The Difficult Environment of Life Insurance Management

By Izumi Masaki

A severe shock wave sent shivers through the life insurance industry in February. The Financial Services Agency (FSA) issued a partial business suspension order against the major firm Meiji Yasuda Life Insurance Company judging that it had committed violations of the Insurance Business Law, including the non-payment of life insurance proceeds even when policyholders' duty to inform the company about their medical history had not been breached. The order prohibited new sales of individual insurance products at all branches, including agencies, from March 4 to 17, 2005. The two week business suspension order was the longest ever against a life insurance company and was an exceptionally severe penalty. The FSA also found that the company had used unlawful solicitation, canvassing customers by stating "Insurance claims are payable after a certain period even without a report of medical history." The FSA simultaneously issued a business improvement order requiring radical strategies to improve the management control system and to prevent a recurrence.

When policyholders subscribe to life insurance, they have a duty to report their medical history and health status to the life insurance company. According to the FSA, the former Meiji Life Insurance Company, the predecessor of Meiji Yasuda, decided in 2002 on a policy of strictly applying the Civil Law provisions that allow policies to be annulled when the duty to report is breached. Non-payment claims increased sharply around this time, and "the management team permitted rampant misuse of the non-payment application by the division responsible" (FSA), even after the company merged with the former Yasuda Mutual Life Insurance Company in January 2004.

A number of Meiji Yasuda salespeople misused a clausal point that a policy could not be annulled more than two years after being taken out by new customers. A "double standard" appeared with a contradiction between the reason for the refusal to pay and the explanation given at the time of solicitation, and there has been a string of problems with customers over the surrender of policies.

As a result of the report based on complaints to the FSA, 162 cases of illegal non-payment between April 1999 and the end of September 2004 have come to light. Of these cases, 61 involved "improper solicitation" in which the salespeople did not advise new customers to report on their health status or concluded policies without reporting the health status of new customers to the company despite knowing the facts. Meiji Yasuda has indicated that it intends to pay a total of ¥1.522 billion in insurance claims related to all of these policies.

The problem surrounding Meiji Yasuda reflects the difficult management environment of the life insurance business, as well as the intentions of the FSA in the new financial era following the full implementation of the deposit insurance cap in April 2005 (¥10 million plus interest). Given the situation that the emergency disposal of non-performing loans (NPLs), the negative legacy of the bubble economy, has passed its peak and the main thrust of FSA administration is shifting to activating the financial markets, the FSA is increasingly conscious of customer protection, which can be pinpointed as the reason for the exceptionally severe penalties.

The new policy for financial administration, the Program for Further Financial Reform, which the FSA published at the end of last year, clearly shows its intentions. As the successor to the Program for Financial Revival, which pushed the major banks to dispose of NPLs quickly, it promotes deregulation with a view to integrating the banking, securities and insurance industries and new market entrants while clearly stating the establishment of a legal system for customer protection in response to diversifying financial services. At the press conference, Ito Tatsuya, Minister for Financial Services, emphasized a change in the financial administration, saying the FSA will "proceed with our financial reform emphasizing users' benefits."

Briefly introducing the details of the new policy, the program encourages financial institutions to improve earning potential through efficient management based on the use of IT, at the same time clearly stating the establishment of rules for electronic financial transactions to prepare for the spread of on-line and IC card fund settlements. In response to the development of conglomerates such as the mega-banks, the reconsideration of legal provisions to completely eliminate unnecessary regulations, and the formulation of an Investment Services Law, which comprehensively controls newly emerging financial services to protect consumers and investors, are also included.

The program also specifies the introduction of an evaluation system that rates financial institutions based on the results of inspections. It postponed the establishment of uniform numerical targets for the disposal of NPLs, but major banks are required to reduce their NPL ratios below a certain level at the end of March 2005, and regional financial institutions are obligated to formulate new plans that state numerical targets based on their own judgment.

In terms of deregulation aimed at market revitalization for the insurance sector, where product planning and solicitation methods are strictly circumscribed, the policy promotes diversifica-

Photo: Kyodo News

Kaneko Ryotaro, President of Meiji Yasuda (second from left) at a press conference

tion in products and services, which includes widening the range for discretion in the setting of premiums as well as establishing rules that will make it easy to conduct comparative advertising.

Gomi Hirofumi, the director general of the FSA, stresses that in expanding the choice of products, "We can only require investors (customers) to be responsible for themselves when proper information disclosure and control of unfair and illegal transactions are inseparable." With regard to the Meiji Yasuda problem, Gomi has requested the Life Insurance Association of Japan to formulate industry guidelines to prevent illegal activities. There is no doubt that the FSA is strengthening its stance on severe penalties for illegal activities by financial institutions, including life insurance companies, in parallel with the promotion of deregulation.

On the other hand, the business environment for life insurance companies continues to be challenging. Looking at the business results of the 10 leading life insurers for the first half of FY 2004, total individual insurance and annuity policies in force (total death coverage) for the 10 companies fell 2.1% compared to March 31, 2004 to ¥1,039.6267 trillion, recording a fifteenth successive half-year decline. All of the six top companies, led by Nippon Life Insurance, suffered double-digit declines in the number of new policies, which clearly indicates "a lack of interest in life insurance."

The number of new policies saw negative growth at nine of the companies – the exception being Daido Life Insurance – with Asahi Mutual Life Insurance down by 51.6% Y/Y, Mitsui Life Insurance by 26.8% and Meiji Yasuda by 23.5%. With the level of surrendered and lapsed policies remaining high, the result was that the policies in force recorded negative growth at seven of the companies.

Against a background that includes investments and loans locked up in real estate, which grew during the bubble economy period, and operational difficulties in an environment of ultra-low interest rates, seven life insurance companies went bankrupt between 1997 and 2001. Compared to this wintry era, their managements have regained stability, albeit thanks to the general recovery in share prices. Nevertheless, the tough environment allowing no escape from the doldrums persists, as demonstrated by the fact that total new policies for death coverage products at the top 10 companies fell by 15.1% in the first half of FY 2004.

With the private life insurance membership rate among people in their 20s falling below 60% in FY 2003, the "lack of interest in life insurance," mainly among the young, also casts a serious shadow. Some analysts are concerned that the failure to attract young customers is a problem which may become a body blow to the business. Although life insurers are responding by beginning a shift in focus to the third sector such as medical insurance, this only intensifies the competition with foreign-affiliated insurers.

The conventional style of doing business, which relies on massive sales force tactics, is also approaching a turning point. The major life insurers have kept up methods that employ upwards of 10,000 salespeople every year, and the sales tactics are slow to change. Apparently, about half the salespeople quit in less than a year, which wastes training costs. The pay of some 200,000 salespeople is usually structured so that the basic wage is kept low, and pay increases in proportion to insurance sales performance. Driven by strict quotas in an environment of a slump in business results, salespeople tend to resort to the illegal activities and solicitation seen at Meiji Yasuda.

At the end of last year, foreign-affiliated American Family Life Assurance (AFLAC) was the talk of the industry. As of September 2004, AFLAC overtook Nippon Life Insurance and went into the lead for the first time on the number of individual policies, including annuities, in force. Compare with Japan's major insurer, which focuses on death coverage-type products, mainly through door-to-door and face-to-face sales by salespeople, AFLAC has a low proportion of death coverage products and provides medical and cancer insurance at a low cost by mail order and through agencies. The reversal in position of the two companies symbolizes the sad plight of the Japanese life insurance industry.

Diversification in sales networks is moving along with the complete lifting of the ban on bank counter sales of insurance in April 2007. A change of management will be needed even more, but the ideal vision of life insurance management befitting the new era which the FSA leadership envisions is not completed yet. JS

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