Bridge Institution and Transfer of Business
Nissan Mutual Life (2007)

Background and context

In the mid-1990s, Japanese insurers experienced problems of negative spread[85] from severe business conditions arising from the collapse of the economy in 1992, prolonged challenges in the investment environment (low interest rates and poorly performing stock market), and a market dominated by high guaranteed return insurance products that were issued during good times of the preceding "bubble economy"[86]. While most of Japan's life insurers survived this crisis, seven life insurers turned insolvent including Nissan Mutual Life Insurance Co. (Nissan Life). Nissan Life was then Japan's 19th largest life insurer with 88 years of experience and ¥2.2 trillion ($20 billion) worth of assets. It was also the first life insurer to fail in Japan since World War II.

During the recession, asset deflation and low interest rates created a large gap between investment yields (about 3.1%) and guaranteed returns (average of 4.7%) that Nissan Life paid to its policy owners.[87] Nissan Life also suffered losses in its foreign investments and could not rely on huge unrealised capital gains from the stock market as domestic stock and property markets nosedived by 60% and 80% respectively. Nissan Life ended up meeting the annuity payments by selling more high yielding policies. To improve its financial standing, Nissan Life reduced its workforce, consolidated branches and streamlined operations. Despite these efforts, it failed to recover. Nissan Life's solvency also worsened as loans to real estate developers in the late 1980s turned bad (debts of ¥25.1 billion or $230 million). By 1997, Nissan Life's liabilities exceeded its assets by ¥300 billion ($2.7 billion),[88] leading to suspension of its operations by the Ministry of Finance (MoF).

[85] The insurers suffered from "gyaku-zaya", or negative spreads, in which actual investment returns were below promised yields
[86] The Japanese asset price bubble or "bubble economy", was an economic bubble inJapan from 1986 to 1991 in which real estate and stock market prices were greatly inflated. In early 1992, this price bubble burst and Japan's economy stagnated
[87] Nearly half of Nissan Life's assets consisted of individual pension fund contracts that guaranteed a high return of about 5.5%. These contracts normally account for 7% to 8% of Japanese insurers' portfolios. Such an exceptionally high proportion made Nissan vulnerable to any sudden drop in investment yields
[88] In the fiscal year ended 31 March 1997, Nissan Life registered substantial losses relating to the valuation of marketable securities

Resolution actions

The first action was Nissan Life's transfer to a bridge insurer. In the absence of an institution to rescue Nissan Life, the MoF appointed the LIAJ[89] as the trustee to handle the assets and liabilities of Nissan Life. In the process, Aoba was established as a subsidiary of LIAJ to take over Nissan Life's assets and existing policies in October 1997. Aoba only managed Nissan Life's existing policies and did not handle new contracts. Aoba was set up to ensure continuity of Nissan Life's policies, as termination would adversely impact public confidence in the insurance industry, more so as half of Nissan Life's contracts were individual pension plans. In addition, the Japanese insurance guarantee fund or IPPF was a voluntary scheme that could only provide support to a saviour company up to ¥200 billion ($1.8 billion). The IPPF was a voluntary scheme and in the case of Nissan Life, there were no interested acquirers and its deficit exceeded the IPPF's maximum amount by ¥100 billion ($0.9 billion).

Other actions include reducing Nissan Life's policy reserves, modification of policy owners' contract terms and the suspension of surrenders of insurance contracts. While the IPPF ended up providing financial support of ¥200 billion ($1.8 billion), the remaining amount to cover Nissan Life's asset-liability gap was borne by policy owners. The surrenders of insurance contracts were also suspended to protect the interests of policy owners (avoid loss of insurance coverage), as well as to manage Nissan Life's liquidity position.

In November 1999, Aoba was acquired by Artemis (a French retailer group) for ¥25 billion ($230 million). In March 1999, Aoba's asset size stood at ¥1.19 trillion ($11 billion). This deal was a milestone as it marked the first instance that a failed Japanese FI was sold to a foreign company and could pave the way for the resolution of other failed insurers such as Toho Mutual Life. During that period, foreign firms were eyeing stakes in distressed or failed Japanese FIs. Five years later in November 2004, Artemis sold Aoba to US-based Prudential Life Insurance for ¥20 billion ($180 million).

> ***The acquisition of insolvent Japanese companies by foreign insurers ... helped make the Japanese market more global***
>
> Geneva Association

The failure of Nissan Life also resulted in institutional reforms. After the resolution of Nissan Life, the IPPF was replaced with a new and strengthened guarantee fund scheme in 1998 – the LPPCJ. Membership of life insurers in the LPPCJ was made mandatory. The LPPCJ's financial capacity expanded to ¥400 billion ($3.6 billion) with broader resolution powers of providing direct financial assistance to and taking over the policies of troubled insurers.

Resolution of Nissan Life – Timeline of Key Events

Apr 1997
MoF ordered Nissan Life to suspend its operations.
Liabilities exceeded its assets by ¥300 billion.
Life Insurance Association of Japan (LIAJ) was appointed as trustee to handle Nissan Life.

Jun 1997
No saviour company.
Aoba Life Insurance Co (Aoba) was established by the LIAJ, as its own subsidiary, to take over Nissan Life's insurance contracts.

Oct 1997
Aoba took over Nissan Life's assets and policies.
Aoba only managed Nissan Life's existing policies and did not handle new contracts.

1997-1999
Series of measures:
Insurance Policyholders' Protection Fund (IPPF) provided ¥200 billion for Nissan Life's resolution.
Balance was borne by the policy owners (through reduced payments on policies).
Suspension of policy surrender to protect policy owners' interest and manage liquidity.

1998
Reform of guarantee fund.
IPPF discontinued.
New guarantee fund scheme, Life Insurance Policyholder Protection Corporation of Japan (LPPCJ), was established with improved features.
The Non-Life Insurance Policyholder Protection Corporation of Japan was also established.

Nov 1999
Aoba was sold to Artemis.

Nov 2004
Prudential US acquired Aoba from Artemis.

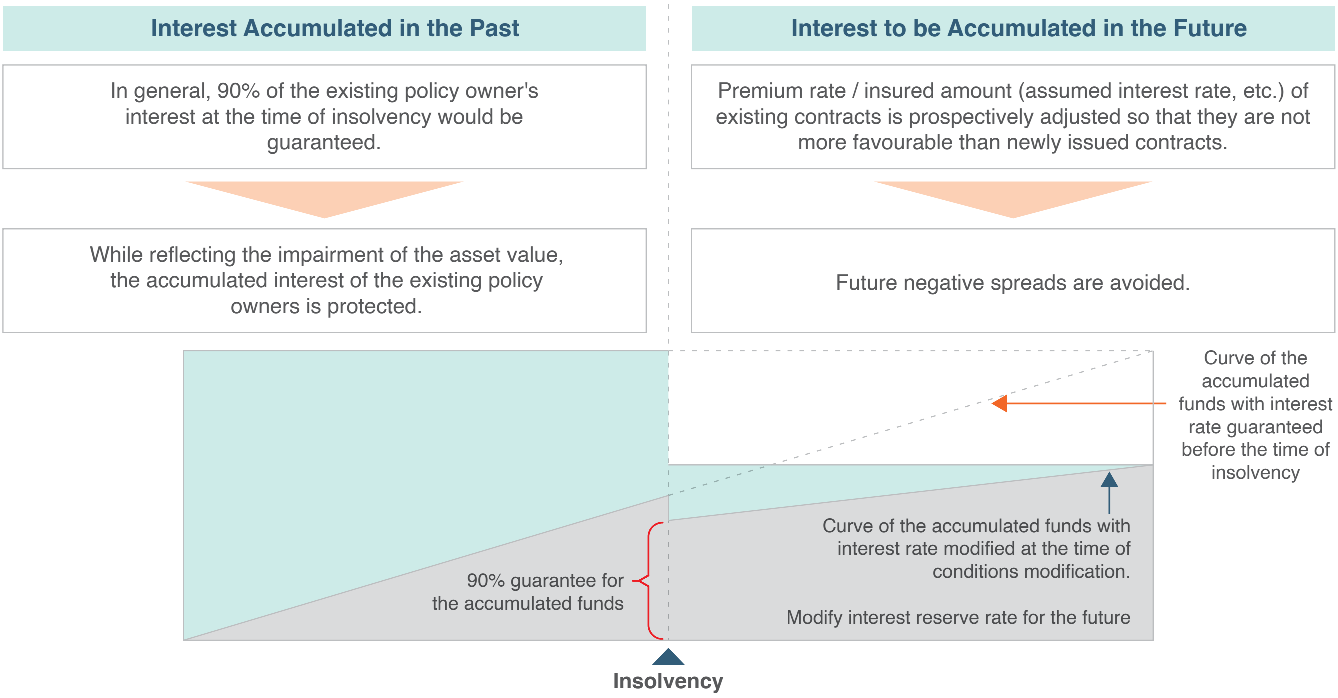
[89] An industry association of life insurance companies, to which all insurance companies operating in Japan (42 companies) are members (as of 21 December 2020)

Broader resolution actions taken for Japan's life insurance insolvencies

In addition to Nissan Life, the period from 1999 to 2008 saw the failure of other Japanese life insurers. In those cases, the LPPCJ adopted several resolution measures including the reduction of policy reserves and modification of contract terms at insolvency. While coverage depended on the type of policy, generally, only about 90% of policy reserves were protected. This was intended to reduce the moral hazard of consumers selecting cheaper insurance products without due consideration of an insurer's financial soundness. Besides that, several contract terms were modified going forward, including policy owners' accumulated interest and reduction of assumed interest rates. This ensured that the grandfathered right of policy owners to receive benefits higher than the market rate would cease at insolvency. Lastly, similar to Nissan Life, insolvency involved the suspension of surrenders of insurance contracts. In summary, resolution by way of insolvency led to financial stability by avoiding a liquidity crisis / substantially improving the position of troubled life insurers, and preserving both the assets of insurers, as well as the interests of policy owners.

Modification of contract terms at time of insolvency

Illustration 3: Life Insurance Resolution System in Japan



Source: Geneva Association / Nippon Life Insurance Company

Key takeaways

The resolution of Nissan Life was unique as it involved a combination of interventions by the life insurance industry and insurance guarantee fund, with a clear primary objective to provide continuity of coverage and protect the interest of policy owners. The establishment of a bridge institution (Aoba) and provision of financial assistance by the guarantee fund, ensured continuity of coverage for policy owners through transfer of policies to Aoba, and Artemis. Nissan Life's case demonstrates how the selection and collective use of several resolution tools effectively facilitates the well-organised resolution of a failed financial institution.

Nissan Life's failure also triggered the reform of Japan's insurance guarantee scheme and resolution arrangements. Substantial improvements in the financial capacity, governance and resolution powers of the new guarantee scheme were important foundations for sustainability and resilience of the Japanese life insurance industry to tackle future crises.