The Disclosure Practices of Life Insurers

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1. Introduction

With each release of financial statements by life insurers, the mass media today reacts with a stream of sensational stories assessing each firm's viability and providing "penetrating analyses" of their financial condition. Interest in information disclosure by life insurance companies has reached an unprecedented level.

This interest stems from the Big Bang financial reforms, which make policyholders and other users of financial services accountable for their decisions, and from the once unthinkable spectacle of seeing a life insurer become insolvent. After Nissan Life failed in April 1997, net liabilities initially valued at 200 billion yen quickly grew to 300 billion yen by May, while policyholders helplessly watched the value of their policies wither. One outcome of this was a swell in public interest to know the actual financial condition of life insurers.

The disclosure that is done by life insurers is generally considered sketchy and of little practical use. In this paper, we look at the present status and issues regarding disclosure practices in the life insurance business.

2. Present Status of Disclosure Practices

Disclosure by life insurers is primarily done through pamphlets for each company. To promote accurate and voluntary disclosure, the industry issued disclosure standards in 1979 which have been revised and improved over the years.

To meet the growing demand for information on market valuation of assets and quality of loan portfolios, life insurers have been more aggressive than other financial sectors in providing market valuations of securities and derivatives, and data on risk management of loans to failed or ailing companies.

Furthermore, in response to growing interest in the financial health of life insurers, unique disclosure practices have been implemented for liability reserves and solvency margins.

(1) Liability Reserve Data

More detailed disclosure is made regarding liability reserve provisions, with detailed explanations of different methods.

(2) Solvency Margin Data

Solvency margin ratios (total solvency margin / total risk) are disclosed and explained.

The current disclosure items (1998) are shown in the following table.

Item	Description
(1) Company outline	History, information on officers, directors, personnel, organization, office network, etc.
(2) Management	Management policy, business activities, product information, training of sales force, public welfare activities, etc.
(3) Operations	Description of financial statements, asset management, distribution system, performance data, growth rate of policies, and other indicators.
(4) Accounting	Financial statements (including solvency margin) , assets & liabilities (liability reserves,etc.) insurance business performance, asset management performance, market valuation data, etc.
(5) Special account	Assets in separate account, individual variable insurance, etc.

In parallel with fuller disclosure, insurance companies are actively striving to increase the public's understanding of their business. For example, the Life Insurance Association recently compiled and distributed a booklet explaining disclosure (*Tora no Maki FY 1998*).

The industry's voluntary pursuit of disclosure received a legal basis in the Revised Insurance Business Law enacted in 1996. The revision contained new stipulations on disclosure similar to those applying to banks (Article 111).

Moreover, as a result of further revision of the Insurance Law pursuant to the Financial System Reform Law established in 1998, disclosure provisions were strengthened as shown below.

- The specific contents of disclosure are set by administrative order.
- Penalties are established for violations of disclosure provisions.
- Disclosure must be done on a consolidated basis.

These improvements to the legal framework are expected to further enhance the role of disclosure.

3. Why Disclosure is Difficult for Life Insurers

Despite the legal implementation of disclosure standards on a par with the banking industry, and the industry's efforts to explain the contents of disclosure, criticism lingers that disclosure by life insurers remains unclear. The primary reason for this lies in the characteristics of the life insurance business that distinguish it from other businesses.

(1) Long Duration of Policies

In essence, a life insurance company's business model consists of receiving premiums from policyholders, and in exchange paying out benefits if certain accidents occur.

Further, the premiums follow a schedule based on actuarial calculations. Since policies usually cover an extended period of time, it is not known for certain until the policy expires whether premiums were appropriate or whether benefits could be paid over the expected life of the policy. In addition, reserves need to be built over the long duration as explained below. Thus measurement of profit and loss for the full period requires considerable expertise.

(2) Difficulty Evaluating Liabilities

The evaluation of liabilities for liability reserves greatly complicates accounting practices. The liability reserve is the largest liability item equivalent to 90 percent of total assets, and is built up using premiums and portfolio gains so that life insurers will be capable of paying out benefits in the future. Simply put, the liability reserve is calculated by subtracting future premiums at current prices from future benefits at current prices. To evaluate the present value of future cash flow, we must make fixed assumptions regarding death rates and discount rates. Moreover, due to the complexity of methods used in practice, actual calculations are done by actuarial experts (who are also required to be used by law).

(3) Incompatible Perspectives Due to Accounting Objectives (Profitability vs. Financial Soundness)

A further complication in judging the financial condition of life insurers is that accounting methods vary depending on how and why the business is being examined. Since evaluation factors enter the accounting picture, financial statements are compiled differently depending on whether the objective is to judge the business's financial health or to measure its profitability.

For example, from the perspective of insurance regulators, the biggest concern is the company's ability to pay out benefits—that is, information on the company's financial health.

From this perspective, assets and liabilities including liability reserves are conservatively calculated, and the difference between assets and liabilities—the company's equity capital—is of primary concern. In general, balance sheets are emphasized over profit and loss statements.

On the other hand, investors—for example, stockholders receiving dividends—are more concerned with the accurate measurement of earnings.

These different perspectives lead to differences in the measurement of profit and loss. For example, regarding one-time expenses that occur when a new policy is sold (sales and processing expenses, etc.), the insurance auditor would have these expenses written off in full the year they were incurred. But from the viewpoint of earnings and expensing, these expenses should be carried over so that earnings are normalized. In fact, two accounting methods are recognized in the U.S.: statutory accounting, which is favored by insurance regulators, and GAAP accounting for investors.

Japan does not distinguish between the two methods and has one method that closely resembles the insurance audit type. The lack of this distinction contributes to the confusion surrounding the financial statements issued by life insurance.

(4) Lack of Competent Life Insurance Analysts

Despite the aggressive efforts at disclosure, life insurance accounting practices remain inaccessible for most people due to technicalities unique to the business and the complexity of accounting methods. Only the most knowledgeable experts can decipher the information disclosed by life insurers to accurately assess their financial condition.

While such disclosure issues are common to all types of businesses and not strictly limited to life insurers, the fact is that a large information gap exists between the company and outsiders. This problem is known as information asymmetry, and can be alleviated with the help of external analysts who can decipher the data. In recent years, while more analysts have emerged, their level of expertise remains low compared to their counterparts in the U.S., in part due to Japan's lack of life insurance stock companies listed on stock exchanges.

4. Suggestions for Improving Disclosure

The following measures are needed to further improve disclosure and thereby protect the interest of policyholders.

（1） Greater management transparency

Even though life insurance disclosure in the U.S. and Europe is generally regarded as being more advanced than in Japan, Japan does have an edge over Germany and France.

However, there is one important point Japan can learn from England and the U.S. regarding the improvement of transparency.

For example, consider solvency ratios, which have become a growing concern in recent years. England clearly defines the calculation process for both the broadly defined solvency margin involving equity capital, and the required solvency margin corresponding to total risk. This is a good example to follow in the interest of improving transparency.

（2） Improved evaluation by analysts

As explained earlier, outside analysts are playing a growing role in analyzing the condition of life insurers and providing useful information to the public.

However, in this area Japan trails far behind the U.S., where life insurers are rated not only by general rating agencies but by rating agencies that specialize in the life insurance business. Consumers use this rating information to choose a life insurer.

While the U.S. has a huge number of life insurers （1,600） and a vastly different business environment that requires analysts for consumers to choose a suitable policy, Japan needs to emulate the U.S. in boosting the competency of its analysts.

（3）Educating consumers

Financial deregulation is based on the premise that consumers will become accountable for their financial decisions and able to assess and assume risk. Toward this end, it is crucial that consumers be educated regarding financial matters at every opportunity from the most basic level of compulsory education all the way to classes and seminars for adults.

Disclosure works best when both information suppliers （companies） and recipients （analysts, consumers, and investors） do their best to make use of the information. Recipients need to digest the information and provide feedback to companies, who need to respond by further improving their disclosure as well as financial soundness. As the disclosure system improves, we expect other aspects of the business to improve as well.