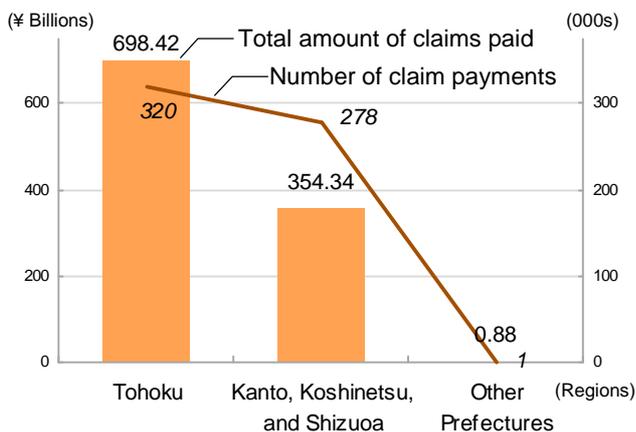




The Tohoku disaster presents challenges and opportunities

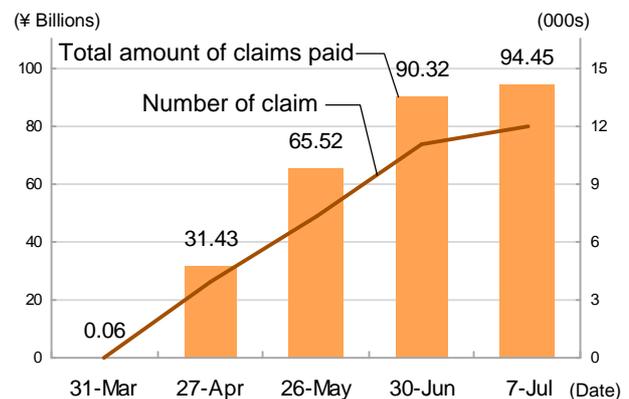
Before the Tohoku catastrophe, Japanese insurers were already facing considerable challenges, including weak demand, increasing competition arising from deregulation, and tighter capital adequacy regulations. Unfortunately, given the significant devastation caused by the earthquake and tsunami, insurers must now also contend with increased claims volume and investment portfolios that may be too heavily allocated to the domestic market. One positive for the industry, however, is increased demand for earthquake and auto insurance.

As of July 7, nonlife insurers have paid claims, totaling about ¥1 trillion.



Source: General Insurance Association of Japan (GIAJ)

Japanese life insurers also have experienced accelerated claims.



Source: The Life Insurance Association of Japan

Japanese insurers are dealing with escalating claims, in midst of challenging macro factors.

Japanese insurers—already strained before the disaster by a shrinking domestic market, stiffer competition because of deregulation, and tighter capital adequacy regulations intended to strengthen insurers' balance recognize that rapid response to settlement claims may help restore an image tarnished by a 2005 scandal that erupted after companies failed to pay legitimate claims. As of July 7, nonlife insurers have paid out approximately ¥1 trillion on nearly 600,000 claims. As for life insurers, the Life Insurance Association of Japan has paid out about ¥100 billion on about 12,000 claims.

With insurance inquiries and payouts continuing to escalate, insurers are working diligently to settle claims in hopes of restoring customer confidence in the industry and striking a chord with underinsured and uninsured businesses and individuals to tap into new markets and bolster growth.

High claims volume has increased need for skilled labor to evaluate and process claims.

The volume of claims stemming from the natural disaster has strained insurers' workforces, leading to a sharp increase in the need for skilled insurance professionals, such as claims adjusters and call center representatives, to evaluate and process claims. As claims volume continues to escalate, finding skilled labor will be increasingly important. Professionals adept in business development will also be needed.

Increasing demand for claims professionals will likely extend beyond the short term. History suggests greater awareness of the need for insurance will create a persistent demand for skilled labor. Consider: Before the Hanshin earthquake of 1995, only 9% of households had earthquake coverage in that region. Now, 23% do. If that trend is repeated, the Tohoku catastrophe will significantly increase demand for skilled insurance professionals over the long-term.

Nonlife insurers looking to promote earthquake coverage

Given the severity of the Tohoku earthquake, Japan's nonlife industry is trying to improve market penetration of earthquake insurance. Earthquake penetration is relatively low in Japan, with about 14% to 17% of homes and businesses covered, according to AIR Worldwide. Similarly, penetration is low in other areas with substantial earthquake risks, including Chile, where it is 24%; and California (US), 12%.

In the wake of the disaster, homeowners are rushing to purchase insurance policies covering earthquakes. Prior to March 11, sales of earthquake insurance trended at prior-year levels. Through May, however, sales were up 14.5% year over year. For Japan's insurance industry the quake may benefit top-line growth, but the sector must manage exposure.

Japanese Insurers: Also of interest

The Tohoku earthquake significantly affected Japan insurers' profitability, but insolvency is not a concern. In FY2010 (ending 3/31/11), Japan's top eight nonlife insurers suffered a profit decline of ¥207 billion, excluding residential earthquake insurance. The loss represented a record amount for quake-related claims in Japan. Despite that, the losses represented about 3% of the companies' adjusted capital, so the impact was reasonably limited.

Top nonlife insurers may face credit downgrade pressures. Standard and Poor's has maintained its ratings on the top eight nonlife insurers, as FY2010 results were in line with expectations. Credit ratings for the top nonlife insurers, however, could face pressure if the companies are unable to improve underwriting profits in the domestic nonlife market, or if another massive natural disaster strikes before they are able to restore their financial bases.

Tohoku could lead to a re-visitation of risk modeling in Japan. In terms of data points, the Tohoku earthquake and resulting tsunami provided and continues to provide much information and insight about quakes and loss exposures. Japan's earthquake modeling system currently does not have the magnitude 9 level, which indicates the need for a review on the maximum magnitude in Japan.

The most substantial earthquake in Japan's history

	Name of earthquake	Date	Claims paid (billions of yen)
1	Tohoku	3/11/11	1,053+
2	Great Hanshin (Kobe)	1/17/95	78.3
3	Geiyo	3/24/01	16.9
4	Fukuokaken Seiho-oki	3/20/05	16.9
5	Chuetsu Earthquake in Niigata Prefecture (2004)	10/23/04	14.9
6	Chuetsu-oki Earthquake in Niigata Prefecture (2007)	7/16/07	8.2

Source: General Insurance Association of Japan

Non-insurers' profits and capitalization levels vulnerable to domestic stock prices.

As of March 31, unrealized gains on the marketable securities of the top eight nonlife insurers fell 23.9% from the prior year. As a result, their adjusted capital declined 8.2% year over year. In FY2011, as catastrophe loss reserves are likely to be reversed and the constant risk of natural disaster continues, nonlife insurers will face considerable challenges in building financial bases resistant to domestic stock price fluctuations.

Key issues for nonlife insurers are risks related to massive natural disasters and stock price fluctuations affecting their domestic equity holdings. Effectively hedging these risks, through geographic diversity in terms of market participation and investment portfolio allocation, should be critical components of insurers' enterprise risk management models.

Japan's nuclear crisis creating uncertainty over insured loss estimates. Japan's lingering nuclear crisis, evacuation, and resulting exposure has hampered the insurance industry's calculation of losses. Accessing damaged properties in areas near the Fukushima nuclear plants for loss estimates has been difficult. Other hurdles in tallying loss estimates have been the power shortages and blackouts resulting from the nuclear crisis.

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