Fitch Ratings 2020 Outlook: Japan Life and Non-Life Insurance

Life Insurers' Main Risk is Low Yields, Non-Life's is Catastrophes

Fitch's Sector Outlook: Stable

Fitch Ratings expects stable underwriting fundamentals, especially for life insurance, and well-managed international diversification to offset challenges faced by Japanese insurers. Life insurers continue to focus on profitable protection products, especially the most profitable and moderately growing 'third' (health) sector products. Non-life insurers are likely to suffer the negative impact from consecutive natural catastrophe losses in their operations in Japan.

The major life and non-life groups are managing their foreign insurance subsidiaries adequately on the whole, which is positive for their business diversification. Insurers' capital buffers continue to strengthen by increasing retained earnings and hybrid issuance.

Fitch continues to believe that the largest risks for Japanese insurers stem from financial markets. Sustained low yields in Japan lead insurers to seek higher returns by increasing credit risk, especially outside Japan, which carries currency risk. Interest-rate, stock-market, currency and credit risks are the most important influences on Japanese insurers' creditworthiness.

Rating Outlook: Stable

Fitch eliminated the "top down" sovereign rating constraint and substituted an enhanced "bottom-up" analysis of country risk in the criteria we adopted in January 2019. Fitch upgraded the majority of rated Japanese life and non-life insurers' Insurer Financial Strength (IFS) ratings, which had been constrained by Japan's Long-Term Issuer Default Rating (A/Stable), given their financial fundamentals and business profiles. As a result, the outlook for ratings in 2020 is Stable.

Rating Distribution Weighting: Investment Grade

Japanese insurers are rated between 'BBB+' and 'AA-'. Insurers with better credit profiles tend to have access to quality business, and apply prudent underwriting strategies in both Japan and overseas. A healthy solvency buffer, sound profitability and operating stability are also key influencing factors.

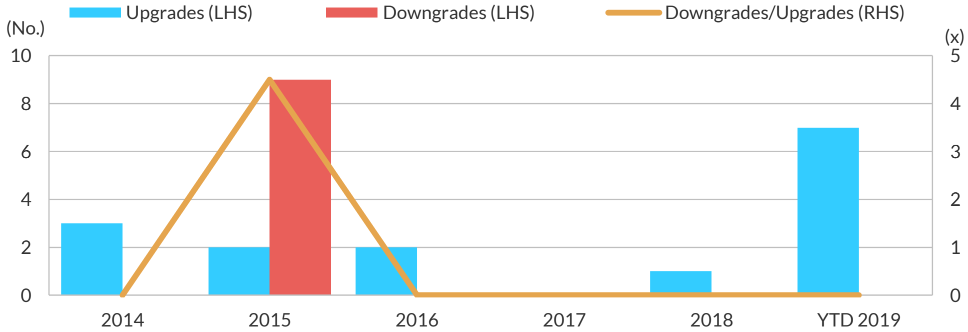
What to Watch

- Super low yield environment forces life insurers to invest more in foreign assets
- Global group management and governance at Japanese major insurance groups
- Continued hybrid debt issuance
- Underwriting to remain sound on the whole for life insurers, although stricter regulations restrain some specific segments
- Catastrophe risks remain the biggest underwriting risks for non-life insurers

Teruki Morinaga, Director

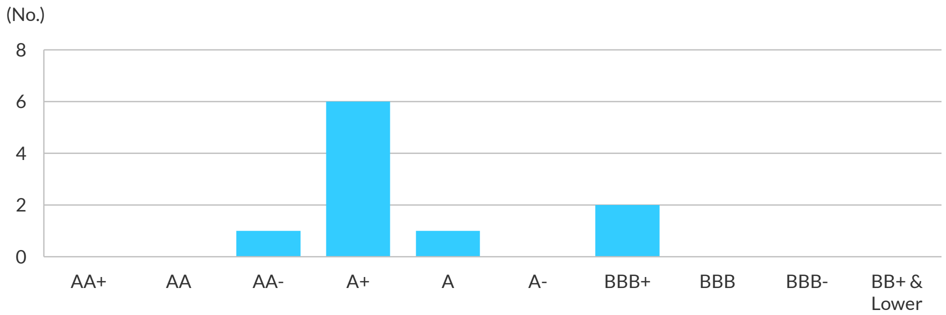
"Fitch believes stable underwriting fundamentals, well managed international diversification, and strengthened capital buffers will offset challenges faced by Japanese insurers. We view the biggest potential risks for Japanese insurers will continue to come from financial markets, including the equity, interest rate, currency and credit markets."

Japan's Life and Non-Life Insurers - Rating Changes



Source: Fitch Ratings

Japan's Life and Non-Life Insurers - Rating Distribution



Source: Fitch Ratings

Increasing Foreign Credit Investments – Positive Spread, Rising Credit Risk

Fitch expects Japanese life insurers to keep increasing their investment allocations to foreign-currency fixed-income in the hunt for higher yield. This is due to the low yields on Japanese government bonds (JGBs). For example, the 20-year JGB yield has been well below 1% for nearly four years, while the yield curve has moderately steepened in the last six months. Major insurers are raising exposure to credit risks, including illiquid infrastructure loans, by using the expertise of their foreign insurance subsidiaries or their groups' foreign asset-management companies.

Currency Risk More Likely to Rise Gradually

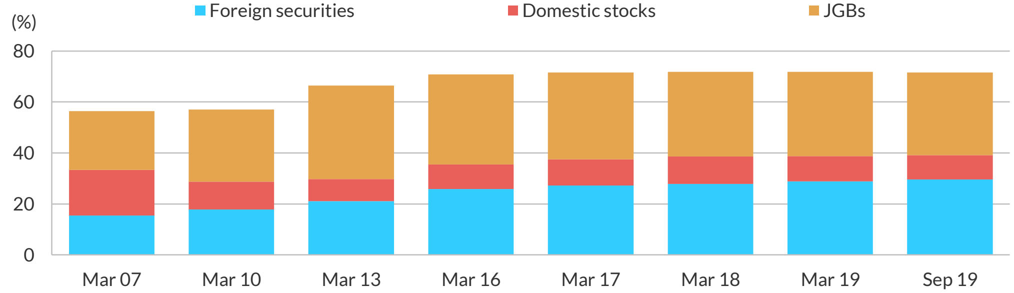
We believe increased investments in foreign-currency bonds will prompt more insurers to manage their growing currency and asset/liability management risks. Most insurers that have boosted their foreign-bond assets have hedged against currency risk on the majority of their positions and strengthened their risk-management focus. However, the cost of hedging currency risks remains high, so most insurers plan to raise their non-hedged positions for 2020. We believe insurers should be able to retain a positive investment spread unless the Japanese yen appreciates substantially.

Importance of Overseas Business Opportunities and Risks

Fitch expects insurers to continue expanding overseas, driven by a saturated domestic market – especially for life insurance – caused by an ageing population and shrinking workforce. The country's four major life insurance groups and three major non-life insurance groups are likely to continue acquiring insurers in the US, the UK and Australia (see table on the following page).

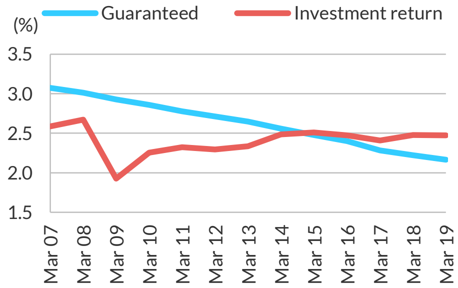
These developed markets will immediately provide significant additional premiums and earnings after acquisition. These markets are mature, but we believe their growing populations will provide moderate growth for Japanese insurers. Meanwhile, a few major non-life groups started to divest their unnecessary foreign subsidiaries, which is positive for their credit profiles.

General Account Assets Breakdown: Life Insurers



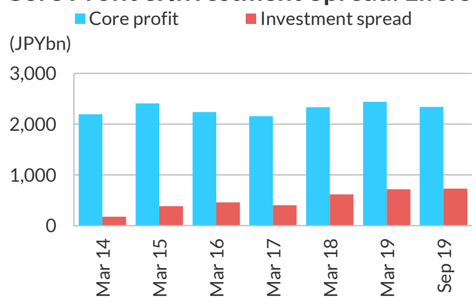
Source: Fitch Ratings, Companies

Gap Between Guaranteed Interest and Investment Return: Life Insurers



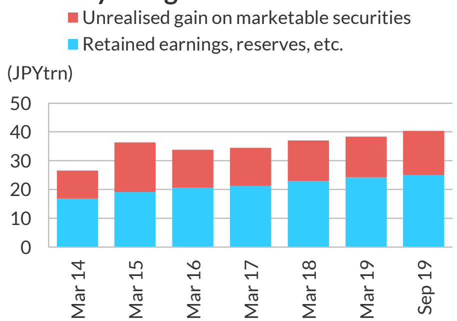
Source: Fitch Ratings, Companies

Core Profit & Investment Spread: Lifers



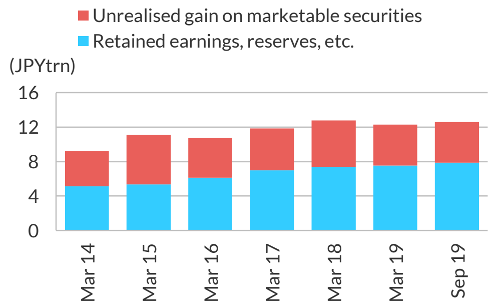
Note: Sep 19 numbers are annualised ones
Source: Fitch Ratings, Companies

Solvency Margin: Life Insurers



Source: Fitch Ratings, Companies

Solvency Margin: Non-Life Insurers



Source: Fitch Ratings, Companies

Negative Impact from Stricter Regulations in a Few Segments

The Japanese government has tightened regulation in a few segments, which will have a negative impact on the revenues of Japanese life insurers.

For example, the Japanese tax authority introduced stricter standard for tax-saving type products for SMEs. As a result, the sales of this type of product fell substantially. Another example is the stronger guidelines on the disclosure of risks when insurers sell foreign currency-denominated insurance products to unsophisticated customers, such as elderly people. This is likely to dampen sales of these products. However, Fitch believes Japanese life insurers' underwriting profits will not be much affected by the changes as the profitability of these segments is not very high.

Hybrid Issuance Continues to Sustain Sound Capital Adequacy

Fitch expects accumulation of retained earnings and capital reserves. The average statutory solvency margin ratio of the nine traditional life insurers was 1,013% at end-September 2019, up from 935% a year earlier, and that of the four major non-life insurers rose to 801% from 762%. Insurers are also likely to keep strengthening their capital by issuing hybrid securities. Japanese insurers treat hybrid securities as regulatory capital in their solvency margin ratios, partly so they can maintain their credit ratings when undertaking major M&A.

Life Insurers: Persistent Interest-Rate Risk

Fitch estimates that the asset duration of traditional life insurers is three to 10 years shorter than their liability duration. We view the pace of narrowing in the asset/liability duration mismatch will continue to be slow if JGB yields remain low. Sensitivity analysis shows that at end-March 2019, a 0.5% decrease in the risk-free rate would have caused a moderate rise of up to 16% in European embedded value (EEV), compared with up to 12% a year earlier. This demonstrates high balance-sheet sensitivity to interest-rate changes.

Life insurers' economic value-based surplus would compress if the yield curve were to further flatten, as the economic value of liabilities rises by more than the economic value of assets.

Life Insurers: Health to Lead Stable Profitability

Fitch expects life insurers' earnings to be steady in 2020. We believe demand for mortality and morbidity products is resilient supported by insurers' focus on sales of third-sector products. Furthermore, insurers are likely to promote new protection products, such as income-security insurance and nursery care insurance.

We expect growth in the third sector to continue for the next several years, as life insurers expand into health insurance products to meet the needs of Japan's ageing society. This is the life industry's most profitable category. Annualised in-force premiums from the third sector increased by 1.2% in the six months to end-March 2020, from 2.1% a year earlier, helping to sustain most life insurers' underwriting profitability.

Non-Life Insurers: Natural Catastrophes in Japan the Biggest Underwriting Risk

Each of the three major non-life groups' net insured losses from domestic natural catastrophe rose to nearly JPY100 billion in April to September 2019, due mainly to several typhoons. However, the non-life groups maintained decent profitability due to the overall improved profitability in their domestic non-life operations and their robust international insurance businesses.

The continuous and substantial catastrophe events in Japan lead us to expect non-life companies to continue to raise premium rates for domestic non-life products, partly influenced by steadily rising reinsurance premium rates for Japanese natural catastrophes risks.

Hybrid Issuance by Japanese Insurers in 2018-2019

Issuer	Security	Issuance	Maturity	Amount
Meiji Yasuda Life	Sub debt	Apr 18	Apr 48	USD1bn
Nippon Life	Sub debt	Apr 18	Apr 48	JPY100bn
Asahi Mutual Life	Sub debt	Aug 18	Perpetual	USD430m
Nippon Life	Sub debt	Sep 18	Sep 48	JPY120bn
Meiji Yasuda Life	Kikin	Sep 18	Sep 23	JPY50bn
Mitsui Sumitomo	Sub debt	Mar 19	Perpetual	USD0.9bn
Dai-ichi Life Holdings	Sub debt	Mar 19	Perpetual	JPY85bn
Nippon Life	Sub debt	Apr 19	Apr 49	JPY90bn
Sumitomo Life	Sub debt	Jun 19	Jun 79	JPY50bn
Nippon Life	Kikin	Aug 19	Aug 24	JPY50bn
Meiji Yasuda Life	Kikin	Aug 19	Aug 24	JPY50bn
Fukoku Life	Kikin	Aug 19	Aug 24	JPY12bn
Aioi Nissay Dowa	Sub debt	Sep 19	Sep 79	JPY50bn
Dai-ichi Life Holdings	Sub debt	Sep 19	Perpetual	JPY65bn
Meiji Yasuda Life	Sub debt	Sep 19	Sep 49	JPY80bn

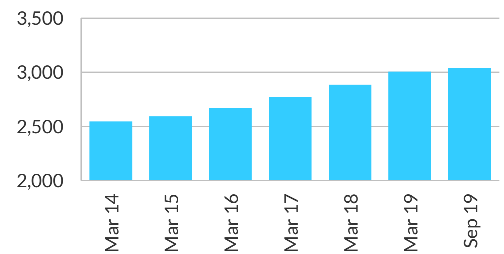
Source: Fitch Ratings, Companies

Japanese Life Insurers: EEV and Sensitivity Analysis

	Adjusted net worth (JPYbn)		Value of in-force business (JPYbn)		EEV (JPYbn)		Mar 19 EEV sensitivity analysis (%)		
	Mar 18	Mar 19	Mar 18	Mar 19	Mar 18	Mar 19	(a)	(b)	(c)
Dai-ichi Life	5,878	6,059	-991	-1,509	4,887	4,551	11	-13	-10
Sumitomo Life	4,043	4,441	-75	-559	3,968	3,882	11	-10	-5
Meiji Yasuda Life	6,508	6,754	-1,723	-2,200	4,785	4,554	12	-16	-8

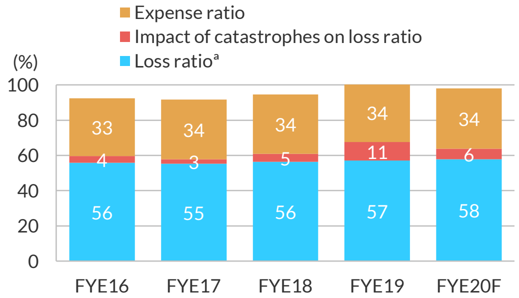
(a) 0.5% increase in risk-free rate
(b) 0.5% decrease in risk-free rate
(c) 10% decrease in equity and real estate value
Source: Fitch Ratings, Companies

Annualised Premiums - Third-Sector In-Force: Lifers



Note: Sep19 number is annualised
Source: Fitch Ratings, Companies

Combined Ratio of Major Non-life Insurers



[a] Earned to incurred basis excluding compulsory auto liability insurance and residential earthquake insurance
Source: Fitch Ratings, Companies

Optional: Appendix

Issuer Ratings

Issuer	IFS Rating/Outlook or Rating Watch (current)	IFS Rating/Outlook or Rating Watch (end-2018)
Nippon Life Insurance Company	A+/Stable	A/Stable
The Dai-ichi Life Insurance Company, Limited	A+/Positive	A+/Stable
Meiji Yasuda Life Insurance Company	A+/Stable	A/Stable
Sumitomo Life Insurance Company	A+/Stable	A/Stable
Asahi Mutual Life Insurance Company	BBB+/Stable	BBB-/Stable
Fukoku Mutual Life Insurance Company	A/Positive	A/Stable
FWD Fuji Life Insurance Company, Limited	BBB+/Negative	BBB+/Stable
Tokio Marine & Nichido Fire Insurance Co., Ltd.	AA-/Stable	A+/Stable
Mitsui Sumitomo Insurance Company, Limited	A+/Stable	A/Stable
Sompo Japan Nipponkoa Insurance Inc.	A+/Stable	A/Stable

Source: Fitch Ratings

Major M&A and Strategic Investments by Japanese Insurers

Announced	Insurer	Target	Country	Sector	Amount (JPYbn)	Status
14 June	Dai-ichi Life	Protective Life Corporation	US	Life	575	Acquired
15 June	Tokio Marine	HCC Insurance Holdings, Inc.	US	Non-life	940	Acquired
15 July	Meiji Yasuda Life	Stancorp Financial Group, Inc.	US	Life	625	Acquired
15 August	Sumitomo Life	Symetra Financial Corporation	US	Life	467	Acquired
15 September	Mitsui Sumitomo Insurance	Amlin plc	UK	Non-life	635	Acquired
15 September	Nippon Life	Mitsui Life Insurance Company Limited	Japan	Life	280	83% stake
15 October	Nippon Life	MLC Limited	Australia	Life	204	80% stake
16 October	Sompo Japan Nipponkoa	Endurance Specialty Holdings Ltd.	US	Non-life	638	Acquired
17 August	Mitsui Sumitomo Insurance	First Capital Insurance Limited	Singapore	Non-Life	176	98% stake
17 September	Sompo Japan Nipponkoa	Sompo Canopius AG	Switzerland	Non-Life	105	Sell 100% stake
18 March	Nippon Life	MassMutual Japan	Japan	Life	104	85% stake
18 September	Dai-ichi Life	Suncorp Life & Superannuation Limited	Australia	Life	52	Acquired
18 October	Tokio Marine	Tokio Millennium Re AG	Switzerland/UK	Non-Life	169	Sell 100% stake
19 October	Tokio Marine	Privilege Underwriters, Inc.	US	Non-Life	326	Acquired

Source: Fitch Ratings, Companies

Outlooks and Related Research

2020 Outlooks
Global Economic Outlook (September 2019)
Japanese Life Insurance Dashboard FYE19 (June 2019)
Japanese Non-Life Insurance Dashboard 2019 (June 2019)

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