Focus on Japan

Market restrictions, a weak insurance culture and severe economic difficulties have thwarted the development of products for Japanese insurance buyers, but there are positive signs on the horizon. By Miho Yoshizaki

Japan is the fourth largest non- life insurance market in the world, but until the late 1990s it was tied up within the conglomeration system that dominated the country. Insurance firms were part of huge interlinking companies, held together by executives who grew up in the *Zaibatsu* tradition, and cross-ownership of stocks. Companies did not compete with one another, and global companies were not permitted to provide international competition. Buyers were faced with little choice and were at the mercy of insurers setting rates through associations. All non-life companies provided the same insurance, at the same rates.

Deregulation started in 1996, but has been slow to be implemented. The reason for this is largely because insurers want it that way. Personal automobile selection has become more competitive as non-Japanese insurers are starting to advertise. And now, 13 years since 1996, competition in the corporate business sector is kicking in, and insurers are prepared for premium income to fall.

The corporate insurance market has been slow to develop, as there remains a great deal of rigidity in the way insurance is bought. According to one industry official, there is a shared sense of frustration among brokers as their activities are still restricted in the market. Under the law, brokers are not entitled to conclude insurance contracts, to accept applicants' representations or to receive insurance premiums. It is in-house agents who conduct this business. According to the General Insurance Association of Japan (GIAJ), agencies sell almost 93 per cent of policies, whereas sales through brokers still remain at 0.4 per cent. In addition to a further deregulation, a system of reinsurance may need to be established in Japan to rejuvenate the market, the official says.

The effects of recession

Demand has also been hampered by economic difficulties, which have been part of Japanese life since the beginning of the so-called 'lost decade', and are the key risk for companies in Japan. The country saw dramatic cuts in consumption and output when the global financial crisis struck, and although it briefly pulled out of a technical recession in the autumn, its return to negative growth in November 2009 revealed the downturn is likely to be prolonged and painful this time too.

The economic deterioration has led to a long period of softer rates and a buyers' market for many insurance products. There is little appetite for increasing rates, and in any cases where rates have increased it has often been due to claims, such as those from natural disasters.

The recession has also led to an upswing in demand for one segment of the market. Buyers are increasingly turning to insurance to cover increased risks in this climate. New product areas, such as insurances for credit and pecuniary losses are growing – albeit slowly and from a low base.

However, this remains the exception to the rule, and in most cases economic pressure

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The outlook for the insurance industry in Japan is promising

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and its effect on budgets is leading buyers to take less insurance rather than more. Isaku Murakami, Director of Jardine Lloyd Thompson Japan explains: "The Japanese perception about insurance is somewhat different. They rely on savings when something happens. In the case of corporations, when their profits are squeezed, it's a common pattern that they stop buying insurance policies." So, it is important to introduce "the idea of risk management," he says.

Natural hazards

It has been vital to address risks to the supply chain during the downturn. Supply chain management has been widely addressed within Japan since 1995 when the Great Hanshin Earthquake hit Kobe and shut down Japan's largest port for 26 months. However, the increased risk of business failures has encouraged a broad reassessment of risk. These risks have tended to be planned for rather than insured, but Mitsui Sumitomo Insurance, says insurances against business interruption risks are gaining importance.

Buyers are also increasingly insuring against natural hazards. Regular earthquakes, and the memory of the Great Hanshin Earthquake are behind the rise. Karen Gorman, who coordinates global insurance programmes in London as a Partner at Jardine Lloyd Thompson says: "The main concern for our clients is the earthquake risk in certain regions and the sub-limits that insurers apply. In general, a global carrier will sublimit earthquake in Japan as a whole, and in some cases excess coverage will be sought from the market."

The percentage of people who added the earthquake insurance to their fire insurance policies has increased to 45 per cent in the fiscal year of 2008 compared with 33.3 per cent in the fiscal year 2002, the GIAJ says. Earthquake insurance is sold as an option only on top of the fire insurances, and cannot be bought on its own.

Changes on the horizon

There are some changes on the horizon, particularly with the Insurance Act coming into effect in April next year. It is designed to enhance the protection of policyholders' rights, update the language and improve the way insurance functions in order to help it work better in a modern globalised economy.

The Act is one of the things aiding the role of London's insurance market, which has become increasingly important, allowing insurance to fit more easily into global programmes. Gorman says "more companies arrange insurance on a global basis and many of these global programmes include Japan."

Lloyd's is keen to expand in the region. It has had a local licence since 1996 for a wholly owned subsidiary, through which »»


Competition in the Japanese market is picking up

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a limited number of syndicates have been trading over the last ten years via a joint venture arrangement. Reinsurance can also be written through the subsidiary, although most of Lloyd's reinsurance premium from Japan is currently written outside of it. In line with its strategy of growth in Asia, Lloyd's is looking to expand in Japan and, in particular, to develop the subsidiary company into a flexible operating platform that will enable all managing agents to exploit fully Lloyd's Japanese trading licences and develop existing and new business opportunities.

Looking ahead, there are opportunities for Japan's non-life insurance market, as the export-driven economy is slowly emerging out from recession. The International Monetary Fund (IMF) expects Japan's gradual recovery will materialise to a 1.7 per cent growth in 2010. Japanese corporate bankruptcies are falling too. The number of Japanese business failures declined in October for a third straight month from a year earlier to 1,261 cases, according to Tokyo Shoko Research.

There are also changes within the insurance culture in operation. Increasing globalisation of business means Japanese managers are seeing the way insurance products and markets help their overseas counterparts – particularly with pressing issues such as economic instability and supply chain problems, and are implementing insurance solutions to handle it. According to Mitsui Sumitomo Insurance, one of the areas seeing particular growth is liability insurance on the back of the fact that the current risks are becoming more diverse in an increasingly complex world.

Future progress

But there is a long way to go. Nobuyuki Akahane, a Development Executive for Jardine Lloyd Thompson in London, points out that Japan's non-life insurance market is heavily relying on 'Ka-Ji-Sho' products, a Japanese acronym for fire, automobile and personal accident products, and the market is expected to shrink. "The Japanese market structure is unique compared with other countries. If the product ratio was the same as the West, the Japanese market would be much larger. It means that there is a potential for other products to grow, and the progress should be encouraged," he says.

While economic problems and market restrictions within Japan hamper the growth of both business and the insurance market, businesses will continue to look overseas for opportunities elsewhere in the world. "I am seeing a recovery in overseas projects," says Akahane, "projects in the Middle East and Asia are showing signs of recovery in the last 2-3 months." RS

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CONSOLIDATION IN THE INSURANCE MARKET

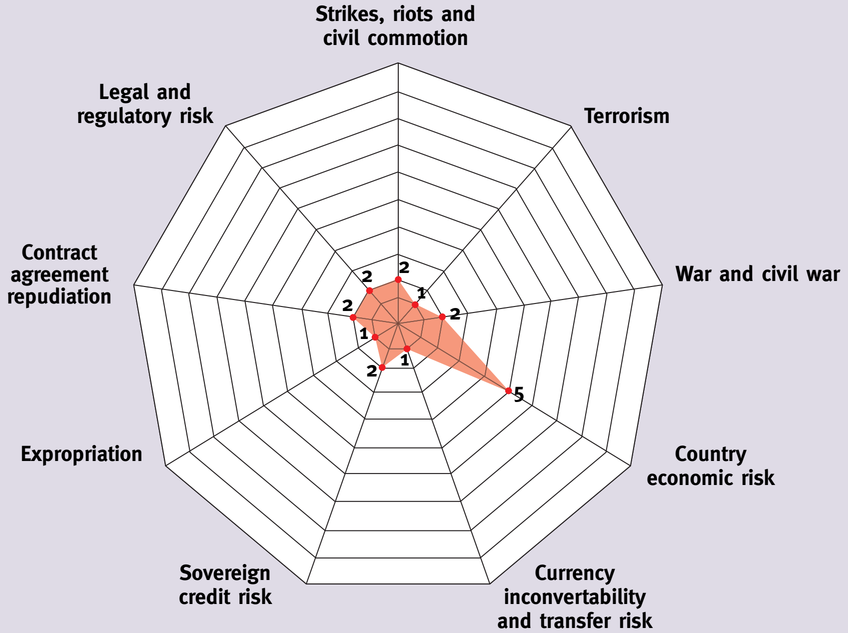
Japanese non-life insurance companies are accelerating merger activities for survival at the turn of its 150 years of history. Isaku Murakami, Director of Jardine Lloyd Thompson Japan sees the main reason for consolidation is in "reducing costs," as the fixed rate system before the deregulation of the late 1990s discouraged competitiveness in the industry. By April 2010, the insurance market will be shared by three major players.

Mitsui Sumitomo Insurance Group Holdings has announced it is teaming up with Aioi Insurance and Nissay Dowa General Insurance, Japan's number three, four and six respectively, to merge under a holding company MS&AD Insurance Group Holdings. MS&AD will be the biggest Japanese non-life insurance company with the combined net premiums of ¥2.4 trillion for the financial year to March 2009, overtaking the current market leader Tokio Marine Holdings.

Meanwhile the second largest Sompo Japan Insurance and the number five Nipponkoa Insurance have also announced a merger plan to create NKSJ Holdings with ¥1.9 trillion worth of net premiums.

According to Japan's Financial Services Agency (FSA), which oversees non-life insurers, the six largest companies hold over 80 per cent of the ¥7.4 trillion market. The rest of the market shares are pecked by much smaller rivals such as Kyoei Fire & Marine Insurance, and Fuji Fire and Marine Insurance, which is more than 40 per cent owned by American International Group.

Japan's risk rating



World Risk Review™ ratings for Japan

Overall Japan has a relatively benign risk profile. However, there is one particularly striking exception: economic risk. Recession and deflation have brought serious concerns for both businesses and a government forced to rapidly increase borrowing. Structural imbalances in the country have exacerbated these issues, with a shortage of natural resources and an ageing population hampering the response.

Elizabeth Stephens, Head of Credit & Political Risk Analysis at Jardine Lloyd Thompson explains: "Japan has suffered from deflation, exports have fallen 26 per cent and there has been a 15 per cent drop in GDP over the past 12 months. The economy isn't in that great shape." Japan is, in fact, expected to be overtaken by China as the second largest economy in the world by the end of 2010. All these factors are reflected in an economic risk rating of 5.

The World Risk Review compares countries in terms of how well placed they are to deal with economic challenges, as well as where they are in the economic cycle. Japan is struggling here too. Problems are compounded by structural issues, including an ageing population, which gives it little room for manoeuvre, and a shortage of natural resources. Some 96 per cent of these have to be imported. Stephens explains: "There is talk of allowing the yen to appreciate. It has been traditionally thought to be too difficult, as it would increase the cost of exports, but it is being considered in order to bring down the price of imports."

In an effort to deal with economic problems, Japan, like many other OECD countries has taken on a lot of debt, resulting in a downgrading by Moody's in the summer. This has raised the sovereign credit risk rating to 2. Stephens says: "The economy isn't going to crash like Iceland, but it will take a long time to rebound." The new government has also promised to increase spending, which has raised concerns of how it will be paid for. "It may be through more borrowing or more taxes, so businesses are also concerned about possible tax increases."

Beyond the economy, the next risk is the threat of strikes, riots and civil commotion, rated as 2. Stephens says these are not an imminent danger. However: "There were demonstrations in the run up to the election, and there are also labour reforms which have to be passed." The country also faces tension over immigration and has a history of ultra-nationalist disturbances, but as Stephens says: "This is a honeymoon period for the new government, so tensions died down."

War has a rating of 2, as there are tensions with North Korea. Stephens says: "Japan is nervous that North Korea is testing nuclear weapons, although under the leadership of Kim Jong-il the country is very good at escalating tensions and then stepping back from the brink."

Other risks with a rating of 2, such as regulatory risk, are partly due to the election of a new government which raised the likelihood of changing regulation. RS

World Risk Review™

The World Risk Review™ provides short- to medium-term assessments of the level of risk associated with a range of political and economic perils that may impact upon business.

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The diversity and breadth of the data sources is intended to reduce, to the greatest extent possible, cultural bias, political influence and personal interpretation.

This approach contributes significantly to the robustness and integrity of the model and recognises that most country risk ratings available to the business have traditionally been heavily influenced by western bias reflecting the historical dominance of western foreign investors and trading businesses.

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