

The history and the future of policyholder dividends in Japan from the viewpoint of policyholders' benefit

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(The content in this paper is the personal views of the author,
and have no relation to Nippon Life Insurance Company.)

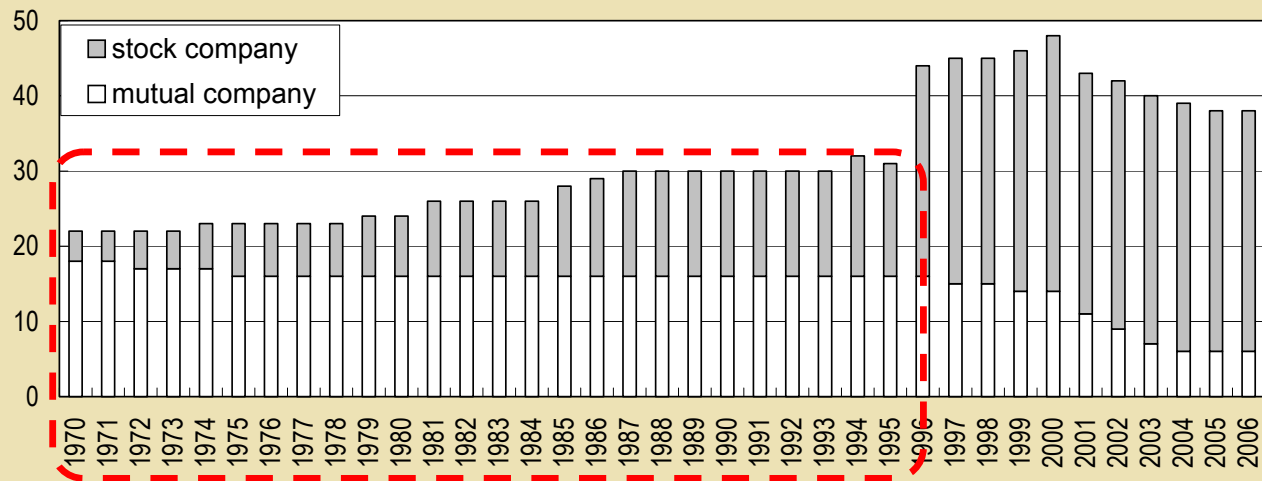
1. Introduction

About the life insurance market in Japan and participating contracts

- ◆ Many companies were mutualized after the World War II
- ◆ Due to the regulations that prevented foreign companies from entering the Japanese insurance market

Mutual companies were the majority in the market

Transition of the number of life insurers



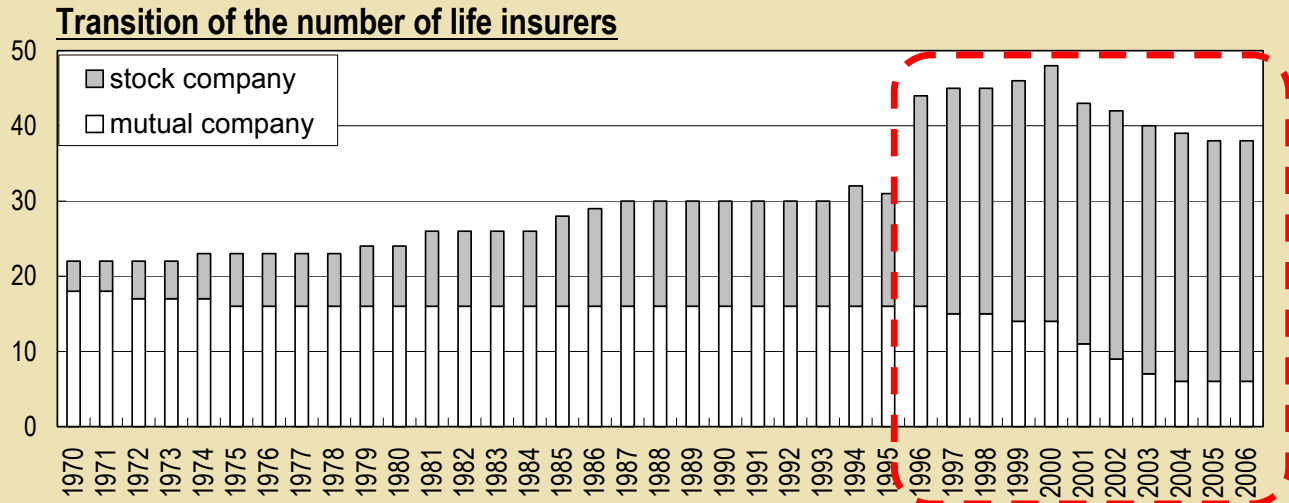
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- ◆ foreign life companies as well as the life subsidiaries of non-life insurers begun entering the life market
- ◆ several bankrupt mutuals were also acquired by foreign firms
- ◆ mutuals were demutualized

Stock life companies outnumbering mutual companies

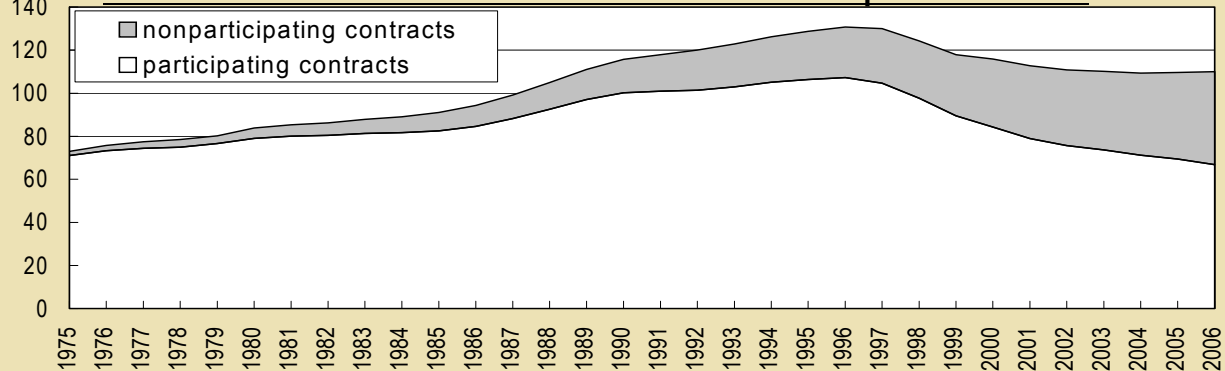




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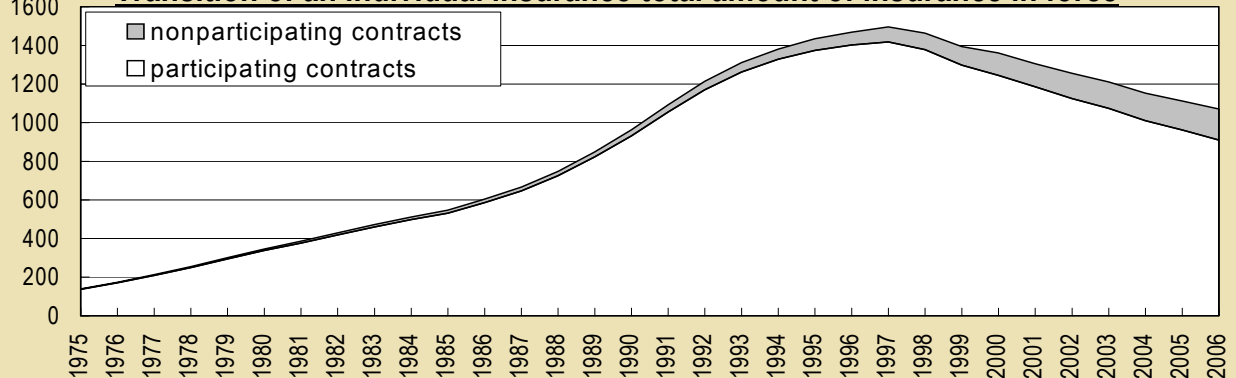
The total number of nonparticipating contracts in force is increasing

(Million) **Transition of the individual insurance total number of policies in force**



However, in terms of sum insured participating contracts still represent the majority.

(¥Trillion) **Transition of an individual insurance total amount of insurance in force**





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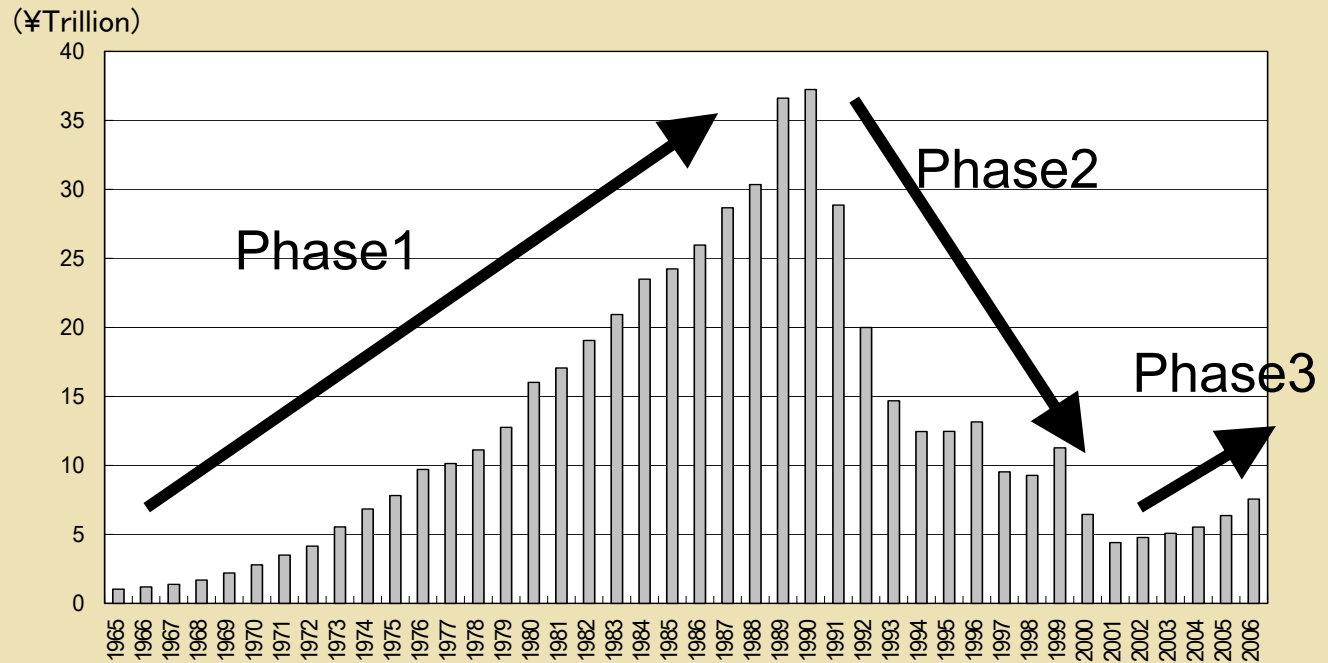
- ◆ In the past several years, each life insurance company which sells participating contracts has been increasing dividends to policyholders
- ◆ Contracts with high guaranteed interest rate began to mature or reach payout periods
- ◆ However most of these contracts are not the ones whose dividend rates are increased

The gap between actual amount of dividends and expected amount at inception became very wide

Consumers may therefore have more focus on the dividend increase in the near future

2. The history of policyholder dividends

Transition of the total amount of dividends



In this section, I'll divide the period from the postwar to the latest into three phases, and consider meanings and problems of policyholder dividends in every phase

2. The history of policyholder dividends

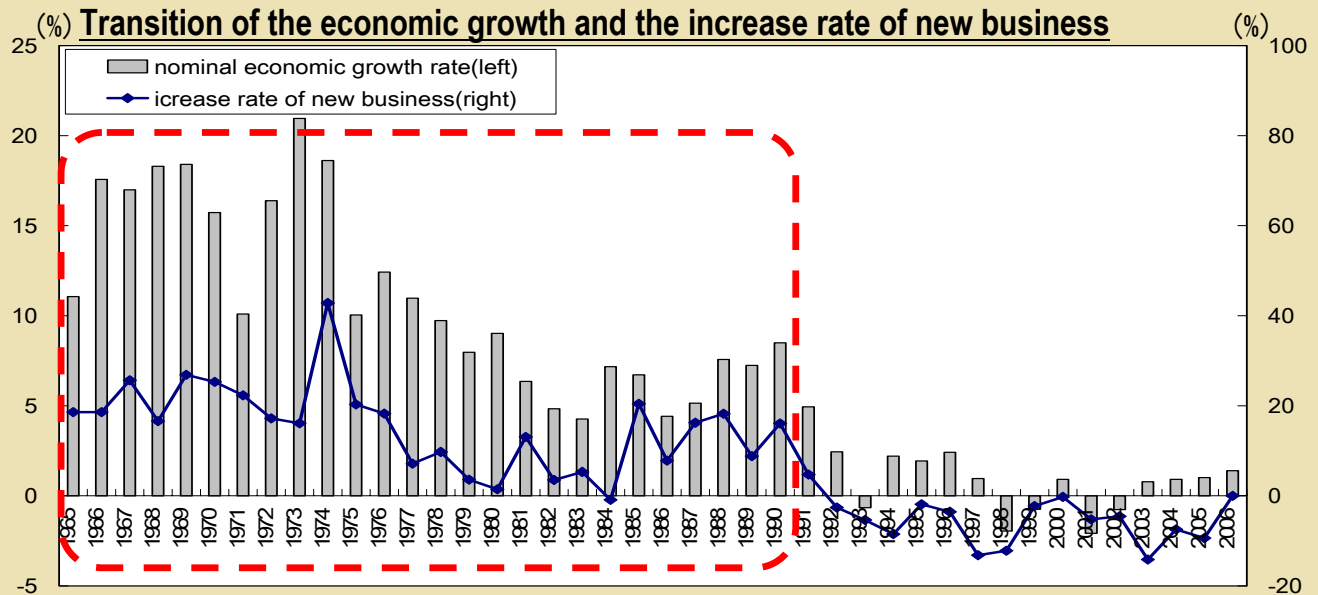
The period of economic growth which continued from the postwar period to the bubble burst (Phase1)

【 Economic conditions 】

- ◆ The economy continued growing up basically

【 The life insurance industry 】

- ◆ The life insurance businesses of this phase was strongly influenced by business fluctuations



2. The history of policyholder dividends

【 Policyholder dividends 】

- ◆ A rate for calculating dividends* was set high(7%-8%)

〔 * In the case that if this rate exceeds guaranteed interest rate, interest profit dividend will be paid 〕

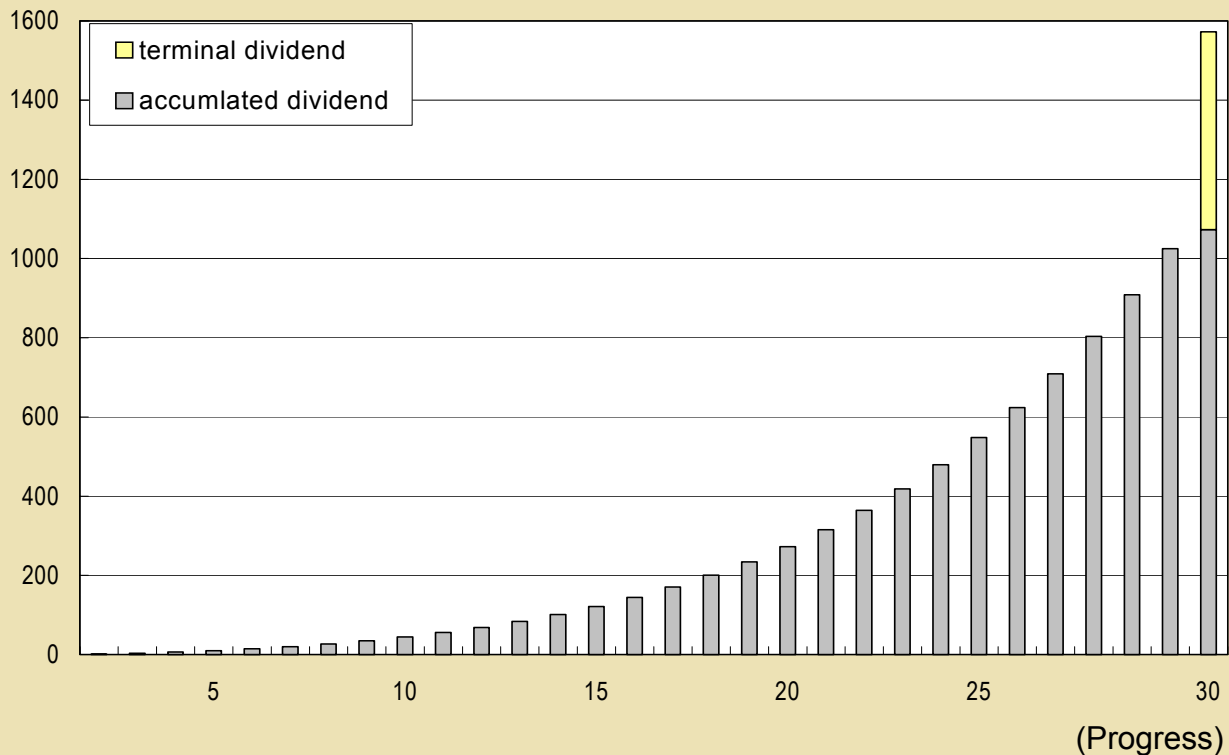
- ◆ Terminal dividend was introduced in 1971
 - The regulation for valuation was changed
(A shift to net premium method from Zillmerized reserve)
 - However in the fiscal year 1970 many companies reached the limit of reserves under a net premium method
 - In addition, from the viewpoint of policyholders' protection against high inflation and a surge of consumerism
 - It was necessary to give inflation protection to fixed amount insurance contracts
- ◆ Terminal dividend increased repeatedly

2. The history of policyholder dividends

Expected amount of dividends at inception based on the dividend rate set in the fiscal year 1976

Endowment contract settled in 1977
(insurance a million yen, insurance period 30 years)

(¥Thousand)



2. The history of
policyholder
dividends

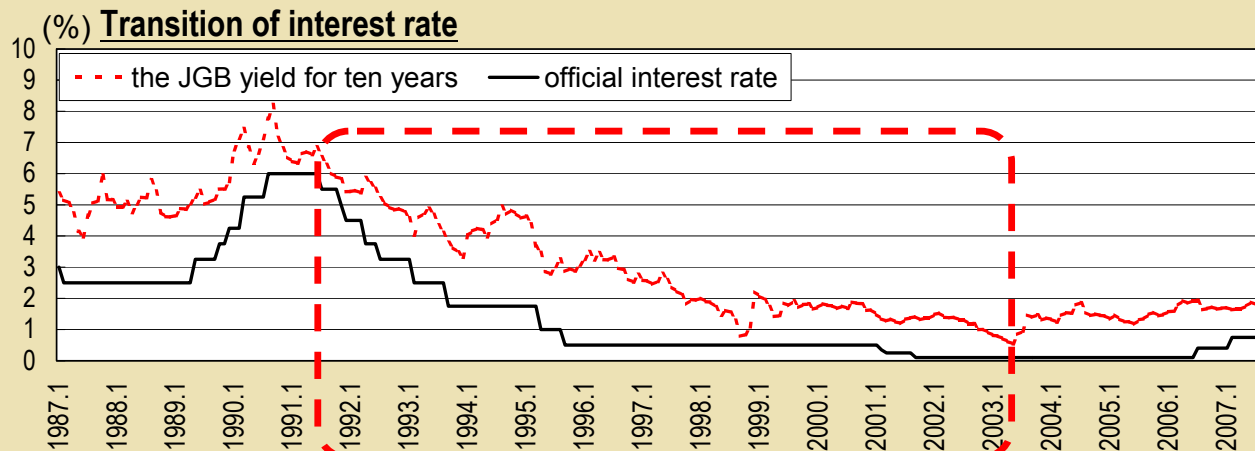
The Heisei recession period with the bubble burst (phase2)

【 Economic conditions 】

- ◆ The rapid economic expansion from November 1986 turned to recession period in April 1991
- ◆ Also, by the reduction of official interest rates, ultra-low interest environment continued

【 The life insurance industry 】

- ◆ As life insurer's investment yields was by far less than guaranteed interest rates of contracts under ultra-low interest rates, so-called "negative spread" problem got worsen
- ◆ Because some life insurers cannot endure a negative spread after 2000, life insurers went bankrupt one after another



2. The history of policyholder dividends

【 Policyholder dividends 】

- ◆ For contracts with high guaranteed interest rates, the so-called "negative spread" problem, that investment yields were by far less than guaranteed interest rates became serious
- ◆ And in fact it interrupted fair dividend allocation to policyholders
- ◆ Going to extremes, it was in a situation that the profits earned from contracts with low guaranteed interest rates, might be used to fill negative spread for contracts with high guaranteed interest rates

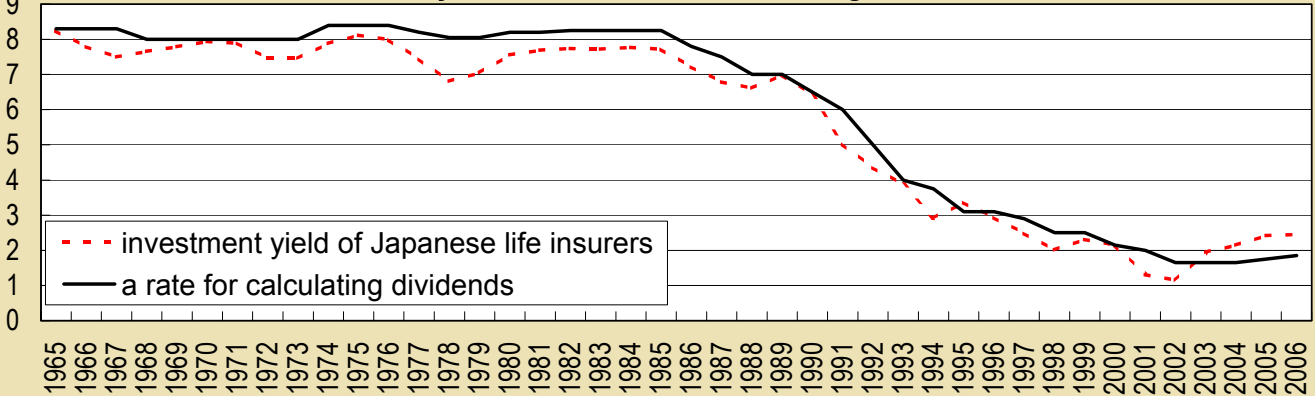
2. The history of
policyholder
dividends



2. The history of policyholder dividends

- ◆ In this situation, to provide dividend depending on the contribution of each contract in a limited source of profits, we introduced new dividend systems
 - Deduction for negative spread
 - Various rate for calculating dividends
 - Offset of dividends between main contracts and rider contracts
 - Adjustment for loading profit dividends and mortality profit dividends
- ◆ Many companies reduced the amount of dividends largely to satisfy solvency

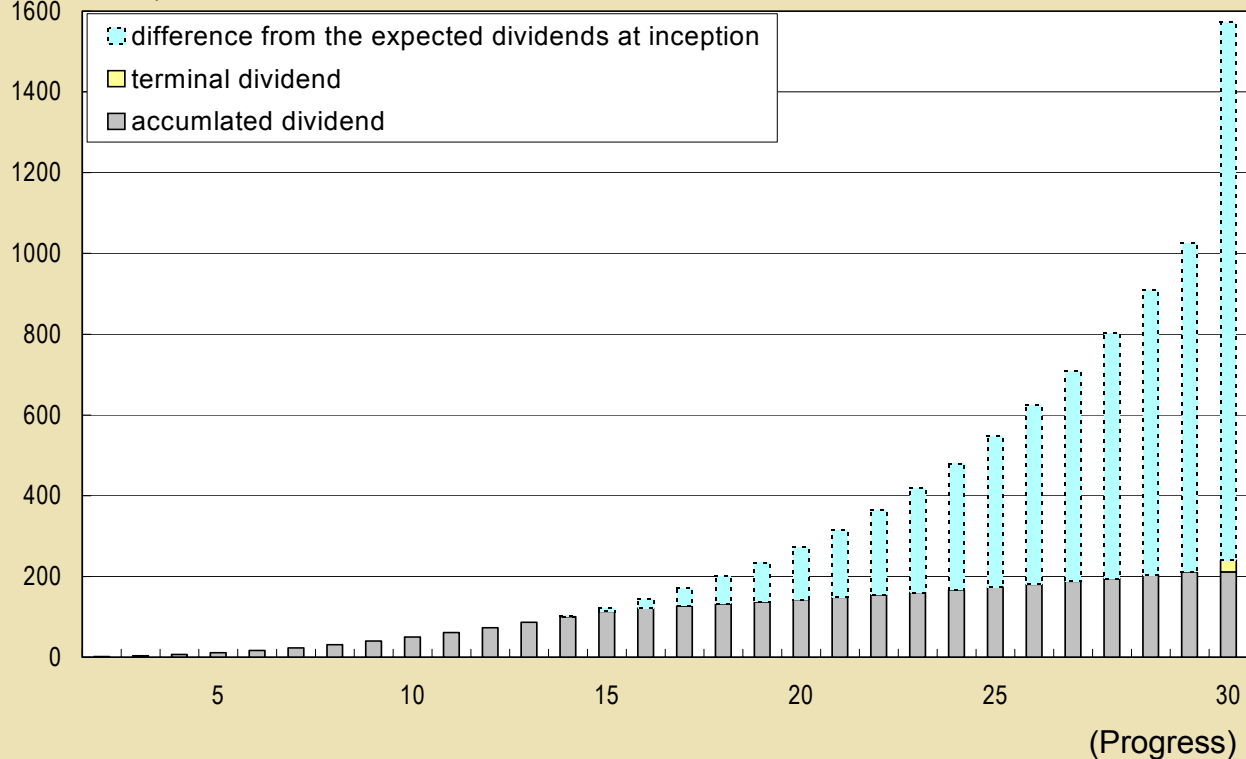
(%) Transition of investment yield and a rate for calculating dividends



Actual amount of dividends

Endowment contract settled in 1977
(insurance a million yen, insurance period 30 years)

(¥Thousand)



2. The history of policyholder dividends

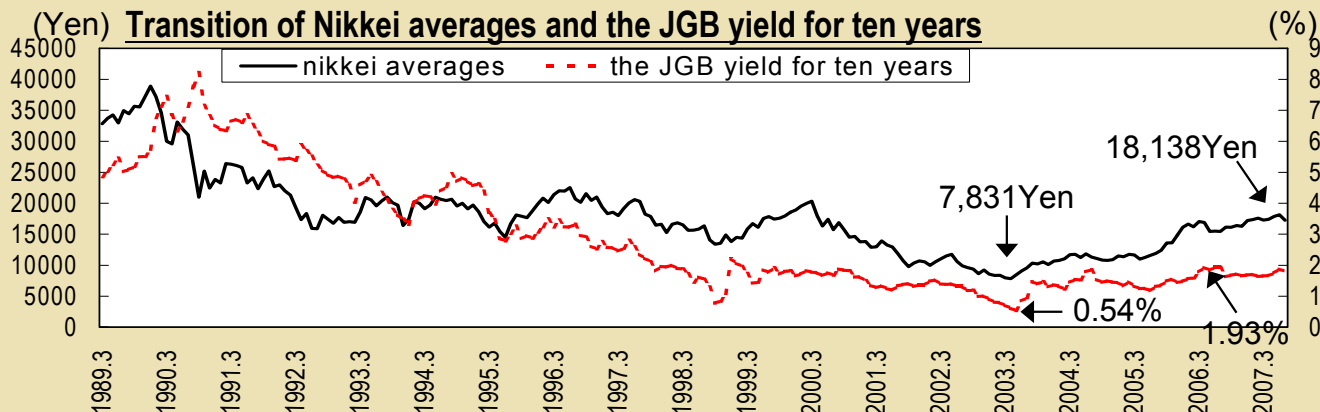
The increasing dividends phase backed by economic recovery (phase3)

【 Economic conditions 】

- ◆ Backed by steady economic recovery, up-trends brought a large increase in profits to many domestic companies
 - Nikkei averages rose from 8,000 yen to over 18,000 yen
 - The JGB yield for ten years also rose from 0.5% to nearly 2%

【 The life insurance industry 】

- ◆ Both the number of contracts and the amount of premium income (for policies both in force and new business) show a tendency toward improvement a little
- ◆ The profitability and the soundness of companies improved largely because of the large increase of investment income based on brisk market environment

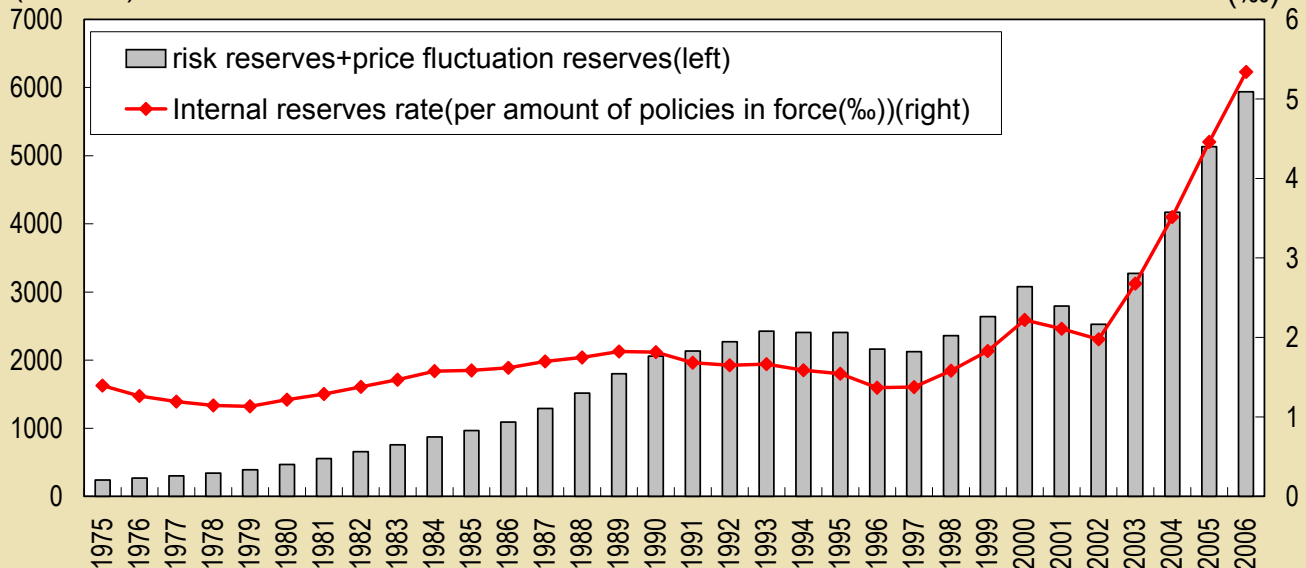


2. The history of policyholder dividends

【 Policyholder dividends 】

- ◆ Because economic environment improved and many companies satisfied solvency, they began to increase policyholder dividends.
- ◆ Even though the tendency to increase policyholder dividends continues in future, a problem is how to divide the limited source of profits, depending on contribution to profit of policies.

(¥Billion) Transition of internal reserves rate



2. The history of policyholder dividends

3. The dividend policy based on the policyholders benefit

A legal requirement for policyholder dividends

- ◆ Article 55-2 of Insurance Business Law
 - “Allocation of dividends to policyholders should be based on the principles for fairness and equitability.”
- ◆ Appointed actuaries have the role to confirm fair and equitable dividend policy by a rule of Article 121 of Insurance Business Law.
- ◆ The concrete method must be followed as the standards for appointed actuaries of life insurance companies, which is published by the Instituted of Actuaries of Japan and is inspected by JFSA.

3. The dividend policy based on the policyholders' benefit



3. The dividend policy based on the policyholders' benefit


- ◆ According to “the standards for appointed actuaries of life insurance companies”, fair and equitable dividend policy must satisfy the following matters.
 - ① To calculate the amount of dividends under the situation where policy reserve is accumulated appropriately enough to maintain the soundness of companies
 - ② To allot and distribute dividends depending on the contribution of individual contract
 - ③ To calculate, allot and distribute dividends based on reasonable actuarial mathematics and standard of generally accepted corporate accounting, conforming to laws, rules of notifications and terms of contract of insurance article
 - ④ To allot and distribute dividends considering policyholders' expectation from the viewpoint of the trend of the death rate of the nation and the trend of market interest rates

The balance between satisfying solvency and policyholder dividends

- ◆ "Expectation of policyholders" should be to receive insurance coverage with as low premium as possible, primarily.
- ◆ But it would be a great problem for a company to go bankrupt if premium were too low and they couldn't satisfy solvency.
- ◆ But even though it's important to satisfy solvency, policyholders wouldn't allow a company to accumulate internal reserves endlessly.
- ◆ It became the most important how to keep the balance between to satisfy solvency and policyholder dividend.

It is necessary to grasp how much risk there is in companies and how much solvency we need to cover the risk.

We must provide persuasive explanations for policyholders and get their understanding in order to maximize their benefit.



3. The dividend policy based on the policyholders' benefit

The reason why policyholders do not choose non-participating contracts but participating ones

- ◆ The reason is the outcome of policyholders' expectation that an actual premium adjusted by dividend might become lower than that of non-participating contracts.

The setting of dividend rates that considered the premium of non-participating contracts is expected from the viewpoint of considering the expectation of policyholders that the standards for appointed actuaries require.

3. The dividend policy based on the policyholders' benefit

Possibility of explanation to policyholders

- ◆ The dividend system depending on contribution may be the other side of concise dividend system.
- ◆ Dividend system that an actuary would regard fair, but a sales person, who is in charge of explaining to policyholders, couldn't explain is self-satisfaction of an actuary.

It is very important to draw up dividend policy from the viewpoint of concise dividend system and explanation possibility to policyholders.

3. The dividend policy based on the policyholders' benefit

The terminal dividend

- ◆ terminal dividends have a purpose such as the final adjustment of retained earnings.
- ◆ Early payments of dividends will be demanded considering policyholders' needs.
- ◆ It's natural to be careful about early payments.
 - The actual profit will not be settled until the time of expiration
 - The first duty is to accomplish long-term coverage surely
 - Low interest and negative spread have continued in latest years
- ◆ We can't request additional premiums in general

3. The dividend policy based on the policyholders' benefit

Controlling dividends and filling up terminal dividends at expiration days when accumulated earnings become clear, will meet policyholders' benefit

Equitableness between generations

- ◆ Profits earned from contracts with low guaranteed interest rate may be used to cover negative spreads and to satisfy solvency.
- ◆ So it's very difficult to realize the equitableness between generations.
- ◆ The profit, which should be allocated if there was no negative spread, can not be allocated to contracts with low guaranteed interest rates.

The amount of contribution must be managed strictly, and it's important to pay dividends to these contracts (whose guaranteed interest rates is low) with precedence if earnings will improve in the future.

3. The dividend policy based on the policyholders' benefit

Concluding Remarks

- ◆ Even though policyholders don't expect as much dividend as before after the sharp drop in the past
- ◆ It is an undeniable fact that actual premium (including a dividend) is an important factor to choose a product.

In order to maximize their benefit, it is our responsibility to give persuasive explanation to them as well as fix the level of dividends and ensure profit so that we could return dividend through entire period, considering their expectations.

3. The dividend policy based on the policyholders' benefit



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Thank You

Any questions? email to aoki17859@nissay.co.jp