JAPAN
Key characteristics of the insurance market

1 Introduction

1.1 General

As of April 2018, 105 insurance companies[1] in Japan were authorised by the Japan Financial Services Agency (FSA) to provide their services. In comparison, these companies represented 28,908% of total assets of insurance undertakings operating within the European Union (EU).

Table 1 depicts the number of regulated insurance undertakings in Japan by insurance activities and the importance of the country compared to the EU, based on total assets.

Table 1 - Regulated insurance companies

Size of sector	#
Life undertakings	41
Non-life undertakings	52
Insurance holding undertakings	12
Total	**105**
Total assets JP / Total assets EU %	**28,908%**

Source: FSA and Deloitte-CEPS analysis

1.2 Balance sheet

At the end of 2017 (2017 Q4), assets held by Japanese insurance undertakings totalled 3 264 billion EUR.

In terms of technical provisions, 83,4% of the total balance sheet relates to the life business (i.e. non index-linked and unit-linked business) while 3,9% represented non-life obligations.

Table 2 - Solvency II balance sheet (S.02.01) and EU comparison (solo)

in Mio EUR			EU				
	Amount	**%**	**%**	**Avg**	**Min**	**Max**	**StD**
Investments, deposits, cash and cash equivalents			67,8%	67,3%	22,6%	90,1%	17,2%
Assets held for index-linked and unit-linked contracts			24,2%	24,3%	2,5%	59,3%	16,2%
Other assets	84 251	2,6%	8,1%	8,4%	2,1%	19,5%	4,9%
Total assets	**3 264 063**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**0,0%**
Technical provisions – life	2 722 945	83,4%	46,3%	32,2%	3,0%	64,2%	17,9%
Technical provisions - non-life	128 115	3,9%	6,6%	12,9%	2,4%	38,5%	9,1%
Other liabilities	274 770	8,4%	8,9%	9,0%	4,0%	21,3%	3,9%
Total liabilities	**3 125 830**	**95,8%**	**86,9%**	**77,6%**	**49,1%**	**92,7%**	**11,1%**
Excess of assets over liabilities	138 232	4,2%	13,1%	22,4%	7,3%	50,9%	11,1%
Total liabilities + Excess of assets over liabilities	**3 264 063**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**0,0%**

Note: All reported figures correspond to fiscal year ended March 2017.

Source: General Insurance Association of Japan (GIAJ), Life insurance Association of Japan, EIOPA Solvency II statistics and Deloitte-CEPS analysis

[1] In the report, the term 'insurance companies' indicates direct insurance companies. The insurance market therefore refers to insurers.

1.3 Solvency ratios

As of 1996 the FSA has introduced the Solvency Margin Ratio (SMR), which is the ratio of solvency margin (net assets and special reserves based on accounting balance sheet, excluding items such as intangible assets) to half of risk requirements calculated based on standard factors stipulated in subsidiary legislation.[2] In other words, a 200% SMR implies that the margin exactly covers the risks. The table below shows the SMR for Life and Non-Life insurers for the fiscal year 2017.

Table 3 - Solvency margin ratios Life and Non-life insurance undertakings

in Mio EUR

	Life	Non-Life
SMR	958,3%	756,0%
Total net assets	170 063	64 502

Source: FSA

The FSA continuously monitors and regularly inspects all insurance companies. For the fiscal year ended March 2017, the reported SMR ratio for Life insurers was 958,3%, lower by 25,2 points from the previous year, mainly due to an increase in investment risk, which was caused by an increase in the balance of domestic stocks in some insurance companies.

On the other hand, Non-Life insurers had an SMR equal to 756,0%, which increased by 52,1 points from the previous year, primarily due to an increase of solvency margin caused by strong earnings.

[2] More information is available at: https://www.fsa.go.jp/en/refer/ins/capital.html

2 Investments

2.1 Asset exposure

At the end of 2017, and from an asset exposure perspective, the insurance market in Japan was heavily invested in securities (in total 81,7% of total Investments Deposits, Cash and Cash Equivalents), and to a lesser extend in Loans (8,3%), and Cash Deposits and Savings (2,4%).

Within the securities category, the insurance market was mainly exposed to government bonds (48,8%) and corporate debt (8,5%). At the same time the EU averages were 28,7% and 26,9%, respectively.

The category of foreign securities was also one of the most important for the Japanese Insurance market in terms of asset exposures. In total 769 million EUR were invested in foreign securities, representing 23,6% of total investments

Table 4 – Asset exposure Japan

In Mio EUR	Amount	%
Cash deposits and savings	**79 936**	**2,4%**
Call loans	**13 646**	**0,4%**
Monetary claims bought	**14 364**	**0,4%**
Monetary trusts	**46 753**	**1,4%**
Securities	**2 668 257**	**81,7%**
Government bonds	1 203 342	45,1%
Local government bonds	97 985	3,7%
Corporate bonds	227 058	8,5%
Stocks	242 742	9,1%
Foreign securities	769 081	28,8%
Other securities*	128 050	4,8%
Loans (financial loans)	**272 301**	**8,3%**
Tangible fixed assets**	**54 187**	**1,7%**
Receivables under resale agreements and under securities borrowing transactions	**30 367**	**0,9%**
Other***	**84 251**	**2,6%**
Total assets	**3 264 063**	**100,0%**

Note: Tangible fixed assets include land, buildings and construction in progress. Other includes lease assets, intangible fixed assets, and any other assets. Regarding foreign bonds, the Bank of Japan Review of April 2017[3] *mentions that insurers have accumulated foreign bonds since 2010. Notably, a high ratio of foreign-currency-denominated bond investments is a feature that cannot be observed at insurers in other countries. As a result, they have become more easily affected by not only overseas bond markets, but also foreign-exchange swap markets.*

Source: General Insurance Association of Japan (GIAJ), Life insurance Association of Japan and Deloitte-CEPS analysis

[3] More information available at: https://www.boj.or.jp/en/research/wps_rev/rev_2017/rev17e02.htm/.

2.2 Asset exposures between Life, Non-Life and Composite insurance undertakings

The table below gives further insight into the investment behaviour of Life and Non-Life insurance companies.

Table 5 – Asset exposure Life and Non-Life insurance undertakings

	Life	Non-life
Cash deposits and savings	**2,1%**	**6,5%**
Call loans	**0,4%**	**0,4%**
Monetary claims bought	**0,5%**	**0,3%**
Monetary trusts	**1,5%**	**1,0%**
Securities	**82,3%**	**75,3%**
Government bonds	47,0%	21,0%
Local government bonds	3,9%	1,4%
Corporate bonds	8,3%	10,6%
Stocks	7,4%	31,1%
Foreign securities	28,4%	34,7%
Other securities	5,1%	1,2%
Loans (financial loans)	**8,6%**	**4,7%**
Tangible fixed assets*	**1,6%**	**2,7%**
Receivables under resale agreements and under securities borrowing transactions	**1.0%**	**0,6%**
Others***	**2.1%**	**8,4%**
Total assets	**100,0%**	**100,0%**

Note: Tangible fixed assets include land, buildings and construction in progress. Other includes lease assets, intangible fixed assets, and any other assets.

Source: General Insurance Association of Japan (GIAJ), Life insurance Association of Japan and Deloitte-CEPS analysis

At EU level we note that Non-Life insurers invested a significantly higher portion of their Investments in Equity (18,8% equity investments) in comparison to pure Life insurers (6,6% equity investments). This is even more evident in Japan, were Non-Life insurers are exposed four time more (31,1%) than their Life counterparts (7,4%).

At EU level, pure Life insurers allocate a larger share of their investment to government bonds (28,1%) than Non-Life insurers (19,6%). This is similar for Japan, however, the difference is large, as Life insurers invest approximately 47,0% of their total assets in government bonds, whereas Non-Life insurers spend 21,0% of their total assets in government bonds.

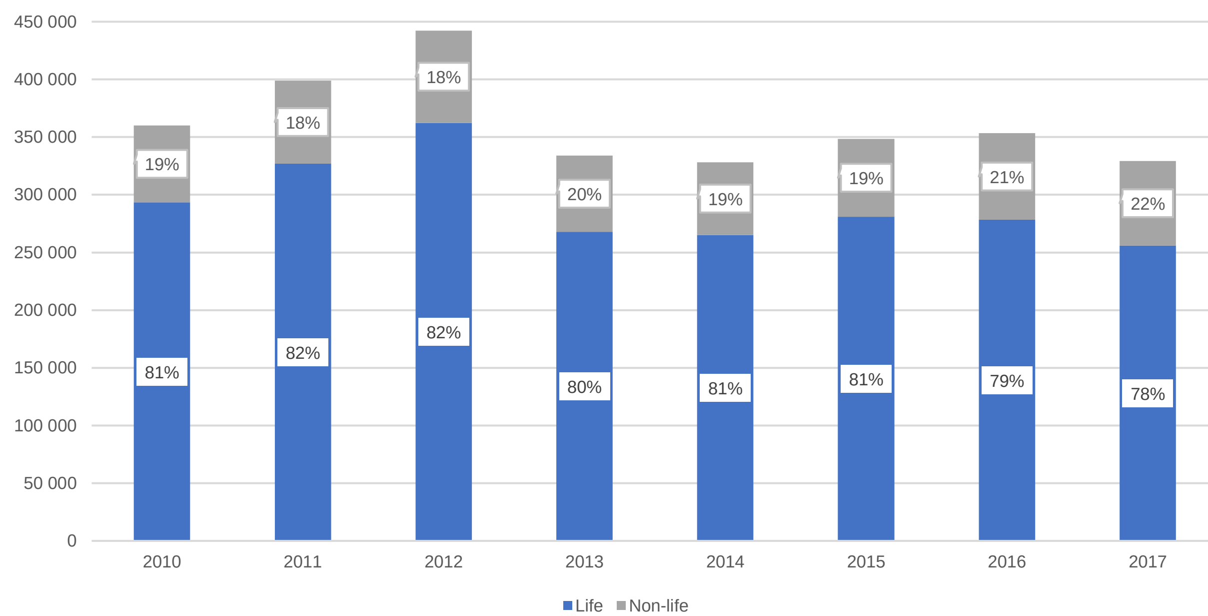
3 Insurance products

3.1 Overview

This section covers the most important insurance products offered in Japan and the volume of the market. Data reported in this section obtained from the Japanese Financial Services Agency (FSA), the Life insurance Association of Japan and the General Insurance Association of Japan (GIAJ).[4]

From 2010 gross written premiums of Japanese insurance companies increased by 22,8%, and totalled 442 billion EUR in 2012. However, since then, premium income has fluctuated, with an overall downward trend, and reached 329 billion EUR at end 2017. The market is largely tilted towards life insurance products, which represents approximately 80% of the total market.

Graph 1 - Direct premiums (in million EUR)



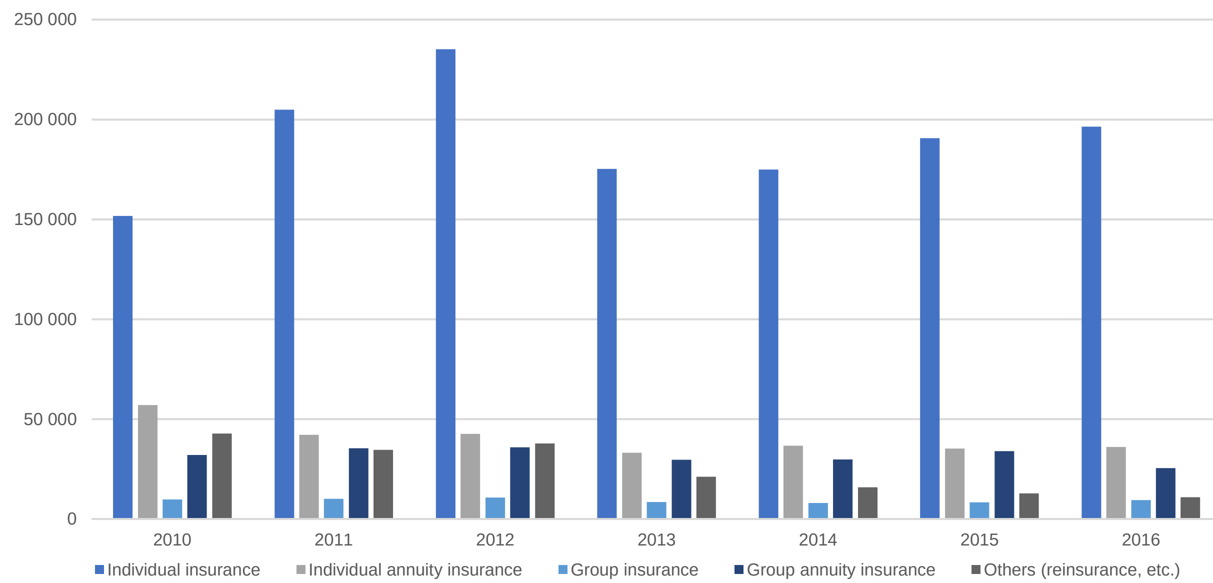
Source: Life insurance Association of Japan and GIAJ

[4] Available at https://www.fsa.go.jp/en/regulated_institutions/index.html, http://www.seiho.or.jp/english/statistics/ and http://www.sonpo.or.jp/en/statistics/.

3.2 Life insurance products

In 2016 life insurance business declined by 0,9% to 278 billion EUR and represented 78% of the insurance market. The sector can be divided into two broad categories: individual insurance and group insurance products. The former, which represents the biggest share of the market, accounted for 83,5% of the total life income, while the latter accounted for 12,5%. Other life insurance products, such as reinsurance, accounted for 3,92% of the premium income at the end of 2016. The breakdown of premium income by life insurance products for the period 2010-2016 is presented in Graph 2.

Graph 2 – Premium income for life insurance products (in million EUR)



Source: Life insurance Association of Japan and GIAJ

3.3 Non-Life insurance products

Gross written premiums of the non-life segment of the Japanese insurance market, have been fluctuating over the last years. In 2017 the income amounted to 73 230 million EUR, which was 2,31% lower than a year ago.

3.3.1 Motor insurance

Automobile insurance in Japan is operated under two different systems: voluntary insurance and compulsory automobile liability insurance. The voluntary insurance is an insurance for the interpersonal object covering damage such as the own loss and fellow passenger in a traffic accident.

Despite the decline by 3,29% to 2016, voluntary automobile insurance represents the largest non-life insurance class, with 44,53% of total premiums (or 32 609 million EUR).

3.3.2 Fire

Fire represents the second largest insurance class of the non-life segment. In 2017, premiums dropped marginally by 0,9% to 11 644 million EUR.

3.3.3 Personal accident

Personal accident insurance, the third largest non-life business line, account for 10,8% of non-life premiums. Gross premiums written amounted in 2017 to 7 894 million EUR, 3,8% down compared to a year ago.

3.3.4 Compulsory automobile liability

Total gross premiums written in compulsory automobile liability amounted to 7 681 million EUR, exhibiting a decline by 11,4% to 2016. Liability premiums accounted for 10,5% of total non-life premiums written during 2017.

3.3.5 General liability

Premiums for general liability rose by 3,8% in 2017 to 4 642 million EUR, representing 6,3% of the non-life sector.

3.3.6 Financial loss

In 2017, insurance products related to financial loss represented 3,9% of the non-life premium income. The segment increased by 3,6% to 2016 at 2 852 million EUR.

3.3.7 Marine and inland transit

Marine and inland transit represents 3,0% of the non-life segment. Gross written premium remained stable at 2 121 million EUR.

3.3.8 Workers' accident liability

Workers' accident liability insurance, recorded the highest change since 2016. Premiums rose by 70,6% to 1 233 million EUR. However, the sector represents only 1,7% of the total non-life income.

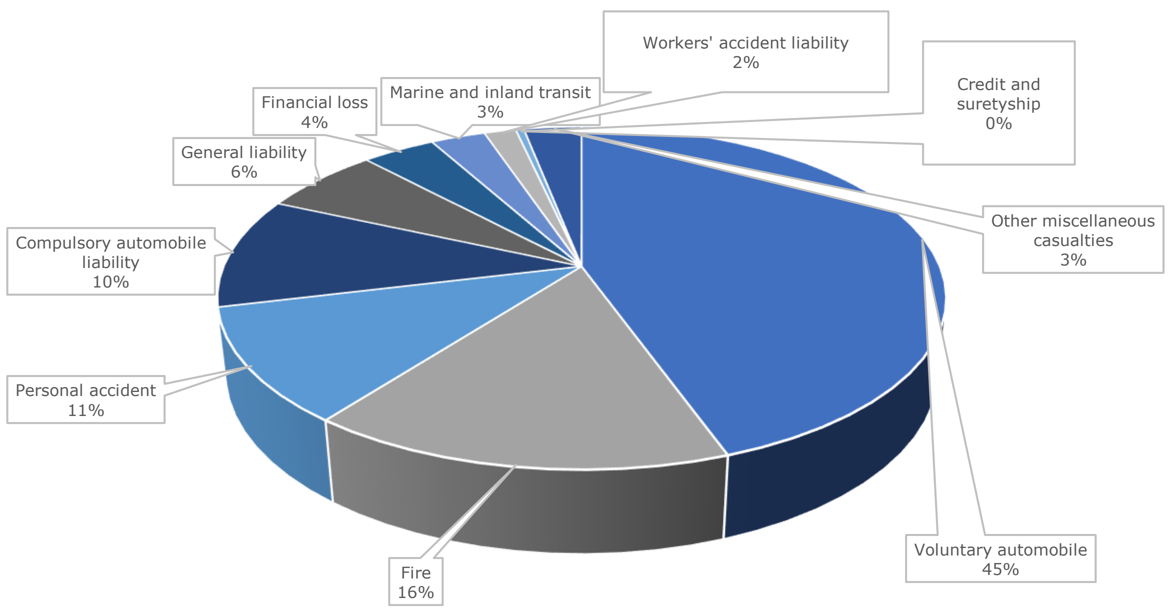
3.3.9 Credit and suretyship

Total gross premiums written in credit and suretyship insurance business amounted to 316 million EUR, exhibiting a decline of 9,2% compared to 2016. Premiums accounted for 0,4% of total non-life premiums written during 2017.

3.3.10 Other Non-life

Other classes of non-life business accounted for 2 239 million EUR in gross written premium in 2017 (down by 0,9% on 2016).

Graph 3 - % allocation of gross written premiums non-life insurance products



Notes: Other non-life insurance includes burglary, boiler & turbo-set, livestock, machinery & erection, contractors' all risks, atomic energy, movables comprehensive, and pet insurance.

Source: GIAJ and Deloitte-CEPS analysis

4 Accounting, Tax and Prudential framework

4.1 Accounting framework

Japanese Accounting Standards ('Japanese GAAP'), developed by the Accounting Standards Board of Japan (ASBJ), entered into force in August 2007 under an agreement between the ASBJ and the International Accounting Standards Board (IASB). While Japanese GAAP is not identical to IFRS, it has been found to be equivalent to IFRSs as adopted by the European Union (EU) since 2008.

As stated in the EFRAG discussion paper on Equity instruments impairment and recycling, under Japanese GAAP, equity instruments that are not held for trading are carried at FVOCI. In case the fair value is very difficult to obtain, instruments are carried at cost. An entity used judgement to recognise impairment loss for equity instruments carried at FVOCI, when the fair value has declined significantly, unless the fair value is expected to recover. However, the standard indicates:

- if the fair value has declined more than 30,0% but less than 50,0%, the entity shall assess the recoverability;
- if the fair value has declined more than 50,0%, the investment is presumed to be impaired, unless the entity can prove otherwise.

If the entity assesses that the fair value is expected to recover close to the original value within a year, it does not recognise an impairment loss.
For equity instruments carried at cost, an entity shall recognise an impairment loss when the value has declined significantly, unless it can demonstrate that the decline is recoverable.

Since 2010, eligible listed companies in Japan have been permitted to use IFRSs as designated by the Financial Services Agency of Japan (FSA) in their consolidated financial statements, in lieu of Japanese GAAP. This implies that Japanese listed companies or those applying for listing, can use designated IFRSs in their consolidated financial statements on a voluntary basis. In order to do that, they must establish internal processes to ensure appropriate reporting under designated IFRSs.[5]

4.2 Tax framework

4.2.1 Capital gains on shares

Capital gains derived by resident companies from the sale of shares in resident and non-resident companies are included in the ordinary income and are subject to tax at the general rate of:

1. 23,4%, however this rate will be reduced to 23,2% for fiscal years commencing on or after 1 April 2019;
2. A lower rate of tax applies to income up to a specified limit earned by small corporations.

[5] https://www.iasplus.com/en/jurisdictions/asia/japan

4.2.2 Capital losses on shares

Capital losses on shares are generally deductible.

4.2.3 Taxation of dividends

Exemptions are granted based on the participation percentage:

1. A 100,0% exemption applies if it concerns a 100,0% group company;
2. If the recipient company owns at least 33,33% in the distributing corporation for a continuous period of at least six months, an exemption applies on dividends (reduced by interest expenses) received from resident or non-resident companies by resident corporate shareholders;
3. If the recipient company owns less than 33,33% but more than 5,0% in the distributing corporation or if the recipient company holds more than 33,33% but for less than six months, a 50,0% exemption applies;
4. If the recipient company owns less than 5,0% of the shares in the distributing corporation, a 20,0% exemption applies (for dividends from portfolio investments received by insurance companies, the exclusion percentage will be 40,0%).
5. 95% of dividends received by a company from a foreign company in which it has held at least 25,0% of the outstanding shares for a continuous period of six months or more, are exempted provided that the dividends are not deductible in the residence state of the distributing entity.

If one or more of the above conditions is not met, the dividend is taxed at the ordinary rate.

Japanese source dividends are subject to 20,0% withholding tax, unless a tax treaty provides for a lower rate. The rate is 15,0% for dividends paid by listed companies.

A tax credit is available for foreign tax paid, subject to certain limitations.

4.3 Prudential framework

Regulation of the Japanese insurance industry is done under the Insurance Business Act (IBA) under the remit of the Financial Services Agency of Japan (JFSA). The FSA has the authority to demand reports and inspect insurers and if necessary, to take administrative action them. The IBA also provides a solvency margin ratio as a standard to assess the soundness of an insurance company’s business. Under their prescribed solvency rates, insurance companies must maintain a solvency margin ratio of at least 200,0%. In practice, however, all insurance companies maintain a higher ratio.

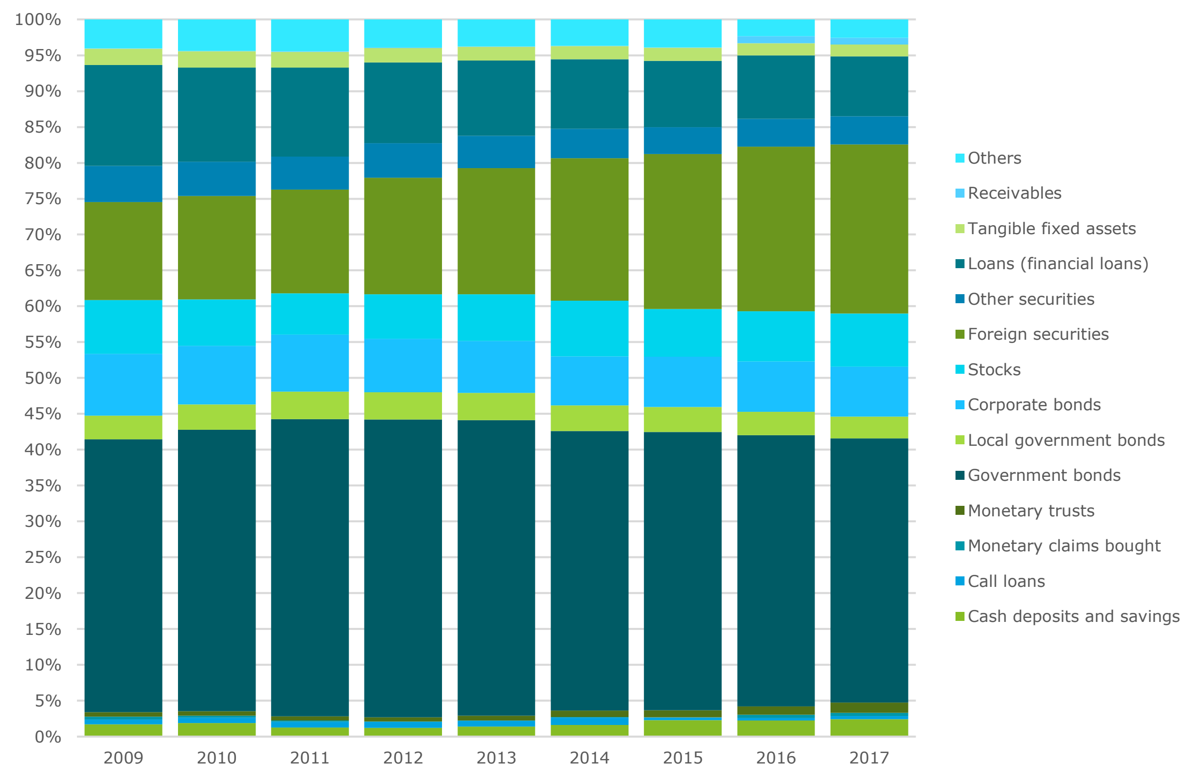
5 Historical data

5.1 Evolution of balance sheet

The graph below depicts the evolution of the different investment asset categories from 2009 until 2017.

The composition of the Japanese insurers balance sheet has remained relative stale over time. The most dominant assets classes are bonds, which represent on average 50,0% of the total assets. The lion's share is attributed to government bonds (39,3%), with local government and corporate bonds representing smaller share of insurers investment (3,5% and 7,5%, respectively).

Graph 4 - Evolution of balance sheet items (investment assets)



Notes: Tangible fixed assets composed of land, buildings and construction in progress. Others composed of: cash in hand; furniture and fixtures; construction in progress; amounts due from agency business; amounts due from other domestic companies for reinsurance; customer's liability for acceptance and guarantee; deferred tax assets; and miscellaneous.

Source: General Insurance Association of Japan (GIAJ), Life insurance Association of Japan and Deloitte-CEPS analysis

A pattern that has evolved over the years, is the increase in the allocation of asset towards foreign securities. While in 2009 they represented 13,7% of the total investment assets, by the end of 2017 they stood at 23,5%. Since the domestic interest rate remained low over the last years, financial resources were increasingly allocated to foreign securities (because of their comparatively higher interest rates). The magnitude of this increase is more evident in Life insurers, for whom foreign investments rose by 113,1%, as compared to Non-Life insurers (up by 70,3%).