BRIEF ARTICLE

Japanese Consumers' Demand for Cash Value Life Insurance: A Case of Mistaken Identity

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Abstract: Statistics provided by official government and industry sources suggest that, with respect to the choice between various forms of life insurance, Japanese consumers display a strong preference for cash value varieties. The implication is that Japanese consumers seek to secure both death and maturity benefits when purchasing life insurance—i.e., they view life insurance as a savings vehicle. This conclusion has significance not only with respect to life insurance consumption but to broader savings behavior as well.

This paper disputes these conclusions, however, and illustrates how problematic data collection and presentation methods contribute to a flawed understanding of Japanese life insurance consumption habits. The paper goes on to present an alternative profile of life insurance consumption that incorporates expert opinion. This latter profile suggests that Japanese consumers actually have very limited demand for cash value forms of life insurance—contradicting official data sources.

INTRODUCTION

Spending more than US$3,103 per person annually on life insurance premiums, the Japanese are the world leaders in the consumption of life insurance (Swiss Re, 2000). Additionally, the size of the Japanese market (in terms of aggregate annual premiums paid) is essentially the same as that of the United States, despite having only approximately half the

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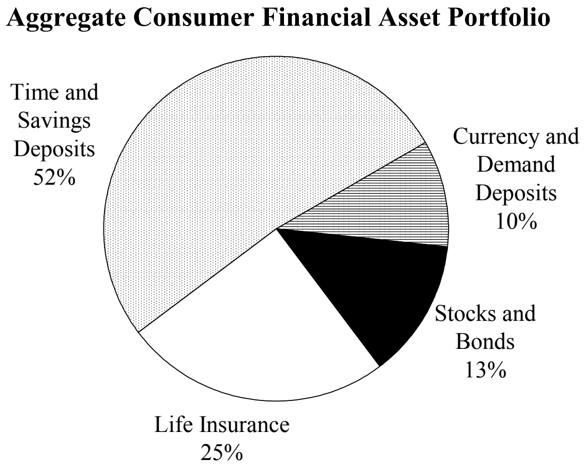

Fig. 1. Financial asset allocations (1995 figures). *Source: Economic Statistics Annual 1997*, The Bank of Japan.

national population.[1] When considered within the broader context of the set of household financial assets, sums-insured associated with life insurance represent about 25 percent of the portfolio[2] (see Figure 1). It is obvious that life insurance plays a significant role in the personal financial planning undertaken by Japanese consumers.

According to statistics published by the Life Insurance Association of Japan[3] (LIAJ), about 68 percent of the life insurance market consists of cash value varieties—i.e., whole life and endowment policies (see the first graphic in Figure 3). In support of these statistics—or perhaps because of them—a number of authors have cited the importance of life insurance as a savings vehicle within the Japanese market. See for example:

> "… savings-type life insurance, … , is more popular than term insurance" (Ito and Kitamura, 1994, p. 147).

> "Both life and nonlife policies in Japan … have large savings components …" (Ostrum, 1998, p. 2).

> "… term insurance accounts for only a small portion of personal life insurance policies …" (Shimono and Tachibanaki, 1989, p. 1).

> "… quite a few people in Japan demand endowment or whole life contracts having large cash values …" (Chuma, 1994, p. 32).

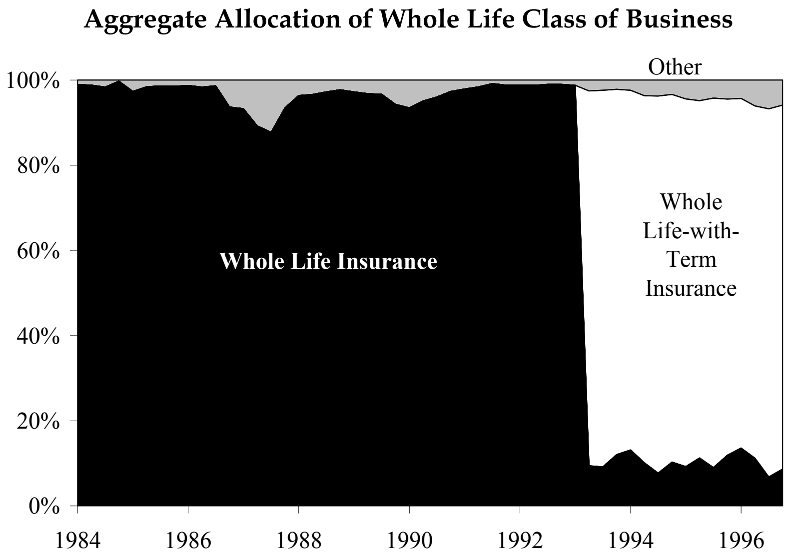

Fig. 2. Aggregate sums insured—whole life variety (new business). *Source:* The Life Insurance Association of Japan, unpublished quarterly data, various years.

The implications are that the Japanese display a significant preference for the use of life insurance as a savings vehicle. This conclusion, however, despite all its apparent support identified above, is incorrect.

This paper identifies the consistent misclassification of sums-insured associated with the dominant variety of life insurance in the Japanese marketplace. Additionally, this paper presents an alternative allocation that suggests that the life insurance consumption habits of Japanese consumers, in reality, reflect a strong preference for non-cash-value forms of life insurance—i.e., term life. The implication is that the Japanese, while heavy users of life insurance, do not seek to use life insurance as a savings vehicle to the degree previously thought. These findings have significance not only for those who investigate life insurance consumption habits, but also for those who seek to gain a better understanding of savings behavior in that market.

In 1993 a new life insurance product seemingly burst onto the scene in the Japanese marketplace. Within the year this new product, whole-life-with-term insurance, was found to dominate all forms of whole-life insurance sold in Japan (about 90 percent of all whole-life varieties were of this form; see Figure 2). Additionally, it assumed the role of overall market leader, capturing approximately 50 percent of the total new business in force (a figure that remains representative of its current market share). The reality, however, was that this product was not new at all. Rather, its seemingly dramatic introduction into the marketplace was due to a change in the data collection and reporting methods of the LIAJ.

While the LIAJ cannot provide explicit data on the whole-life-with-term insurance product prior to 1993, Seiichi Yamada, manager of the International Affairs Division of the LIAJ, confirmed that this product has a long history in the marketplace. Prior to 1993, however, the sums-insured associated with this product were aggregated together with the more generic variety of ordinary life insurance, merely identified as "whole-life insurance" (not to be confused with the broader category of life insurance that includes *all* variations of whole-life products included in Figure 2). Once the whole-life-with-term product was separately identified, the extent of its popularity in the marketplace could be clearly seen.

As the product's title suggests, it is a hybrid variation that includes both a non-cash-value (i.e., term) and a cash-value (i.e., whole-life) component. In purchasing this product, customers may choose any ratio between those two components, with a maximum ratio of 29:1 (29 parts term to one part whole life).[4] In practice, this product operates as a whole-life policy with a level-term rider. While a decreasing term structure would likely approximate more closely the actual values-at-risk for a given household as it ages, such forms are not presently popular in that marketplace. Typically, the formal age of retirement of the subject of the insurance (usually around 60 years of age in Japan) serves two functions with respect to this product. First, retirement is typically the target date when the cash-value component of the policy is paid-up (the maturity benefit). Additionally, it is the date on which the term component expires.

In its annual publication, *Life Insurance Business in Japan*, the LIAJ defines this product as,

> "a whole life policy combined with a term policy, which pays, for example, five to ten times the amount payable at death when death occurs during the premium-paying period."

While acknowledging the hybrid nature of the product, in its official statistics the LIAJ chooses to attribute 100 percent of the sums-insured to the whole-life category of life insurance. The rationale for this allocation is that the underlying policy to which the rider is attached is of the whole-life variety. Within the structure of the whole-life-with-term policy, however, the death benefits typically are significantly larger than the maturity benefits (as hinted in the LIAJ definition above). This suggests that the term component of the product is similarly larger than the whole-life component. The data presentation methods employed by official sources—e.g., the LIAJ, Bank of Japan—do not specifically identify this relationship. The result is the complete attribution of sums-insured associated with this hybrid product to a cash value variety of life insurance (i.e., whole life)—which leads to a mistaken perception as to the true nature of life insurance consumption in the Japanese marketplace.

Empirical evidence helping to better define the true allocation of sums-insured is scarce. Because such data are not collected by official sources, objective estimates simply are not available. The popularity and basic nature of this product are well known by Japanese consumers and suppliers alike. However, lacking statistical transparency—i.e., data describing the internal allocation between term and whole life—the specifics of consumption, and the associated implications, are left somewhat obscured. What is known is that the term component typically is significantly larger than the whole-life component. Lacking more objective means, industry experts have been consulted with respect to a representative ratio (term to whole life) that might allow for a better understanding. Two Japanese life insurance actuaries—Messrs. Yoshinori Nakamura, Manager of the Internal Audit Department of Orico Life Insurance, and Ryoji Inaba, Assistant Manager, Actuarial Department, Sony Life—were consulted with specific regard to this matter. Each independently suggested that a reasonable estimate as to the typical allocation ratio between the term and whole-life components for a given policy would be about 9:1. This estimate falls within the range suggested by the LIAJ in its earlier definition.

Given a 9:1 ratio, it would suggest that upwards of 90 percent of the total sums-insured associated with the whole life-with-term product would be more appropriately attributed to the term life insurance category. Figure 3 compares the LIAJ presentation (where 100 percent of the sums-insured associated with the whole-life-with-term product are attributed to the whole life category) of sums-insured (first graph) with a proposed reallocation employing the 9:1 ratio (second graph), as suggested by industry experts. The result is a dramatically altered portfolio—with, roughly speaking, a reversal of market shares associated with cash-value (whole life and endowment) and non-cash-value varieties (term and group).

This paper does not argue that a 9:1 allocation ratio is the "true" average ratio in the marketplace. It does argue, however, that there is a statistical misrepresentation in the current presentation of life insurance data and that it is significant. Lacking more substantive data, however, a 9:1 ratio is likely to be a closer approximation than the current data presentation offered by the LIAJ. While the imprecision of this estimate does not allow for easy application to empirical modeling, it does wave a red flag for those who are attempting to incorporate such data into various analyses, e.g., incorporation of cash-value forms of life insurance into

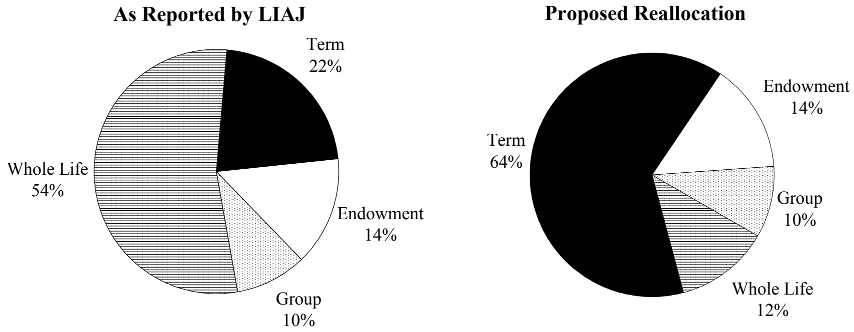

Fig. 3. Japanese life insurance market share (new business-in-force).[5] *Source: Life Insurance Business in Japan 1993*, The Life Insurance Association of Japan.

savings behavior studies. Conclusions derived from such analyses must be critically evaluated in light of the issues raised in this paper.

Additionally, this paper does not mean to suggest that all participants in the marketplace lack an understanding of the nature of the whole-life-with-term product. Indeed, it is reasonable to presume that some participants, such as insurance providers, have a strong understanding of the true nature of consumption in the marketplace, even if they cannot explicitly define the statistical allocation between cash-value and non-cash-value forms of consumption. Rather, it would appear that certain participants, e.g., entities such as those cited early in this paper, have not successfully reconciled their qualitative understanding (the dominance of non-cash-value forms of life insurance within the whole-life-with-term product) with their statistical understanding (published data). The result has been an inaccurate assessment of the true nature of life insurance consumption in the Japanese marketplace. This paper has attempted to bring these issues into focus in hopes of raising awareness as to the limitations of published data and clarifying the life insurance consumption patterns in the Japanese marketplace.

NOTES

[1] Japan is the world's second-largest life insurance market in terms of aggregate premiums volumes, only minimally smaller that that of the U.S., with market shares of 27.8 and 27.9 percent, respectively (Swiss Re, 2000).

[2] As a point of reference, similar statistics (*Statistical Abstract of the United States 1997*, U.S. Department of Commerce) suggest that about 5 percent of the aggregate household portfolio in the United States consists of sums-insured through life insurance.

[3] The LIAJ (www.seiho.or.jp/english/index.html) is a central coordinator of life insurance industry activities and data collection within the Japanese market As of July 2000, the LIAJ had 47 association members and lists among its main activities the representation of the opinions of the life insurance industry, conducting of surveys, research, and collection of statistics. Membership in the association is on a voluntary basis, but its members represent virtually a 100 percent market share of the Japanese life insurance industry. Additionally, Japanese life insurers report directly to the Insurance Research Institute and the Financial Services Agency (FSA). The FSA is the governmental regulatory body that has oversight responsibility for the financial services industry in Japan and acts as a disseminator of data to other governmental organizations and ministries, such as the Bank of Japan, the Statistics Bureau, and the Statistics Center.

[4] The 29:1 ratio limitation exists because regulations will not allow the term-premium component to exceed the whole life–premium component. For example, the ratio suggests that one unit of whole life costs approximately the same as 29 units of term life. Increasing the term component of the policy beyond this ratio would result in the term-premium contribution exceeding the whole life–premium contribution—which would violate the regulation.

[5] The sums-insured included in these figures represent over 98 percent of the new business inforce for FY 1993. Group life is of a term variety—group whole-life figures have been included in the whole-life market share.

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