5-II).

In addition, a policy on dealing with any case in which the relationship between an institutional investor and a company constituting an investment target potentially constitutes a conflict of interest with a client needs to be publicly disclosed.

An institutional investor shall also work to identify issues by ascertaining information on companies constituting investment targets and resolve such issues through dialogue with such companies. It must also have an appropriate policy for exercising voting rights at general meetings of shareholders.

An institutional investor shall also explain to clients how it is fulfilling its stewardship responsibilities.

The Corporate Governance Code is slated to be revised again in April 2022, with June 2021 as the base date for this purpose.

(3) Foreign securities

In general, foreign securities refer to non-yen-denominated public and company bonds and shares held overseas. Examples of investment targets include U.S.-dollar-denominated or euro-denominated bonds, U.S. shares, European shares, and shares in companies based in emerging markets.

Over the past ten years, foreign securities have doubled in terms of investment amount and nearly doubled in terms of percentage.

Investments in foreign securities increased when domestic securities lost their appeal as investment targets due to a zero-interest rate policy in Japan, while in contrast foreign interest rates could be expected to stay above a certain level. In addition, some believe that investing only in Japan means that risk diversification is inadequate and that risks should be diversified regionally across countries.

When it comes to foreign securities, however, there is a need to assess the extent of risks pertaining to a given country or company as well as country-specific and currency-specific risks; this process can be more difficult than it is for domestic investments.

Given the ongoing severity of the investment environment in Japan, opportunities to invest in foreign securities will need to continue to be seized with precision. From this perspective, focus is currently being placed on infrastructure investments.

Chapter 5: Latest developments in the life insurance business

In Chapter 5, I will first look at changes in the environment surrounding the life insurance industry.

The column in this chapter will explore dementia insurance and long-term care insurance.

I will also shed light on SDG-based management, a new movement being promoted in the area of management.

In addition, I will explain the client-oriented principle that constitutes a new regulatory approach for life insurance companies.

Furthermore, the current state of and outlook for the latest in ICT innovations in the life insurance industry will be discussed.

I. Changes in the environment surrounding the life insurance industry

In this section, I will first present an overview of the environment surrounding the life insurance industry as it has evolved to this day. I will proceed by looking at (1) the law and regulations, (2) the economic environment, and (3) the demographic structure.

1 The law and regulations

In this section (Section 1), I will quickly review matters that have been discussed up to this point in this book.

The life insurance industry was substantially reformed with the enactment of the amended Insurance Business Act in 1995. This statute induced significant progress in terms of regulatory reforms designed to ensure the operational and financial soundness of insurance companies, and also allowed both life insurance companies and non-life insurance companies to enter each other's domain through subsidiaries. This statutory reform gave rise to the establishment of a succession of life insurance companies as subsidiaries of non-life insurance companies, thereby increasing the number of life insurance companies seemingly at once.

Subsequently, beginning in 1997, we saw an increase in foreign participation through the acquisition of failed life insurance companies. There are now many types of life insurance companies operating in Japan, including life insurance companies specializing in over-the-counter products that were established once the ban on over-the-counter sales of insurance at banks was fully lifted, life insurance companies specializing in online sales made possible by the spread of the Internet, life insurance companies catering to corporate clients, and life insurance companies primarily dealing with products for independent agencies. The number of life insurance companies stayed at around thirty until 1996 but has now increased to forty-two in total (as of February 2021).

In terms of sales channels, independent agencies came to be allowed under the amended Insurance Business Act of 1995; this triggered an expansion of large-scale independent agencies that has been underway since 2000.

Starting in 2001, we have seen the ban on over-the-counter sales at banks progressively lifted. The ban on the selling of individual annuity insurance was lifted in October 2002. This led to the substantial presence of banks in the

industry through the selling of savings-type and investment-type products. Later, the ban on single-premium whole life insurance policies and other products was lifted in December 2005. The ban on the selling of all products was lifted in December 2007 after a two-year monitoring period.

In terms of products, life insurance companies came to be expressly permitted to underwrite not just life insurance but also third-sector insurance products under the amended Insurance Business Act of 1995. Due in part to the impact of U.S.-Japan talks on insurance, however, life insurance companies were not authorized to offer stand-alone medical insurance plans, cancer insurance plans, and other examples of third-sector insurance products. Later, in 2001, the ban on the selling of third-sector insurance products was lifted for major life insurance companies and the life insurance subsidiaries of non-life insurance companies.

The latest developments concerning statutes and regulations that we should take note of include (1) the improved quality of the operations of life insurance companies and insurance solicitors through client-oriented business operations and (2) the enactment of the new Financial Service Intermediary Act. These matters will be discussed in III below.

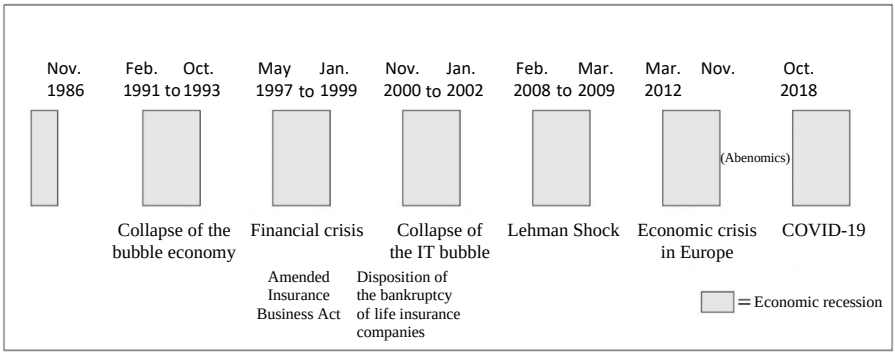
2 Economic environment

(1) Formation of the bubble economy

In this section, I will broadly review the economic environment since the beginning of the Heisei era (1989-2019.4) prior to the onset of the Reiwa era (2019.5-) (see Figure 1 on the following page for economic developments). 1989, when the Heisei era began, coincided with the peak of the bubble economy. The Nikkei average reached 38,957 yen at the end of that year. What led to this bubble economy in the first place was the Plaza Accord of 1985, an international agreement among five leading industrialized economies. This agreement set forth a policy to devalue the U.S. dollar, whereupon the yen rose in value against the dollar at the same time. Consequently, Japanese companies suffered from a recession induced by a strong yen.

In this connection, the Bank of Japan adopted a low interest rate policy to supply money to the market in response to the recession that was induced by a strong yen. However, this caused surplus funds to pool in the market. As companies recovered in terms of their performance, money came to be concentrated in land and shares, thereby creating a bubble.

Figure 1 **Economic trends as based on a representative diffusion index (CI coincident index)**



Source: Produced by the author based on press releases and other reference sources

(2) Collapse of the bubble economy and the lost decade

Share prices began to decline from the beginning of 1990. It may be hard to fathom now but the myth of land was a deeply rooted one until the bubble era, such that people believed that even land that was not being used productively would increase in value just by owning it. What turned this myth completely on its head was the collapse of the bubble economy.

Economic growth since then has been stagnant enough to give rise to the term the *lost decade* or the *two lost decades*. Such long-term economic stagnation has also been recently observed in overseas markets as well. A combination of conditions marked by low growth, low interest rates, and low rates of inflation is known in some quarters as *Japanization.* During the lost decade (or two), only Japan appears to have been left behind as it continues to wrestle with the impact of the collapse of its bubble economy even as other developed nations managed to secure a certain level of growth and emerging countries, particularly in Asia, continued to grow to a considerable degree.

Against this backdrop, it is also said that Japan entered a period of demographic "onus" at the start of the 1990s. While the word *onus* is perhaps unfamiliar to some readers, it is an antonym of *bonus* and means *burden.* Thus, a period of demographic onus refers to a period in which the working-age population (aged 15 to 64 years) declines and economic development slows down.

A period of demographic bonus, which is when the working-age population increases, may be one in which economic growth might occur in an organic

manner. In contrast, a period of demographic onus is one in which the economy inevitably stagnates in the absence of some kind of economic reform or breakthrough.

(3) Deterioration in the state of the management of financial institutions

After the collapse of the bubble economy, financial institutions that had been lending money backed by land suffered from bad loans. Just as the management of companies that had borrowed money worsened, the prices of land that had been used as collateral also declined.

Securities companies also sought to compensate companies with which they had a close relationship and to whom they had sold shares for losses caused by the fall in share prices (compensating for losses was not expressly against the law at the time). In addition, they also engaged in a practice known as *shuffling*, whereby they would shift shares with unrealized losses held by a company with which they had a close relationship to a different company with which they had a close relationship after promising that they would compensate for any losses. It was through these actions that the management of securities companies took a wrong turn.

Life insurance companies too suffered when it came to the management of savings-type products with high assumed rates of interest that were sold during the bubble era.

(4) The failure and rehabilitation of financial institutions

As the crisis continued to affect the financial industry, public funds were injected into housing loan companies in 1995. These companies specialized in housing loans, but they also provided corporate loans as a separate unit of banks and other financial institutions. If these housing loan companies were allowed to fail, the impact of their failure would have spread to the financial institutions that had lent funds to them, which is why public funds were extended to allow for a soft landing. Yet, there was public debate around the question of why housing loan companies, which were not even banks, had to be saved. It has been pointed out that this ended up causing a delay in carrying out the primary objective of the government, which was the injection of public funds into banks dealing with financial difficulties at the time.

In 1997, Yamaichi Securities, one of the four big securities firms at the time,

and city bank Hokkaido Takushoku Bank, went under. Turmoil continued thereafter, such as with the collapse of the Long-Term Credit Bank of Japan. Public funds were finally injected into fifteen major banks in 1999.

Nissan Life Insurance went bankrupt in 1997 and a total of seven life insurance companies failed in the period leading up to 2001. When a life insurance company failed, it would try to reduce policy reserves, lower assumed interest rates, and, if this were still not enough to restructure effectively, receive financial assistance from the Life Insurance Policyholders Protection Corporation of Japan, an entity to which funds are contributed by members of the life insurance industry (see Chapter 1-V-5). In the life insurance industry, financial assistance was extended using only funds provided by life insurance companies. Tax-funded public money was never used for this purpose.

Amid such economic tumult, students found it difficult to find post-graduation jobs. The emergence of a generation that underwent an employment ice age continues to be felt as a problem to this day.

(5) Recovery from financial turmoil

The 1990s were an era of financial turmoil but nevertheless the economy began to grow from around February 2002, which then led to an extended period of growth known as the Izanami Boom. In 2008, the Lehman Shock caused the economy to falter momentarily before the Great East Japan Earthquake struck in 2011. In 2012, the second Shinzo Abe administration was formed. Long-term economic growth continued thanks to quantitative and qualitative monetary easing by the Bank of Japan.

Global economic stagnation attributed to the emergence of COVID-19 began at the time of the writing of this book. Declarations of a state of emergency made between April and May 2020 and between January and March 2021 worsened the state of the economy. COVID-19 spread worldwide and had a huge impact on tourism and trade. Since the last state of emergency was lifted, economic activities have been resumed with people continuing to maintain social distancing practices that are emblematic of what it means to live with COVID-19.

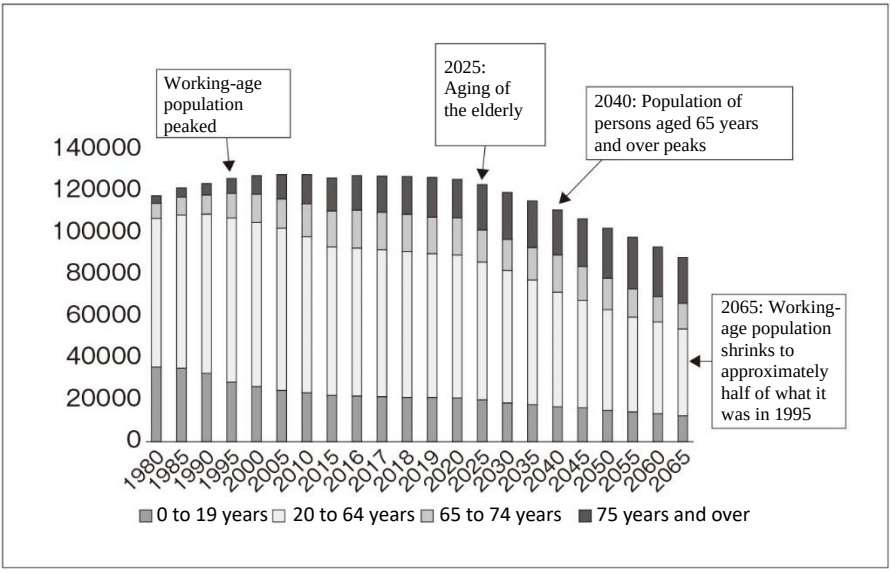
3 Demographic changes

(1) Population changes by age bracket

Japan's population continued to increase over the approximately 72 million people that were alive in the country at the end of the Second World War to a peak of 128.08 million in 2008. The birthrate (total fertility rate; see (2) for more information) exceeded two during the second baby boom of the 1970s but had already declined to 1.57 by 1989. In other words, the increase in the population up to 2008 is likely due to an increase in average life expectancy rather than to an increase in the number of children.

According to population estimates provided by the Ministry of Internal Affairs and Communications' Statistics Bureau, the population of the country in 2020 was 125.81 million. According to the National Institute of Population and Social Security Research, the population is expected to fall below 100 million to 99.24 million in 2053, and decline to 88.08 million in 2065 (Figure 2).

Figure 2 **Demographic changes by age bracket**



Source: "Demographic Dataset (revised in 2017)", National Institute of Population and Social Security Research; annotations added by the author

Generally speaking, the generation that earns money – in other words, the working-age population of people between the ages of 15 and 64 years – peaked at 87.16 million in 1995. It will have declined to 68.41 million in 2020. This

trend will continue apace, such that the working-age population is expected to shrink to 45.29 million by 2065.

(2) A dwindling birthrate and aging population

Let us examine Japan's dwindling birthrate and aging population. First, our aging population is the result of average life expectancy continuing to increase. In 1990 at the outset of the Heisei era, average life expectancy was 75.92 years for men and 81.90 years for women. In 2018, it increased by more than five years to 81.25 years for men and by more than six years to 87.32 years for women. In recent years, it has continued to increase from one year to the next, with average life expectancy increasing by 0.16 years for men and 0.06 years for women from 2017 to 2018.

In 2020, the population of people between the ages of 65 and 74 years will be 17.47 million (13.9% of the total population; same hereinafter) and people 75 years of age and over will be 18.72 million (14.9%). Compare these numbers with those corresponding to 1990, when there were 8.92 million people (7.2%) who were between the ages of 65 and 74 years and 5.97 million people (4.8%) who were 75 years of age and over. The number of elderly persons and the percentage of the total population that they collectively account for are higher by approximately 2.4 times.

On the other hand, as we shall see here, the birthrate is dwindling. We normally look at the total fertility rate to glean birthrate trends. The total fertility rate is the sum of birthrates by age for women between the ages of 15 and 49 and equals the number of children to whom each woman will give birth in her lifetime.

The total fertility rate fell to 1.26 in 2005 but thereafter recovered slightly to 1.46 in 2015 after measures to combat a declining birthrate were implemented.

The total fertility rate declined to 1.42 in 2018 and 1.36 in 2019 (with 865,000 births in that year). In general terms, only 1.36 children will be born to each couple, which means that the population will naturally shrink. It has also been reported that the number of pregnancies that were notified in 2020 declined, perhaps due to the tendency on the part of many people to put off childbirth in response to COVID-19.

The decline in the birthrate is also tied to the increase in the rate of people who remain unmarried. The rate of people who do not get married at any point in their lives (percentage of people who do not get married even once at any

point in time up to their fiftieth birthday) is approximately 26% for men and approximately 17% for women in 2020. These figures were 5.57% for men and 4.33% for women in 1990.

In 2020, there were 20.72 million minors (0 to 19 years of age) (16.5% of the total population). Incidentally, the age of majority will be lowered to 18 years in 2022; however, this will not be taken into account for this discussion. In comparing this figure once again to figures corresponding to 1990, we see that there were 32.49 million minors (0 to 19 years of age) (26.3% of the total population). Both the number and rate of minors today have declined by a third over the last three decades.

(3) Aging of the elderly

Looking to the future, we see that there are two problems that are expected to come up with respect to aging; these are commonly referred to as the 2025 problem and the 2035 problem. The 2025 problem is in reference to the timing at which those who belong to the first baby-boom generation – those who were born between 1947 and 1949 – will be over 75 years of age.

In 2025, there will be 14.97 million people between the ages of 65 and 74 years (12.2% of the total population) and 21.80 million people over the age of 75 years (17.8% of the total population); the so-called "aging of the elderly" will be well underway at that time.

The 2035 problem is in reference to the timing at which those who belong to the second baby-boom generation – those who were born between 1971 and 1974 – will turn 65 years of age. In that year, there will be 15.21 million people between the ages of 65 and 74 (13.2% of the total population) and 22.59 million people over the age of 75 (19.6% of the total population); the elderly population will account for around one-third of the total population. The looming 2040 problem refers to the timing at which the population of those who are 65 years of age or over will reach its peak and 1.5 persons will end up having to support one elderly person.

Let us turn our attention to the declining birthrate. It is expected that there will be 19.42 million minors (0 to 19 years of age) (15.9% of the total population) in 2025 and 17.23 million minors (15.0% of the total population) in 2035. The number of women of childbearing age is already decreasing, such that, together with the reduction in the birthrate, the number of children is expected to continue declining.

4 Impact of a dwindling birthrate and aging population on the life insurance industry

The standard household in which the husband works and the wife raises two children as a homemaker, which is the premise on which the system of social security was designed, is already no longer the norm. Even where households conform to this structure, the rate of female employment has increased over the years. Some women use the parental leave system to remain regular employees of whatever company they joined as new graduates while others return to work in a non-regular capacity of some sort. In any case, while the need for death coverage for household heads remains unchanged, it is thought that the amount of coverage for household heads has gone down compared to before.

Instead, the need for third-sector products like medical insurance and insurance products for oneself in preparation for a super-aging society, such as dementia insurance and long-term care insurance, is on the rise.

Dementia insurance and long-term care insurance **Column 31**

Dementia insurance is, in general terms, a product that pays out insurance money when the insured is certified as having dementia. In addition to a diagnosis made by a doctor, certification in this sense may also require a CT scan or other type of imaging test. Alternatively, a claim might be paid subject to both a diagnosis of dementia and a long-term care certification under the long-term care insurance scheme. With some dementia insurance policies, the policy will be voided if a diagnosis of dementia is made within a certain period after enrolment (between 90 days and 1 year), such that the policy will be deemed to have never been in force from the beginning. In such a case, premiums will be refunded. Some policies will provide coverage not just for a confirmed diagnosis of dementia but also for a confirmed diagnosis of mild dementia, death, bone fractures, and more.

Dementia insurance consists of fixed-term and whole-life plans. Premiums for whole-life plans are high. A point that needs to be considered when designing dementia insurance is the fact that the insured himself or herself needs to submit a claim when he or she develops dementia. However, it is difficult for someone with severe symptoms of dementia to make a claim.

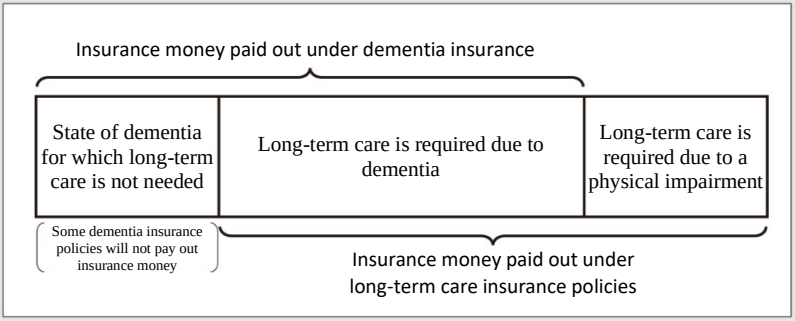
In this connection, dementia insurance is handled to allow a person other than the insured to submit a claim subject to the condition that a claim representative be designated at the time of enrolment.

On the other hand, private long-term care insurance generally pays out insurance money when the insured is assessed as requiring long-term care under the public

long-term care insurance scheme (for example, long-term care level 2 or above). For some products, assessments are made according to the insurance company's own criteria in a manner that is independent of any assessment made under the public long-term care insurance scheme. The public long-term care insurance scheme also provides for payouts of insurance money in cases not involving dementia, such as when a person's lower body has declined in terms of strength.

Dementia refers to the presentation of symptoms of cognitive impairment brought about by certain illnesses. Whether or not dementia impedes daily life varies from person to person, such that a person will not necessarily be assessed as requiring long-term care.

Conversely, there may be cases in which an individual does not have dementia but will still need long-term care due to a physical or mental impairment. Thus, coverage provided by dementia insurance differs from coverage provided by long-term care insurance (see figure).



According to a survey conducted by the Japan Institute of Life Insurance (JILI) (fiscal year 2019), the rate of enrolment in long-term care insurance policies and riders is still low, with 13.0% of men and 11.7% of women taking out such insurance for all life insurance companies (no figures for dementia insurance are available).

As a way to deal with the low birthrate in the country, life insurance products that pay out insurance money for infertility treatments are being sold. Since there is a limit to what private insurance alone can do for this issue, however, it is believed that comprehensive support is needed, including measures to address the increasing age at which people get married these days, support for gainfully employed women, the development of an employment system and leave system that accommodates childcare regardless of the sex of the parent, and the complete elimination of children on waiting lists for admission to preschool institutions.

II. New approach to business administration at life insurance companies

A major management challenge that life insurance companies currently face is the development and implementation of management strategies from the perspective of sustainable development goals (SDGs).

In addition, strategies for making investments and extending loans need to be redeveloped from the standpoint of the environment, society, and governance (ESG).

This section concerns these matters.

1 Sustainable development goals (SDGs)

(1) Societal contributions of companies

It has long been recognized that companies need to make societal contributions. In days of old, it was believed that the foundation of a company's development lay in aligning management with morality and ethics, as reflected in the *Sanpo Yoshi*, a principle that guided the activities of Omi merchants, and explained in Shibusawa Eiichi's *The Analects and the Abacus*.

In recent years as well, such concepts as those of corporate patronage and corporate social responsibility (CSR) have come to be integrated into a company's management strategies. A general consensus has now been reached to the effect that a company needs to make societal contributions while also existing to earn profits.

Sustainable development goals (SDGs) are an example of this movement that can be considered to be groundbreaking on a global scale. They constitute international goals that were set out in the 2030 Agenda for Sustainable Development, which was adopted at a United Nations summit held in September 2015.

SDGs are international goals that aim to achieve a better sustainable world by 2030 through collaborations between public- and private-sector actors. Comprising seventeen goals and 169 targets, SDGs are based on a central promise of *leaving no one behind.* They are universal goals to be pursued by both developing and developed countries together, as well as goals that will be tackled not just by governments but also by entities in the private sector.

In Japan, the SDGs Promotion Headquarters, which is headed by the Prime Minister, was established in May 2016. An SDGs Promotion Roundtable, whose

members consist of experts in the field, was also established under the purview of the Headquarters to proactively work on attaining SDGs.

(2) Aims of SDGs

The significance of SDGs can be found in the way companies, despite differences between countries, emphasize that they are to be managed primarily for the purpose of increasing shareholder value (primacy of shareholders). There is the risk that taking such a short-sighted view could give companies a license to ignore other circumstances that are not directly in their line of sight, such as environmental issues and the issue of poverty in developing countries, as long as they make a profit.

However, if we look at environmental issues as an example, we see that unlimited emissions of carbon dioxide is causing (albeit with some disagreement) average temperatures around the world to rise and abnormal weather conditions to become the norm. These abnormal weather conditions are in turn causing companies to lose production facilities and markets. Thus, managing companies without taking the environment into account is not sustainable. All seventeen sustainable development goals are listed in Figure 3 on the following page.

To address climate change, the Financial Stability Board (FSB), an international organization whose members consist of financial officials from each country around the world, has set up the Task Force on Climate-related Financial Disclosures (TCFD). The TCFD has formulated a declaration on climate change. This declaration is intended to have the financial impact of the risks and opportunities posed by climate change ascertained and disclosed. This declaration entails voluntary participation and disclosure on the part of companies that agree with its aims.

In recent years, the problem of plastic dumping in the ocean has become quite severe. The ingestion of plastic by fish affects people who eat the fish. The mass production of plastic and its adverse consequence as manifested through the dumping of plastic in the ocean are also unsustainable.

Moreover, poverty and human rights in developing countries, which are issues left unaddressed by companies, will ultimately make it difficult for companies to sustainably continue to exist and grow. There are also clear examples of companies based in developed countries that employ children as cheap sources of labor in developing countries.

Figure 3 **The seventeen sustainable development goals (SDGs)**

1: End poverty in all its forms everywhere	*10: Reduce inequality within and among countries*
2: End hunger, achieve food security and improved nutrition and promote sustainable agriculture	*11: Make cities and human settlements inclusive, safe, resilient and sustainable*
3: Ensure healthy lives and promote well-being for all at all ages	*12: Ensure sustainable consumption and production patterns*
4: Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all	*13: Take urgent action to combat climate change and its impacts*
5: Achieve gender equality and empower all women and girls	*14: Conserve and sustainably use the oceans, seas and marine resources for sustainable development*
6: Ensure availability and sustainable management of water and sanitation for all	*15: Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss*
7: Ensure access to affordable, reliable, sustainable and modern energy for all	*16: Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels*
8: Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all	*17: Strengthen the means of implementation and revitalize the Global Partnership for Sustainable Development*
9: Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation	

The cycle of poverty brought about by these circumstances and the existence of disparities between nations and between individuals within nations threaten the lives of people, induce instability in the world, and are not sustainable.

(3) Life insurance companies and SDGs

Life insurance companies also incorporate the concept of SDGs into their management. For example, the Nippon Life Insurance Company has integrated SDGs into their management strategy. Specifically, this company has established eighteen important sustainability challenges and provides progress updates with respect to how they are meeting these challenges each year.

Let me put forth an example. One aim of SDGs is to "ensure healthy lives and promote well-being for all at all ages" (Goal 3).

From this perspective, life insurance companies work hard to engage in management with an emphasis on health. First, a company ensuring the health of employees working for it is an exceedingly important challenge for achieving sustainable growth.

The Nippon Life Insurance Company has enacted a medium-term plan that includes such objectives as a 20% reduction in average monthly overtime hours over fiscal year 2016 and a 70% regular leave utilization rate (Sustainability Report 2020). A non-smoking campaign is also being promoted primarily by health insurance associations.

Health-promoting insurance **Column 32**

The third sustainable development goal aims to ensure healthy lives for all. On this note, I would like to point out that there are health-promoting insurance products that have been developed by life insurance companies in accordance with the concept of promoting the health of clients.

There are many different patterns of such products. One provides a discount on premiums – in other words, cash back – if the results of a medical checkup are submitted. There are two types of such a product: one that requires the submission of results only at the outset of the agreement and another that requires submission of the results once a year.

With these products, a discount is provided upon the submission of a health certificate regardless of the results of the medical checkup. A further discount is offered if the results are favorable. With a product for which results are submitted only at the outset of the policy, there might not be much in the way of a health-promoting effect. For products for which results are submitted annually, a health-promoting effect can be expected but certain issues that a client might have a hard time accepting could emerge in that it can take time and effort to submit checkup results annually and premiums could effectively rise at a later date depending on the results of a checkup.

In addition, there are also products that extend discounts depending on the average number of steps taken per day or that provide discounts on premiums based on the collection of health-related data made possible by the wearing of a smartwatch on the wrist (wearable device) and the conversion of such data into points.

There are also likely to be issues with respect to the calculation of steps and with the ability of the individual to wear a wearable device all day. On this point, companies are developing and providing their own health apps and other tools with which points can be conferred or gifts can be given when a certain amount of exercise is performed.

These products can be criticized for benefiting those who are already conscious of health-related matters and for not really speaking to those who actually need to

be more health-conscious. In any case, these are products that demonstrate that life insurance companies are making an effort that is consistent with the concept of promoting health within the framework of sustainable development goals.

The latter product, which is based on the use of wearable devices, is a type of product known as *insurtech. Insurtech* is a term that combines the words *insurance* and *technology* and refers to what you get by applying information and communication technology (ICT) to the insurance business. This point will be explored in IV hereof.

2 ESG investments

(1) What is an ESG investment?

An ESG investment refers to the policy by which investment companies are selected by taking into account three factors – the environment, society, and governance - whenever an institutional investor makes an investment. Efforts to make ESG investments began before sustainable development goals (SDGs) were recognized. However, as SDGs are a more comprehensive initiative that aims to achieve sustainability, it is believed that ESG investments are often undertaken within a framework consisting of SDGs. The ESG perspective is also reflected in the Stewardship Code. See Chapter 4-VI for more information on this point.

ESG investments are typically undertaken by agreeing with (signing) the Principles for Responsible Investment (PRI) as set forth by the United Nations Environment Programme Finance Initiative (UNEP FI) in 2006. The term *initiative* is perhaps difficult to grasp and there is no suitable Japanese translation, but it refers to voluntary collaborative actions carried out by multiple public-sector and private-sector actors as part of a partnership.

Incidentally, in recent years, we have seen companies and national governments voluntarily participating in and working towards declarations and principles based not on formal laws and treaties but on declarations and announcements of basic principles for the attainment of policy objectives made in domestic and international settings.

Voluntary initiatives taken in accordance with such declarations and principles have a number of advantages. First, they can be pursued independently of any political agenda (and of any conflict between nations in an international sense). In addition, because they are not mandated by law, a company can carry them out to the extent they are capable of doing so. They are

flexible in that companies that are able will be encouraged to voluntarily and creatively undertake higher-level initiatives.

(2) Negative screening and positive screening

As noted above, ESG investments are carried out by signing the Principles for Responsible Investment (PRI) (Figure 4).

The basis of PRI initiatives is negative screening, which means refraining from investing in companies that meet certain criteria. For example, no investment will be made in a company that engages in a business that emits large amounts of carbon dioxide or that otherwise harms the environment.

Furthermore, positive screening – whereby companies that are proactively involved in ESG issues, such as companies that treat environmental and human rights considerations as a basic corporate value and companies that are proactively committed to proper governance, such as by having a majority of their board of directors consist of independent outside directors – are selected as investment targets has also come to be undertaken.

SDGs, ESG investments, and PRI are all concepts that are known by three-letter acronyms. A rough outline of their relationship to one another is provided in Figure 5 on the following page to allow you to better grasp what they mean.

Figure 4 **Principles for Responsible Investment (PRI)**

1. *We will incorporate ESG issues into investment analysis and decision-making processes.*
2. *We will be active owners and incorporate ESG issues into our ownership policies and practices.*
3. *We will seek appropriate disclosure on ESG issues by the entities in which we invest.*
4. *We will promote acceptance and implementation of the Principles within the investment industry.*
5. *We will work together to enhance our effectiveness in implementing the Principles.*
6. *We will each report on our activities and progress towards implementing the Principles.*

Figure 5 **Relationship among SDGs, ESG investments, and PRI**

Sustainable development goals (SDGs)

17 goals, including those addressing human rights issues, environmental issues (TCFD), education, and agriculture

ESG investments (environment, society, governance)
—— PRI (Principles for Responsible Investment)

(3) ESG investments and fiduciary duty

Incidentally, there are some who assert that the exclusion of such companies from the scope of investment or the selection of companies as investment targets according to criteria other than profit will prevent the growth of the stock market from being properly captured. For example, investment funds operate by being entrusted with funds from clients and thus owe a fiduciary duty to investors.

Fiduciary duty will be explained in greater detail below but should be regarded here as the responsibility of an asset management company to maximize the economic return to fund-providing clients (trustees). If this duty applies, the relationship between an ESG investment policy and the fiduciary duty will become problematic if the exclusion of specific companies from the scope of investment pursuant to an ESG investment policy were to be prejudicial to investment performance. This is because, while some studies indicate that the growth rate of companies managed with a focus on ESG exceeds that of companies that are managed without such a focus, this question has not yet been definitively settled.

On this point, the Employee Retirement Income Security Act (ERISA) in the United States has set forth an interpretation of the relationship between the fiduciary duty and ESG investment policies. ERISA is a basic piece of legislation related to corporate pensions in the United States and imposes a fiduciary duty of the managers of corporate employee pensions towards pension beneficiaries (expected beneficiaries). As a fiduciary duty is thus imposed on managers, managers need to invest so as to maximize returns to pension beneficiaries and others.

At one point in time, some interpretations suggested that ESG investment policies could elicit a better investment performance than other investment approaches. Currently (in 2020), the rules have changed to have the monetary return of the trustee prioritized and enable ESG factors to be considered only in the event that the monetary return is insufficient to allow an investment decision to be made. In other words, an investor needs to invest while focusing on both the ESG investment policy and his or her fiduciary duty.

(4) ESG investments in Japan

In Japan, the signing of the PRI by the Government Pension Investment Fund (GPIF), which operates part of the assets held by the country's public pension scheme, in September 2015 represented a major moment of truth. The total assets

of the GPIF amount to 162 trillion yen (fiscal year 2020), the investment of much of which has been entrusted to outside investment management firms. Given this signing, the investment management firms to which investments have been entrusted now need to engage in management activities in accordance with the PRI.

New investment management firms wishing to undertake the outsourcing of investments from the GPIF will be effectively required to sign the PRI as well. For this reason, 85 companies have already signed the PRI in Japan. (Globally, 3,328 companies have signed the PRI as of August 2020.)

III. New regulatory orientation for the insurance industry

Regulation of the insurance industry has undergone significant changes in recent years. This is due to the excessive pace at which socioeconomic conditions have been changing, such as by way of massive developments in the area of ICT, such that the traditional approach to regulating the industry whereby rules would be stipulated by government and complied with by life insurance companies is becoming increasingly ineffective.

In this section, I will be talking about the reformation of the way the insurance industry is being regulated.

1 Overview

(1) Clarifying financial supervisory rules

Until the Insurance Business Act was amended in 1995, the government traditionally controlled the industry by defining a general framework and issuing administrative guidance on very specific points. Regulation at the time was known as the convoy system and was designed to ensure that the industry proceeded at the same pace as the slowest boat (insurance company).

As people then came to call for economic revitalization through deregulation, rules were clarified and a system to enable free competition to flourish under these rules was developed under the amended Insurance Business Act of 1995. In particular, the law aimed to stimulate competition through the codification of rules to ensure financial soundness. This stimulation of competition occurred on the basis of rules by stipulating supervisory regulations applicable to insurance companies and insurance solicitors and allowing competition to play out as long as there was compliance with these rules.

Incidentally, this was a period during which we saw problems with bad loans in the wake of the collapse of the bubble economy and the government issuing instructions on specific aspects of the operations of financial institutions. In addition, the government also developed, in addition to supervisory guidelines, inspection matters setting forth items and content to be checked in the course of conducting on-site inspections of financial institutions. The government also exercised its right of supervision and intervened extensively in the operations of financial institutions.

With respect to the issue of bad loans in particular, the government ranks

borrowers according to the status of borrowers to whom loans have been made, such as those that are sub-performing, those that are in danger of bankruptcy, and those that are substantively bankrupt. There were certain rules in place, such as rules that required an allowance for bad debts to be built up or that prohibited new loans from being made if a borrower dropped in terms of rank. Since borrowers' ranks dropped at the direction of inspectors, some have suggested that such actions led to the downfall of companies.

(2) Limitations of rules-based supervision

On the other hand, it had been pointed out that financial institutions, in order to prevent loans from becoming unrecoverable to them, may have been continuing to lend to companies that should have been allowed to fail at an early stage, thereby allowing so-called zombie companies that should have been culled to survive, which in turn impeded the revitalization of the economy. On this point, it becomes difficult to assess the continuity of a company and to determine the manner in which a sound financial system can be attained. In addition, it is not possible to say which option is correct given that company failures invariably lead to unemployment, however temporary such a situation may be.

Regardless, there are limitations now to this sort of approach to supervision on the basis of rules alone given that it requires compliance with rules that have been stipulated in advance by statute or government decree at a time when there is intensifying competition among companies and substantive changes in the environment surrounding companies, including through innovations in information and communication technology (ICT). From a different perspective, we note that an information gap (asymmetry) between the possession of the latest information on the insurance business by supervised entities in the industry and the paucity of information in the possession of the supervising government authorities is behind the impossibility of continuing to carry out rules-based supervision.

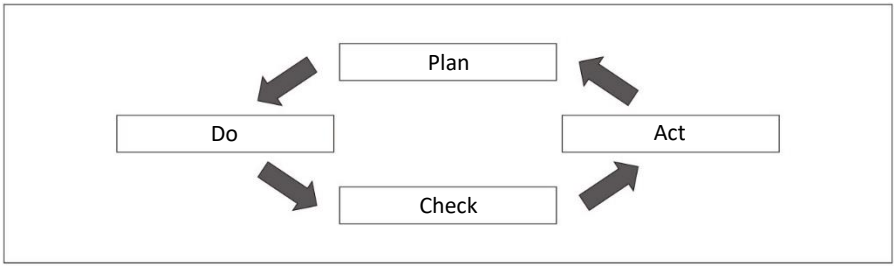
(3) Adopting principles-based supervision

In this connection, the government declared that it would incorporate the perspective of principles-based supervision to go along with rules-based supervision. Principles-based supervision is something for which broad operational principles that financial institutions should observe are set forth

rather than detailed rules that are set forth in advance in a statute or by the government. Financial institutions formulate internal rules in compliance with operational principles and upon determining what kinds of rules have been set forth by other companies and in other industries and figuring out what kind of company they should aspire to become. Normally, principles – such as in terms of putting clients first and contributing to the local community – and rules that set forth the detailed handling of administrative matters and operations are both prescribed.

You should not regard these internal rules as something that is fixed in place. Rather, these rules need to be enhanced through a PDCA (plan, do, check, act) cycle. The PDCA cycle is not a concept that is unique to the world of finance. Generally, it refers to an approach whereby a given rule or strategy that you are unsure about at a certain point in time is tried out and then improved upon over and over again while checking the results. It is one of the basic approaches to be undertaken for any business that is being operated in an uncertain business environment (Figure 6).

Figure 6 **The Plan-Do-Check-Act cycle**



The role of government in the context of this type of approach to supervision is to provide financial institutions with information that could be helpful in formulating their own rules, such as examples of good practice at different companies and examples of improper conduct that companies were required to ameliorate.

(4) Evolution of supervisory policies

The stance taken by government on risk is also changing. Supervision to date has been carried out from the perspective of determining how life insurance companies are adopting policies to avoid risks, including the risk of incurring

investment losses and the risk of paying large amounts of insurance claims, and whether life insurance companies have sufficient funds to cover the materialization of such risks.

These days, however, it is believed that the acceptance of a certain possibility of loss (risk) is necessary to obtain a return. For this reason, life insurance companies define the extent to which they have what is often referred to as an appetite for risk and check to see if sufficient returns are being obtained in accordance with these risks.

In addition, an important change in how we think about government supervision is the emphasis on taking a forward-looking approach.

Historically speaking, the style of supervision essentially consisted of a review of the state of the management and operations of a given life insurance company at a specific point in time, as captured in an inspection or report, to verify the appropriateness of past operations. These days, however, the government is taking the stance that it shall supervise and advise from a future-oriented perspective on what can be described as a better response now that is in line with the changing economic environment and changing state of the management of life insurance companies.

2 Client-oriented principle

(1) Introducing the client-oriented principle

As stated above, the government has introduced a principles-based approach to supervision. The principle at the heart of this approach is the "principle of client-oriented business operations (client-oriented principle)" (Figure 7 on the following page).

The client-oriented principle was formulated and released by the Financial Services Agency in March 2017 in accordance with recommendations made by the Financial System Council's Market Working Group in December 2016. It is not a legal regulation. It is hoped that financial institutions will voluntarily adopt the client-oriented principle and disclose the results as key performance indicators (KPIs). A KPI provides a reference value on the results of efforts taken by a financial institution to abide by the client-oriented principle.

KPI consists of common KPIs and in-house KPIs. Common KPIs are KPIs that are common across a single industry. At this time, there are some that relate to companies that sell investment trusts. KPIs for investment trust selling companies include those that indicate the state of profit and loss for each

investment trust product sold to clients. This particular KPI shows in what ways profitable investment trusts have been recommended to clients. Since investment results are also affected by market trends at the time in question, however, different KPI values need to be examined with caution.

Figure 7 Client-oriented principles related to business operations

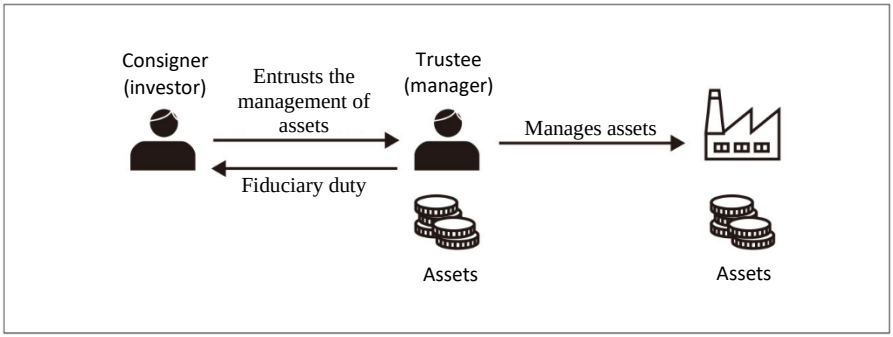
Principle 1:	A financial services provider should formulate and release a clear policy for the realization of client-oriented business operations and periodically release the state of its efforts as pertains to this policy. This policy should be periodically reviewed in order to realize better business operations.
Principle 2.	A financial services provider should possess a high level of professionalism and professional ethics, carry out operations with integrity and fairness towards their clients, and endeavor to serve the best interests of their clients. A financial services provider should endeavor to have such an approach to business operations incorporated into their corporate culture.
Principle 3.	A financial services provider should accurately ascertain the potential conflicts of interest with clients in their transactions and appropriately manage any such potential conflicts of interest that may exist. A financial services provider should formulate a specific response policy for this purpose in advance.
Principle 4.	A financial services provider should provide clients with information to enable them to understand the details of service fees and other costs assumed by clients, irrespective of what any given fee or cost is nominally referred to as and including with respect to an identification of the service to which an incurred service fee or cost relates.
Principle 5.	A financial services provider should provide clients with matters indicated in Principle 4 above as well as important information pertaining to the selling or recommendation of financial products and services in a manner that is easy for clients to understand while remaining cognizant of the fact that there is a state of information asymmetry with clients.
Principle 6.	A financial services provider should ascertain each client's asset situation, trading experience, knowledge, trading objectives, and needs and put together, sell, and recommend financial products and services suitable for such client.
Principle 7.	A financial services provider should develop a compensation- and performance-evaluation system, an employee training program, and other frameworks for appropriately motivating employees as well as an appropriate governance system designed to promote conduct in pursuit of the best interests and fair treatment of clients, and the appropriate management of conflicts of interests.

I stated earlier that the client-oriented principle is not mandated by law but the conducting of business operations in a manner that significantly undermines this principle could cause the government to carry out corrective measures on the grounds that there has been a violation of the obligation to maintain a system to manage the protection of clients as set forth in the Insurance Business Act.

(2) Client-oriented principle and fiduciary duty

The client-oriented principle has been formulated with reference made to the common-law concept of the fiduciary duty (Figure 8). Fiduciary duty originally refers to the obligation to maintain a high level of trust and good faith as imposed on persons who invest assets on behalf of another. The fiduciary duty is recognized as a concept applicable to the managers of investment trusts, investment advisors, and persons in charge of asset management for corporate pension plans.

Figure 8 **Fiduciary duty**



(3) Appropriate management of conflicts of interests

There are various explanations concerning the specifics of fiduciary duty but the two most important points are as follows: (1) the interests of the consignor (principal person) is to be given top priority (pursue the best interests of the client) and (2) do not allow the interests of the entrusted party (trustee) to be at odds with the interests of the principal person (conflict of interest).

Of these two, (2) is more frequently subject to debate and a key point in discussions on this point turns on the identification of the “party from whom remuneration is being received”. For example, in the case of an investment

advisory business, a situation in which advice is provided to a client who wishes to make investments and remuneration is then received from this client does not constitute a conflict of interest. This is because the recipient of the service and the source of the remuneration are the same party and there is no motive for considering other interests (incentives).

On the other hand, an insurance solicitor, for example, can be regarded as providing a service to clients by which he or she explains and engages in the solicitation of insurance products; remuneration, however, is paid by a life insurance company or insurance agency. An insurance solicitor receives remuneration from a life insurance company because he or she is employed by a life insurance company or engages in solicitation as commissioned by a life insurance company. In other words, solicitation activities are essentially undertaken as work for a life insurance company.

As mentioned earlier, if we think of the act of recommending a product to a client as something that is done for the client, then the party to whom the service is provided and the source of the remuneration are different. Thus, it is conceivable that an insurance solicitor would have a clear incentive to recommend a life insurance product whose sale would generate a substantial amount of remuneration for him or her.

In order to broaden the scope of the application of the client-oriented principle to also encompass those who sell financial products, the fiduciary principle requires (1) the provisions of the best interests of the client (Principle 2) but does not require that (2) not allowing the interests of the entrusted party (trustee) to be at odds with the interests of the principal person (conflict of interest) is to be strictly applied as a principle. This is because the strict application of (2) is conceivable if the solicitation of insurance had to be commissioned by the client and remuneration for the solicitation of insurance had to be collected from the client but such an arrangement would be unrealistic.

The client-oriented principle requires that potential conflicts of interest be ascertained and managed appropriately (Principle 3) and that information concerning service fees incurred by clients be provided (Principle 4).

In addition, the client-oriented principle sets forth other principles, including the following: important information shall be provided in an easy-to-understand manner (Principle 5), services suitable for each client shall be provided (Principle 6), and an appropriate framework of incentives shall be provided to employees (Principle 7).

3 Best-interest regulations

Beginning three years after the client-oriented principle was formulated, the Financial System Council's Market Working Group recommended a review of the principle in August 2020. In addition, regulatory revisions reflecting regulatory trends in Europe and the United States have also been made.

I will explain, in principle, current issues in line with the "Report of the Financial System Council's Market Working Group: Towards progress in the area of client-oriented business operations", which was formulated and published on August 5, 2020 (hereinafter referred to as the "Report"):

(1) Sales and recommendations going beyond mere sales

The current Principle 6 requires the provisions of services suitable for the client. In the Report, three issues were presented in connection with this point:

(i) Proposing an appropriate portfolio
(ii) Making a comparative proposal of financial products and services across industries
(iii) Post-sales follow-up

(i) Proposing an appropriate portfolio

When selling financial products, it is not enough to simply sell new products; the selling of financial products is predicated on putting together a portfolio (asset structure) appropriate for a given client.

For example, it is important when managing assets to put together a package of assets by appropriately combining safe assets in the form of government bonds and yen-denominated interest-bearing assets and riskier high-return products, such as foreign currency-denominated investment trusts. Safe assets alone will not generate sufficient returns and risky assets alone could result in a substantial loss of principal.

When it comes to products offered by life insurance companies, it is important to provide balanced coverage in terms of medical coverage, long-term care coverage, death coverage, and more.

(ii) Making a comparative proposal of financial products and services across industries

Selling and recommending a foreign currency-denominated annuity, for example, or any other savings-type product that is highly investment-oriented by comparing it to a foreign currency-denominated investment trust or other similar

financial products used to be considered ideal. From this perspective, "brief explanatory documents (important information sheets)", as described in 4 below, came to be produced. I will discuss this point below.

Solicitation activities that straddle the divide between the insurance business and the securities business in this way are possible only where the person in charge is both a registered securities commission agency and an insurance solicitor. This also applies to over-the-counter sales at banks and securities companies.

(iii) Post-sales follow-up

Post-sales follow-up work is already being carried out by life insurance companies in the form of policy verification actions. As I noted in Chapter 4-IV-3, verification actions entail the confirmation of insurance currently in force as well as a check to see whether any event for which a claim should be paid has occurred. Ideally, the age and life stage of the insured should also be confirmed to see if appropriate proposals can be made accordingly.

What is at issue is the ex post facto principle of suitability. As mentioned in Chapter 3-V-4(1), the principle of suitability is a regulation under the Financial Instruments and Exchange Act that prohibits solicitation that is improper in light of the client's knowledge, experience, asset situation, and purpose of concluding a contract for a financial instruments transaction.

A question here arises as to whether a client who holds a high-risk product should continue to hold it once he or she becomes elderly. This point is limited to the time of the sale of the product since the text of the law stipulates that "solicitation shall not be engaged in" for products that are non-conforming.

Leaving aside the provisions of the law, it would be desirable to see a financial institution make some kind of effort in cases where an elderly client has suffered from a decline in his or her cognitive functions while still in possession of a high-risk product. It is expected that best practices on this point will emerge in the future.

(2) Disclosing the client segment on which the product development process is based

The development of a financial product normally involves a preliminary investigation that is conducted to determine the segment to which it will be sold. For example, a client segment consisting of persons who are willing to accept a certain level of foreign exchange risk in order to potentially secure a nice rate of

return can be assumed for a foreign currency-denominated annuity plan. The clients belonging to such a segment can be assumed to possess sufficient assets and have some experience investing in shares and other such investment targets.

Best-interest rule in the United States **Column 33**

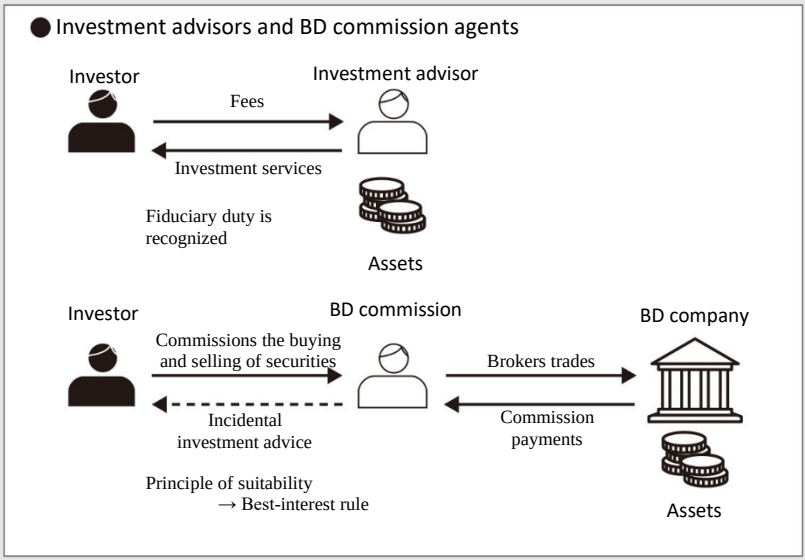
In the United States, variable annuities and other life insurance products are regulated as insurance products and as financial products as well.

A party handling financial products needs to be licensed as a securities company or securities commission agency (broker-dealer; hereinafter securities companies and securities commission agencies shall be collectively referred to as "BD commission agencies") or as an investment advisor.

An investment advisor collects fees from a client, which primarily consist of a fixed-amount fee proportional to the client's asset balance, and provides the client with investment advice in return. Investment advisors owe a fiduciary duty to their clients.

On the other hand, a BD commission agency is mainly tasked with selling financial products, such that the provisions of investment advice (trading recommendations) is allowed to the extent that it is incidental to the selling of financial products.

Compensation for a BD commission agency is received from a financial institution or indirectly from a client largely in the form of a sales commission for each transaction (see the following figure).



To date, BD commission agencies have only been subject to the principle of suitability (obligation to solicit products that are compatible with the client's assets, income, investment objectives, and other such considerations) rather than a fiduciary duty that would be imposed whenever transactions are recommended.

However, there were criticisms to the effect that a typical client would be hard-pressed to figure out the difference between a situation in which a BD commission agency recommends a transaction and a situation in which investment advice is given by an investment advisor, such that there were calls to recognize that BD commission agencies were also subject to the imposition of a fiduciary duty.

I will omit the details but, suffice it to say, the U.S. Department of Labor, which has jurisdiction over corporate pensions, sought to introduce the concept of a fiduciary duty for certain transactions. This effort came to an end when a federal appeals court declared that this was invalid.

In its stead, the U.S. Securities and Exchange Commission (SEC) imposed the best-interest rule on BD commission agencies; there must be compliance with this rule by the end of June 2020.

The best-interest rule first requires that a BD commission agency "when making a recommendation to an individual client, act in accordance with the client's best interests as of the time of the recommendation without placing his or her own interests above those of the client". This obligation is fulfilled when the following four obligations are satisfied:

(i) Obligation to disclose: A BD commission agency shall disclose the fact that recommendations shall be made by him or her in his or her capacity as a BD commission agency.
(ii) Duty of care: A duty to ensure that there are rational grounds for believing that a recommendation could be in the best interests of the client.
(iii) Conflict-of-interest obligation: Ascertain and eliminate or contain and disclose conflicts of interest.
(iv) Obligation to develop a compliance framework

At the end of the day, the point at issue concerns compensation and BD commission agencies will continue to be permitted to receive compensation in the form of commission payments. According to the SEC, this is because (i) commissions are more reasonable for a client who acquires a financial product on a one-time basis and who then holds it indefinitely and (ii) investment advisors retain a minimum amount of deposit assets, which could exclude small-amount investors from services for the buying and selling of securities.

These days, however, rather than engage in the direct solicitation of insurance through a sales agent, many life insurance companies solicit through a solicitation agency instead. In such a case, discrepancies could arise by offering products targeting asset holders to the members of some other client segment. Even in cases where sales agents engage in solicitation activities, it is conceivable that the sales division might carry out sales promotion activities before fully ascertaining the intent of the product development division.

For this reason, a report should require the disclosure of the anticipated client segment for which a financial product is developed and the provisions of information to clients.

4 Brief explanatory documents (important information sheets)

Reports require the formulation of important information sheets as brief explanatory documents. This is modeled in part on KIDs for PRIPs (key information documents for packaged retail and insurance-based investment products), which constitute brief explanatory documents for packaged financial products in the EU, and Form CRS (customer or client relationship summary), which is used in the United States.

The client-oriented principle originally required the provisions of information on financial products and services to clients in an easy-to-understand manner (Principle 5). The client-oriented principle requires the provisions of specific details concerning conflicts of interest with clients, such as fees (Principle 5 (Note 1)), the careful provisions of information on high-risk products (Principle 5 (Note 4)), and the provisions of information to enable comparisons to be made with other products and services of the same type (Principle 5 (Note 5)).

In this connection, the Report indicated that important information sheets on certain investment-type financial products be produced and provided to clients in order to (i) facilitate comparisons with other products of the same type, (ii) clarify risks and costs, and (iii) provide important information for, among others, the clarification of the solicitor's position (to shed light on any possibility of a conflict of interest).

Figure 9 on the following page is an outline of the form shown in the Report. It was decided that the amount of information would be subject to a cap to produce a concise explanatory document to ensure that it would be easy for the client to understand.

Figure 9 **Illustration of important information sheets**

Financiers

1. Basic information on the company
   - Company name…
2. Handled products (Types of financial products that the company can offer clients are as follows.)
   - Deposits, domestic shares, insurance (without investment risk), insurance (with investment risk) …
3. Product line-up concept (Our product-selection concept is as follows.) …
4. Complaints and consultation office

Individual products

1. Description of the product (We have been commissioned by a fund-forming company to solicit sales of the product to clients.)
   - Names and types of financial products, fund-forming company (investment company), sales consignor, …
2. Risks and investment performance (The yen-denominated principal for the product is not guaranteed; there is a risk of loss associated with the product.)
   - Details of the risk of incurring a loss…
3. Expenses (Expenses will be incurred when purchasing or holding the product.)
   - Expenses to be paid at the time of acquisition, expenses to be paid on an ongoing basis…
4. Conditions for conversion and cancelation (Conversion or cancelation of the product could be disadvantageous for you.)
   - Deadline for redeeming the product, amount of cancelation fee to be borne by the client…
5. Possibility of any conflict between the interests of the company and the interests of the client
   - Obtaining sales commission from the fund-forming company…
6. Taxation outline

   …
7. Other reference information (Carefully read the following documents before concluding the contract.)
   - Pre-contract documents, prospectus

Source: Excerpted from "Report of the Market Working Group: Towards progress in the area of client-oriented business operations", Financial System Council (August 5, 2019)

Incidentally, the selling of financial products is already accompanied by the issuance of prospectuses and the statutory delivery of pre-contract documents. Important information sheets partially overlap such documents in terms of included contents.

Accordingly, it has been decided that, if the contents of a product are explained using important information sheets, pre-contract documents and the prospectus can be provided simply by posting them online and sharing an URL link to access them. If requested by the client, these documents would need to be provided in paper form.

Form CRS in the United States **Column 34**

The SEC in the United States introduced the Form CRS rule to go along with the best-interest rule. This rule became a model for the important information sheets as noted above. The Form CRS rule applies not just to BD commission agencies but also to investment advisors. Enacted concurrently with the best-interest rule, the Form CRS rule refers to a form that constitutes an important information-providing document for ensuring compliance with the best-interest rule. You will need to note that the provisions of Form CRS alone does not amount to satisfaction of the best-interest rule.

Form CRS is limited to two pages or four pages if the operations of both an investment advisor and a BD commission agency are being carried out. Form CRS must be provided whenever the opening of an account or financial product trading is recommended, an order is executed, or an account is opened.

The contents thereof are limited to (i) introductory text, (ii) the relationship with the client and provided services, (iii) fees, costs, conflicts of interest, and principles of conduct, (iv) a history of disposition by the authorities, and (v) a description of where additional information can be obtained.

Rather than limiting the amount of content, the form includes language encouraging the client to make inquiries as needed.

5 Coping with a super-aging society

As mentioned in I above, Japan is becoming a super-aging society and is expected to continue to undergo aging in the years to come. In addition, approximately two-thirds of household financial assets are held by households whose members are aged 60 years or over, such that dealing with elderly people

is an exceedingly important management challenge for financial institutions.

Life insurance companies are also required to not just adapt to our super-aging society but also proactively make contributions. The Report makes recommendations primarily regarding the following points.

(1) Flexibility in financial institutions

With this perspective, this recommendation is made primarily with over-the-counter transactions at banks in mind. More elderly persons with impaired cognitive decision-making ability or family members acting on their behalf visit bank branches in person.

However, if a person with impaired cognitive decision-making ability withdraws deposits, takes out a policyholder loan offered by a life insurance company, or withdraws dividends without understanding the implications of such actions, such actions would be rendered invalid. In such a case, there is a risk that the bank or insurance company might make a double payment. Out of concern for such a situation, financial institutions are expected to take rigid measures by refusing to engage in transactions with elderly persons or having transactions subject to the appointment of an adult guardian. The Report recommends that transactions be conducted flexibly with the principal person or an agent of the principal person if the payee of the money is clearly ascertained.

(2) Fortifying links between financial institutions and welfare-related organizations

An adult guardian can be appointed to act on behalf of someone who permanently lacks the capacity to make decisions. The appointment of an adult guardian was often triggered by transactions with a financial institution.

A financial institution should ideally cooperate with a local social welfare council or comprehensive community support center to exchange information, including information on ways to deal with elderly persons with impaired cognitive decision-making ability and information on formulating advice for clients on which organizations should be contacted for assistance.

A financial institution cannot provide personal information directly to such organizations but can contribute to community oversight by encouraging clients to visit them instead.

(3) Consolidating and reducing best practices

The Report touches on products for the elderly, prior efforts to prepare for

the impairment of cognitive decision-making ability, counseling services for the elderly, and follow-up services to be offered subsequent to the sale of financial products. I covered products for the elderly and follow-up services earlier. In this section, I will talk about prior efforts to prepare for the impairment of cognitive decision-making ability.

As mentioned earlier, there is a system at life insurance companies for making designated proxy claims for insurance money and benefit payments. Under this system, a family member or another individual designated in advance may make a claim on behalf of the policyholder when an event occurs that prevents the policyholder from making a claim on his or her own behalf for a severe disability insurance benefit to be paid in the event that he or she as the insured falls into a prescribed state of disability or hospitalization benefit.

In recent years, life insurance companies that have set up a policyholder proxy system have also emerged. Under this system, the proxy can act on behalf of the policyholder to cancel a policy, reduce the amount of coverage provided under the policy, request a policyholder loan, or carry out other such actions.

In addition, the Report also calls for “the use of digital technology to enable clients to be flexibly served” and “the development of a system to allow for inquiries to determine whether or not a financial agreement is in force”.

IV. Life insurance companies adapting to a digital society (insurtech)

In this section, I will explore technological innovations adopted by life insurance companies and solicitation agencies in line with advancements in ICT.

1 General remarks

In Japan, *fintech* has been garnering attention since around 2015. A portmanteau combining *finance* with *technology*, *fintech* refers specifically to financial innovations based on the use of information and communications technology (ICT).

Familiar examples consist of innovations in terms of payment methods, such as those that work with QR codes and those that involve fund transfers. Other examples include household accounting software and robot advisors that provide investment advice.

As noted in II above, *insurtech* is a portmanteau combining *insurance* with *technology* and is a type of *fintech.*

The precise scope of what *insurtech* refers to does not appear to be definitely established. In this section, I will introduce this term broadly from the standpoint of the innovations that we see taking place in the life insurance industry thanks to the application of ICT.

AI technology **Column 35**

Further revolutionizing the application of ICT technology in practice is the evolution of artificial intelligence ("AI"). The concept of AI technology itself had already emerged in the 1950s but people assumed back then that it would take the form of a general-purpose approach to AI that could be employed to carry out various functions. This general-purpose approach to AI was intended as a way to perform jobs and engage in housekeeping functions for people with just a single program.

These days, development work is underway in the area of specialized AI and we have already seen machines prevailing over top professional competitors in matches of *go* and *shogi*. AI is being introduced to all sorts of businesses. To illustrate, it has been reported in the news that there are plans to incorporate AI into the process of underwriting life insurance policies.

The evolution of AI has been boosted significantly by machine learning and more recently by deep learning, which first came on the scene in the 2000s. Machine learning is a process whereby a program is made to learn data and then perform various tasks, such as identification, classification, and prediction, on the basis of what is learned. Traditional machine learning had been predicated on the provisions of instructions by humans to allow the program to know what characteristics to use as criteria (feature values) in order to, for example, identify graphic symbols.

However, deep learning has made it possible for AI itself to develop its own assessment criteria and make decisions accordingly while it processes substantial volumes of information without requiring the provisions of characteristic criteria by humans. With deep learning, you can do more than just, for example, input numbers and have the results properly discerned; you can also have images of dogs differentiated from images of cats. In the area of automated driving, deep learning has rendered environmental recognition of road conditions in your immediate surrounding and the movements of people and cars in your vicinity possible.

2 Online life insurance company

I would like to point to online life insurance company as an example of the use of ICT. An online-only life insurance company launched operations for the first time in 2008 at a time when the term *insurtech* was unknown.

I believe that it was later when you could also submit applications and disclosures rather than just obtain estimates online that marked the beginning of what we know as *insurtech.*

In recent years, we have seen life insurance companies with sales agents and agency networks emerge to provide life insurance for which the process of taking out policies is completed online in addition to life insurance companies that specialize in online operations.

Companies that have also developed chat bot features that use AI to respond to inquiries – albeit text-based ones – from clients and that otherwise provide unmanned client services have also entered the market.

Furthermore, robot advisors are also being harnessed to propose recommended products whenever clients answer simple questions online.

While the sales performance of online life insurance companies is improving thanks in part to COVID-19, whether or not these developments take root will likely depend on future initiatives to enable companies to provide a wide range of products capable of meeting the needs of consumers.

3 Information innovations in the solicitation of insurance

While not recognized as an element of insurtech, information terminals used by sales agents and the employees of agencies to engage in the solicitation of insurance are evolving by leaps and bounds. Along with providing financial planning features that allow for the calculation of necessary coverage amounts, these information terminals can also generate written proposals and more.

In addition, there are companies that have also digitized application forms and enabled the application process to be completed by affixing a signature to the application as it appears on a tablet.

Of course, the first premium amount can be paid with a credit card or other cashless option, thereby obviating the need for cash to be prepared by the policyholder.

Moreover, the ability to change your address or carry out other maintenance procedures or make a benefit claim through a terminal or otherwise online has become commonplace.

Some companies provide these services through an app that can offer other advantages, such as free health consultations.

4 Insurtech products

As mentioned in Column 32 in II above, products are now being offered that provide for yearly premium discounts. For these products, a wearable device is used to measure the amount of physical activity performed by the insured as well as their heart rate and other variables; measurement results are then converted into points, the status of which is used for discount calculation purposes.

justInCase Inc., a small-amount, short-term insurance provider, also offers a product that it calls Warikan Cancer Insurance. With this product, policyholders at a given point in time (excluding persons with cancer) pay on a deferred basis (cost splitting) the sum of insurance money payable to persons with cancer and the operating costs of the small-amount, short-term insurance provider divided according to age group.

This way of sharing the burden of paid insurance money and benefits among a group of policyholders is known as P2P (peer-to-peer) insurance.

There is an example of a plan in China in which a digital platform provider (Alibaba Group) provides a lump-sum payment to anyone who contracts cancer or a serious illness, whereby the burden of these lump-sum payments and any administrative fees are shared among participants; this plan is known as “mutual-

aid treasure". There are already more than 100 million enrollees in this plan. It should be noted, however, that the Chinese authorities have certified that this plan does not constitute insurance.

Insurtech is an option for bicycle insurance, pet insurance, insurance to cover household belongings, and more. A wide variety of products are offered in the non-life insurance sector. Indeed, insurtech appears to be more advanced in the non-life insurance sector than it is in the life insurance sector.

5 The brokering of financial services

There is a type of business involving electronic payment agency's work. The operators of this type of business are a type of fintech company that connects to a bank's system to inquire as to the balance of an account in the name of a client of the bank or issue remittance instructions to the bank at the behest of a client.

A bill to permit such a company to act as an intermediary for bank deposits, financial products, and insurance products passed during an ordinary session of the Diet in 2020.

Previously, a license to operate as a banking agency was needed to mediate bank deposits, registration as a financial products broker was needed to mediate financial products, and registration as an insurance solicitor was needed to mediate insurance products. A so-called affiliated company system was in place whereby a banking agency would be subject to the guidance and supervision of a bank, a financial products broker would be subject to the guidance and supervision of a financial products distributor, and an insurance solicitor would be subject to the guidance and supervision of an insurance company.

Thanks to the recent enactment of the relevant statute (as an amendment to the Act on Sales, etc. of Financial Instruments), a financial institution can now sell these financial products by registering as a financial services broker on an independent basis (Figure 10 on the following page).

The business of such an institution does not always need to be carried out online but a financial services broker will naturally be allowed to operate an electronic payment agency's business (Figure 11 on the following page).

Figure 10 **Current legal system for the brokering of financial products**

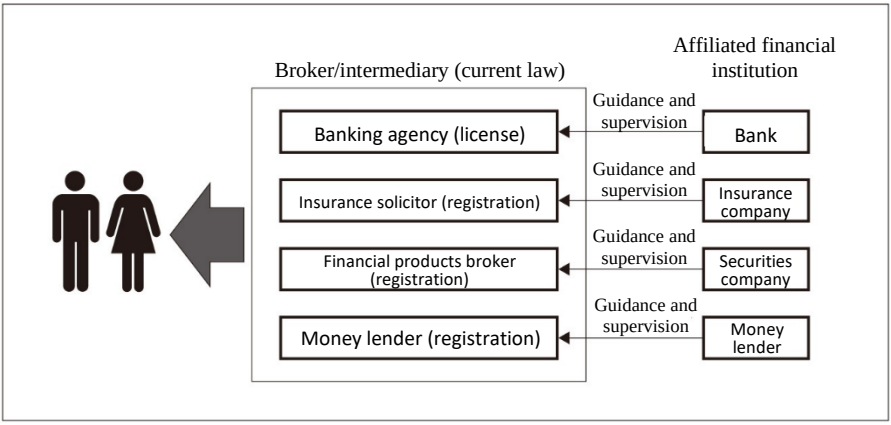
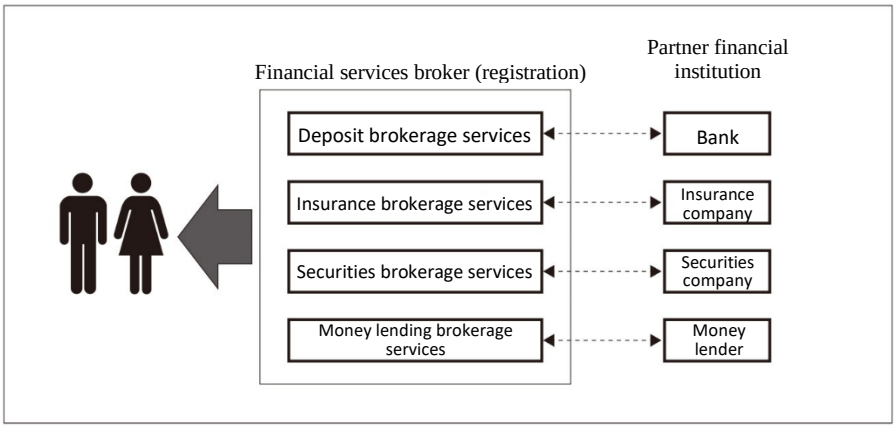


Figure 11 **New legal system for financial intermediary services**



6 ICT for administrative services

ICT is also being applied to an increasing degree to allow insurance companies to carry out administrative work. Since 2014, Nippon Life Insurance has been applying Robotic Process Automation (RPA) to its administrative work. RPA refers to software that enables the automation of routine tasks normally performed on computers by human beings.

Going by the nickname *Nissay Robomi* is software that carries out administrative work for products sold on an over-the-counter basis at financial

institutions. It has been reported that this software handles all administrative work, including the acceptance of new applications, maintenance procedures, and payment functions with a workforce of less than 25 employees and manages to properly take on a workload equal to 20% of over-the-counter sales administration.

Users themselves are now able to develop RPA themselves. Routine operations, such as work to enter the contents of application forms filled out by hand into a core system, can be carried out faster than what humans are capable of and at any hour of the day.

Such examples of RPA are currently being harnessed for operations departments as well and have been helping to streamline operations and allow them to be performed at a higher level.

V. Moves by life insurance companies during COVID-19

This section is the final section. In this section, I will describe the response by life insurance companies to COVID-19, which constitutes the biggest challenge facing our industry as of the time of the writing of this book.

1 Special treatment with respect to payments of insurance money and benefits

Amid the worldwide outbreak of COVID-19 in 2020, even those who tested positive in Japan had to recover at home or be treated in a hotel rented by a local prefectural government if they were either asymptomatic or mildly ill. With this approach, it became problematic as to whether one was considered to have become hospitalized for the purpose of receiving a hospitalization benefit under a private health insurance plan. Policy provisions define *hospitalization* as entering a hospital or medical clinic for the primary purpose of receiving treatment under the supervision of medical doctors and other healthcare workers in the event that it is not possible to receive medical treatment at home or elsewhere.

However, the payment of hospitalization benefits due to the treatment of the receipt of care at home or in a hotel as being equivalent to hospitalization became a universal practice in the industry in response to COVID-19.

In addition, some life insurance companies have treated deaths due to COVID-19 as being eligible for payment of benefits under an accidental death insurance rider (a rider that pays out insurance money in the event of a death caused by an accident rather than an illness).

2 Extending the premium payment grace period

The treatment of policies as immediately lapsing when the premium payment deadline and corresponding grace period have passed was suspended in the wake of the Great East Japan Earthquake and other comparable disasters. The premium payment grace period was also extended by up to six months in response to the outbreak of COVID-19. If a client found it difficult to make a payment by the end of September 2020, his or her payment deadline was further extended to the end of April 2021.

There were apparently many life insurance companies that also waived

interest amounts owing on new policyholder loans in order to meet the need for funds on the part of policyholders.

3 Resuming face-to-face sales

The spread of COVID-19 also had a huge impact on life insurance companies. This was because employees were required to engage in telework and it became difficult for executives and employees involved with sales and administrative duties to report for work but also because engaging in face-to-face sales work especially in channels in which sales agents and agencies played a key role became challenging.

In response to a declaration of a state of emergency issued in April 2020, life insurance companies all chose to voluntarily refrain from engaging in face-to-face sales activities. After this state of emergency was lifted in May of the same year, face-to-face sales resumed with the use of masks and hand sanitizers in cases where the consent of the client was obtained.

In life insurance sales, interactions with clients occur over and over again as clients are found, needs are confirmed, and products are proposed. It may be difficult to arrange a face-to-face meeting every time. In this connection, there are non-face-to-face approaches that are based on the use of telephone calls, email messages, social networking services, and direct messaging services.

Situations will arise in which face-to-face meetings cannot be avoided in order to confirm client needs or explain products that encompass a wide range of coverage options. However, it is important to use non-face-to-face measures effectively in order to reduce the number of times face-to-face meetings are held and the required duration of each face-to-face meeting as much as possible.

While it seems likely that COVID-19 will cause online sales to reach greater heights, it is believed that the Internet is not yet capable of replacing the advice and careful explanation of products given by persons selling insurance to address client needs.

Whether persons selling insurance will become proficient in effectively utilizing remote tools to sell products is a huge challenge for life insurance companies.

In addition, there is also the issue of how to compensate sales agents who are limited to engaging in face-to-face sales activities and are consequently unable to improve their sales performance. On this point, it should be noted that there are many life insurance companies that guarantee a certain amount of salary for sales agents who are affected in this way.

In conclusion

At the time I was authoring this book, COVID-19 was continuing to spread worldwide, and it seemed like the world was changing from what it was like before COVID-19 struck. Vaccines were not yet widely available, and we were being bombarded by wave after wave of infections. COVID-19 forced us to accelerate the adoption of remote ways of working and the digitalization of our operations. We have also seen governments make moves to minimize procedures that require the affixing of personal seals as much as possible.

These changes are irreversible. Combined with the ongoing march of digital technology, all signs seem to suggest that living and working without being in close contact with others are becoming a societal norm.

Whether this crisis can be treated as an opportunity is also a question with which life insurance companies are grappling.

I believe that the key lies in digital transformation (DX). We need to ask whether new value can be created through digital means and what kinds of new value can emerge. Rather than think of DX as something to be achieved by building up visions of the future, it might be better to envisage DX as a process whereby innovative technologies and business models appear at certain junctures to give rise to sweeping disruptive changes seemingly at once. It would seem that such disruptive changes have not yet occurred in the life insurance industry, such that no clear indications of DX in this area can be discerned.

I wrote this book in a time of great historical change and, in order to prevent the contents of this book from becoming quickly irrelevant, have sought to include the latest developments while being mindful of traditional business practices in our industry. I wish for nothing more than for this book to be at least somewhat informative and helpful to readers.

April 2021

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This book is originally published by The Hoken Mainichi Shinbun Co., Ltd., in 2021. With the consent of the authors and the publisher, OLICD Center translated the book into English in 2023


LIS
Oriental Life Insurance Seminar