Foreign Insurance Companies—Cautious Optimism

By Hayden Stewart

Insurance in Japan is unnecessarily expensive. This view shocks many Japanese, because they generally pay lower insurance rates than Americans do. "The point is that Japanese pay lower rates because lawsuits and crime are less prevalent here," says the employee of an American insurance firm. "Their lower premiums reflect the relatively lower risk which their policies cover."

Japanese should be paying even lower rates. Take, for example, similar drivers in both countries with identical cars. The U.S driver might pay $1,000 annually for automobile insurance, of which $800 will be spent on risk coverage. In Japan he or she might pay $900, of which $550 will be spent on risk coverage.

While the Japanese consumer is indeed paying a relatively lower insurance rate, his or her insurance company is earmarking an astonishing 40% of this premium for "loading expenses"—agency commissions, salaries and other expenses. By contrast, the insurance company in the United States is allotting only 20% for such costs.

According to industry insiders, those figures vary greatly between companies and types of policy, but they are characteristic of the Japanese consumer's situation.

When considering these high prices, foreign companies generally point to government regulations and business practices, which have allowed a few companies to dominate the market. Such an atmosphere discourages modernization. Computer networks, for instance, are still not effectively utilized here.

Japan's government is moving to overhaul the insurance industry. In 1995, the Diet expects to consider Japan's first major insurance reform in over 50 years, which should deregulate the industry and help spur competition.

Many foreign companies already do well in Japan; with reform, some will do even better. The United States, for instance, records a trade surplus of between $US400 and $500 million annually with Japan in insurance.

Enthusiasm for the reform among foreign companies is tinged with caution, however. "The government could manipulate this legislation, in order to protect domestic firms," says one company. Indeed, the United States trade representative is asking Japan to guard against discriminatory policies.

An overview of the Japanese market

Success in the Japanese insurance market does not come easily. Foreign-owned companies have captured only 2% of the Japanese insurance market. In other G-7 nations, by contrast, the rate of import penetration is between 10% and 33%.

According to one non-life insurance executive, in many Western countries, foreign firms have expanded by acquiring local companies. But such strategies are nearly impossible in Japan, he says. "More than 1,000 insurance firms operate in the United States. By contrast, 22 domestic companies enjoy 98% of Japan's non-life market. By Western standards, even the smallest of these companies is large." Asks he, "How could foreigners easily buy such a company?"

Domestic regulations are partly responsible, observers believe. Japan does not permit holding companies (diversified firms that engage in banking, investment, various kinds of insurance, and other financial services). By closing the market to other domestic financial interests, this regulation helps to maintain the existing line-up of major corporations.

The insurance industry itself is divided into two sectors: life and non-life policies. A single company cannot sell both types of insurance. A spokesperson for Mitsui Fire and Marine (a non-life company) confirms that, "We are separate from Mitsui Life Insurance. Our salesmen cannot sell life insurance policies."

These regulations are over 40 years old. After World War II, the American military placed a ban on holding companies, as a part of its strategy to dismember Japan's zaibatsu conglomerates.

Instead of buying Japanese companies, foreign firms have opened their own subsidiaries in Japan. Many of these subsidiaries have succeeded and now report a high degree of respect for the Japanese market. But they also protest some government regulations and business practices. Insurance executives single out a few sore points.

Interestingly, most executives spoke on the condition of anonymity, "This is a close-knit business," explains one, "no one wants to say anything controversial."

Policy/price uniformity

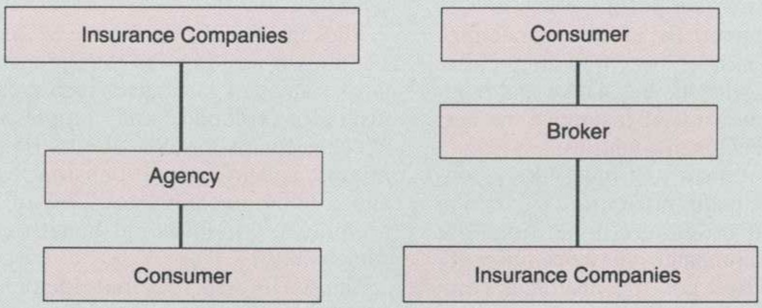
The Ministry of Finance (MOF) regulates Japan's insurance industry in accordance with relevant laws, including the Insurance Business Law, dating from 1939. This law encourages insurance companies to offer nearly identical policies for similar prices.

In order to introduce new policies, insurance companies must receive a license from the ministry. One U.S.-based company, UNUM, recently received approval for Japan's first long-term disability insurance.

"It took nearly two years," reports a company spokesperson. Several other companies received approval to offer similar products within just a few weeks. Explains UNUM, developing companies generally disclose their licensing documents to other companies, who then apply for a license to sell similar products. The MOF will extend a license to firms who demonstrate their capacity to handle the policy. It is an industry tradition.

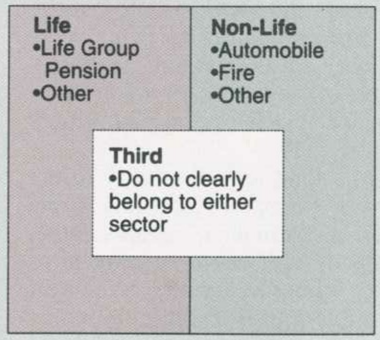
In addition, companies are generally required to charge similar prices for these similar products. The Premium Rating Authority, which is composed of private companies, collects information

Japan's Agent System Compared to the Brokerage System



Under Japan's agent system, intermediaries represent an insurance firm. Some foreign companies allege that this system leads to higher prices and limits the diversity of distribution channels. The MOF will probably introduce the brokerage system to Japan, under which brokers represent their customer.

Market Segmentation



Insurance is divided between life and non-life policies. The "third sector" is a grey area which does not clearly belong to either group. Foreign companies have often pioneered such products.

from insurance firms. It then recommends the premium which companies should charge for some policies. The authority does not consider every type of insurance—marine insurance is one example—but it does regulate the major product areas, including automobile, personal accident, and fire insurance.

In these ways, the MOF fosters a financially stable atmosphere for the introduction of new policies, believes UNUM.

The agent system

Insurance companies often rely on an intermediary to handle their sales. In the West, this company is often a broker. In Japan, it must be an agent.

Brokers and agents are legally distinct. A broker represents his customer, so he is liable for his "errors and omissions"—if a customer cannot fully exercise an insurance policy, even if the error was made by his or her insurance company, the broker must pay the balance.

By contrast, an agent represents an insurance company, not the customer. As a result, only the insurance company will be liable for any problems.

The distinction may seem technical, but it has profound implications in terms of price and distribution, says an account executive with a foreign insurance agency. Because brokers represent their customer, he explains, they deal with several insurance companies and bargain amongst them for cheaper prices and better policies. Of course, this system also helps foreign companies recruit salesmen in other markets.

The agency, the Japanese subsidiary of a U.K.-based broker, represents about 20 companies. Nonetheless, traditional agents account for over 99% of Japan's market, says the executive. "We are not a significant force within the Japanese market."

Japan's agent system leads to higher prices and makes it difficult for foreign companies to develop a sales network, concludes the executive, because they are primarily loyal to an insurance company. "They are not exclusive agents," alleges one company, "nor are they fair and impartial."

Keiretsu

The Japanese government maintains strict anti-trust regulations. Insurance companies may not own more than 10% of another company, yet foreign companies still believe that keiretsu ties bias the purchasing decisions of major Japanese corporations.

A report by the American Chamber of Commerce in Japan (ACCJ) states: "Eleven keiretsu member companies account for more than 80% of the total non-life insurance market in Japan. With respect to the purchasing practices of the eight horizontal groups and six vertical group studied, on average over 70% of the non-life insurance business of those keiretsu groups is given to the respective member insurance companies of the groups. Moreover, at least 92% of the insurance business of such groups is handled by financially related insurers."

Policy/price uniformity, the agent system, and keiretsu ties can frustrate foreign companies. This is because large corporations are often obliged to purchase their insurance from a particular company. At the same time, foreign companies lack a variety of distribution channels and cannot tempt keiretsu-affiliated firms with either innovative products or better prices.

The 'third sector'

Foreign insurers have still managed to do well, as demonstrated by Japan's large trade deficit in insurance.

"The Japanese market is excellent and sophisticated," reports UNUM. "When we came to Japan, we naturally studied its markets and customs. Indeed, we are pleased with the receptivity of the MOF and the market."

Some foreign companies succeed by offering general policies, while others pioneer new products. Amongst the later, says the account executive of the

U.K.-based agency, "Many of these policies cannot easily be classified as life or non-life products."

As a result, the MOF has allowed life or non-life companies to offer these new policies, creating a grey "third sector." Most of these policies involve personal accident, sickness, hospitalization, and nursing.

UNUM's long-term disability insurance is one example. According to the policy, if a customer is incapacitated, the company will pay a percentage of his or her former salary until retirement age. On average, foreign companies collect 53% of their premiums from third sector policies, reports the ACCJ.

In some fields, such as cancer insurance, foreign companies account for over 90% of the market. "Domestic firms may offer third sector policies," says the British agent, "but they generally do not concentrate on marketing them."

Reform

Japan's status quo does have its supporters. "In the United States, insurance companies frequently go bankrupt, but this is quite rare in Japan" says one executive. "Personally I can only remember one case. It was a foreign-affiliated firm."

Japan's insurance industry is also fairer, they say. In the United States, high-risk people are unable to purchase insurance. Due to Japan's rating system, some low-risk people may pay higher premiums so that everyone can obtain insurance.

Nonetheless, agreement on the need for reform cuts across national barriers. Both the MOF and foreign companies are calling for change. On June 17, 1992, the Insurance Council, an advisory organization to the MOF, first recommended that Japan's insurance industry be reformed. Its report, "The Desirable New Insurance Industry," stresses the need for modernization through competition.

On the basis of this report, the Insurance Business Law is currently scheduled for its first reform in a half century. A draft has already been concluded, and the amendment bill is expected to be submitted to the Diet in 1995.

According to the Foreign Non-Life Insurance Association (FNLIA), a private group which represents 24 foreign-based firms, "Our general position is to actively support the effort to modernize Japan's insurance system to more closely align it with the legislative and regulatory framework of insurance markets in other developed countries."

MOF's reform will most likely consist of four major pillars:

First, to promote competition, life insurance companies may open non-life products. And non-life insurance companies may similarly establish life insurance subsidiaries.

Second, the MOF will promote a variety of policies by expediting the approval of new products and encourage price competition by liberalizing insurance premiums somewhat.

Third, the ministry will encourage the diversification of sales channels, including the introduction of a brokerage system.

Fourth, the MOF will protect consumer rights under conditions of increased competition.

In order to do so, the ministry is expected to introduce several measures, including solvency margin standards, and a financial assistance fund (to which all insurers would contribute) to assist financially endangered companies.

Foreign companies protest

Foreign companies recognize that heightened competition will lead to thinner profit margins in deregulated areas. They do not oppose reform for this reason, says FNLIA.

The problem, some foreign companies say, is that the MOF may target the third sector for deregulation. They base this fear on the vagueness of the Insurance Council's report, which indicates that MOF will not deregulate all policy areas at the same time.

Indeed, the ministry is expected to focus on "product categories which would not be problematic in terms of protecting policyholders." According to a FNLIA document, this "could allow the proposed changes to occur only in the areas in which foreign companies have been most successful (the third sector)."

Adds the ACCJ, "So far, the MOF has not shown any plan to deregulate the largest areas of insurance, such as auto insurance (voluntary and compulsory), which accounts for 59% of non-life premiums, and life group pension insurance, which accounts for 27% of life premiums, which would benefit consumers most."

The MOF also may not adequately address Japan's network of keiretsu relationships.

Braver new insurance?

The American and Japanese governments discussed these problems recently. On October 11, 1994, Michael Kantor, the United States trade representative, and Kuriyama Takakazu, the ambassador of Japan, signed an agreement. It seems to be a positive step, say foreign companies.

According to the agreement, the MOF will not deregulate the third sector "as long as a substantial portion of the life and non-life areas is not deregulated."

The agreement does not directly tackle keiretsu relationships, but calls for a study of keiretsu insurance transactions, jointly commissioned by private domestic and foreign companies.

Some companies are optimistic. Says UNUM, "We support the direction of the reform movement and look forward to its gradual implementation."

Yet others are not so positive. "Officially, my company agrees," reports the anonymous employee of a British insurer, "yet everyone privately knows that it will be difficult to compete with domestic firms in a more competitive environment." Explains he, "They have larger asset bases."

As Japan's new world of insurance takes shape, consumers can hope for lower prices, while foreign companies can look forward to freer competition. JJTI

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