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# Future of Life Insurance in Japan



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## FUTURE OF LIFE INSURANCE IN JAPAN

### Shifting toward a noble purpose

A low interest rate environment notwithstanding, Japanese insurers are among the most profitable (and largest) in the world. Japanese consumers have some of the highest rates of insurance ownership in the world and their longevity yields large value pools. Health (i.e., the third sector) is also an area that continues to grow and in which margins remain attractive.

Despite all these favorable trends, few insurers have managed to embrace the customer agenda. None have been able to go beyond a transactional service to build trust with the customer toward a noble purpose: supporting customers through their toughest times.

Changes in customer expectations, digitalization becoming mainstream, emergence of new business models, and step changes in analytical approaches present a unique opportunity for insurers—an opportunity to move beyond selling basic protection to engage more deeply with and provide solutions for the customer.

To capture this opportunity, however, requires insurers to think differently about their purpose, who they want to be, and how they should participate in the market.

This paper examines the changing issues in the life insurance industry and presents a capability model to help insurers succeed in the Japanese market. In addition, we will identify the four “minimum required” capabilities that are critical for achieving results through competition in the life insurance market and alleviating business and structural issues. We also present the conditions for becoming a successful insurer in the future.

### The Changing Customer

The customer base for the Japanese life insurance industry is heavily influenced by three distinct trends: a fundamental change in demographics, emergence of health as an area of worry, and secular increases in digital attitudes.

The aging population is reshaping longevity risk and needs for solutions. By 2040 there will be an extra ~10m people over the age of 65 even as the total population decreases by ~20m<sup>1</sup>. Over the same period, population concentrations in Tokyo will continue to increase (at the expense of rural Japan) and female participation in the workforce will climb to ~45+%. These changes will have a profound impact on distribution footprints and underlying economic models.

Increasing life expectancies and the rise of lifestyle-related ailments are also contributing to increasing awareness about health. In the coming years, ~30%+ of the population will be obese with a BMI of 25+ and ~3m citizens will suffer from chronic illness. Amidst all of this, many service providers are emerging (diet, digital health, fitness, preventative medicine, etc.) and Japanese consumers' spending on health and wellness is estimated to reach JPY10 trillion<sup>2</sup>.

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1. National Institute of Population & Social Security Research – Population Projects for Japan 2016-2065  
2. Estimated from various public and proprietary sources

Unfortunately, none of this is being spent with insurers.

Lastly, customers are changing how they engage with insurers. Across age groups, the portion identifying themselves as digital natives tripled from 7% in 2010 to an estimated ~21% in 2020. Another recent PwC Japanese consumer survey<sup>3</sup> indicated that insurance customers are willing to pay 7% more for a superior experience, and 50% of the same group indicated the need for continued human interactions. Experience matters, and more than ever before, it is about blending digital and physical.

## New Battlegrounds – The Convergence of Life, Health & Wealth

On a national level, healthcare expenditure has continued to grow—the combination of public spending on health, voluntary schemes, and out-of-pocket spending is up more than 50% over the last 15 years. Based on our research, out-of-pocket spending on health-related services in Japan is estimated at \$150-\$250b p.a. and growing quickly. As public finances become more challenged, customers will inevitably have to pay for an increasingly larger share of health-related spending.

In parallel, wealth management is emerging as an area of unmet customer needs. The average age of retirement has not kept pace with the higher life expectancy, leaving customers to fund longer retirement periods. Furthermore, over 70% of retirees' assets are in cash (yielding very low returns). Existing players (mostly fund managers and securities firms) are not meeting customers' needs—performance remains volatile and fees paid by Japanese customers are among the highest in the world. Against this backdrop, there is a genuine opportunity for insurers to support customers.

Insurers are unique in that they typically have long-lasting customer relationships, as customers trust them to be around at times of need and strong agent-customer relationships often span multiple years. Insurers have privileged access, and this gives them a right to play in the wealth management arena at a time when the issues that retirees are most concerned about deal with health and wealth.

## Predictive and Personalized

Since its founding, insurance has been about underwriting the whole pool of risk and many of the processes have been focused on ensuring the “right” pool—for example, underwriting was designed to filter out bad risk such that it met the assumptions that went into defining the pool of risk being insured. This is particularly true in markets like the third sector in Japan, where profitability has historically been driven by scale and managing to average the incidence rates of certain diseases.

However, the evolution of analytics technologies and mainstreaming of experiences as a differentiator mean that an average based business is no longer sufficient. Increasingly, the successful insurer of the future will be the one that is able to use analytics and design to deliver a predictive, personalized experience to customers. With this personalization, there is an opportunity for insurers to tackle the structural drivers of profitability and capital efficiency inherent in their business (Exhibit 1).

## The Regulator takes Notice

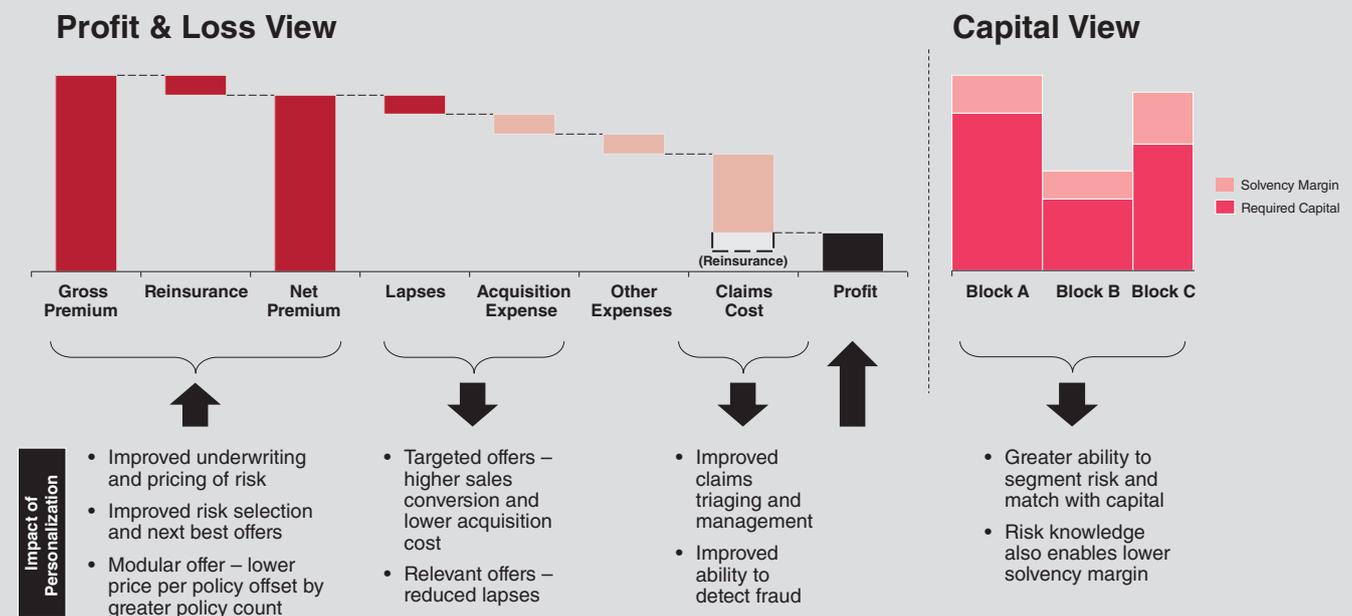
Moving beyond traditional insurance products to new value pools like health and wealth will bring new regulatory imposts. These trends have not slipped the eyes of the Financial

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3. 2018 Global Consumer Insights Survey

## EXHIBIT 1

### Opportunities from personalization



Source: Strategy& analysis

Services Agency (FSA), which is increasingly focusing on customer interests and taking note of regulatory activities in other markets (e.g. Retail Distribution Review, Future of Financial Advice Reforms, Financial Services Royal Commission, Markets in Financial Instruments Directive 2, etc.) to create a template for customer-oriented business practices.

Most insurers adopt a reactive approach to requests from the FSA. The need to shift to proactively address the structural, cultural, and capability root causes by adopting a principle-based approach to compliance policies, processes, and culture to stay ahead of the regulatory regime. Some practical ways in which insurers can do this include:

- Engage proactively with regulators at multiple levels within the organization (including at the top) and seek clarity on the underlying principles and intent, not just the letter of the law
- Stand back from the regulatory guidance and law and ask “what is socially acceptable”
- Address the root causes, not just the symptoms; ensure the response is commensurate, executed at speed and clearly communicated to all
- At all steps, demonstrate that you are putting the customer first

## Increasing Pressure to Maximize Return on Talent

Everyone is talking about the future of work and workforce challenges, and insurers are in a particularly difficult situation. The industry is not attractive for new graduates (#18 preferred sector<sup>4</sup>). Even within the financial services sector, remuneration typically only accounts for

4. DISCO Inc. – Career Survey for University Students, March, 2019

~60-65% of sector leaders and faces one of the most significant skills gaps (digital, data, analytics, etc.).

Compounding this is a set of several macro-factors. Education systems and demographics in Japan in particular are not producing the number of high-quality staff required. New ways of working and expectations from employees are forcing companies to rethink their propositions, and younger generations do not necessarily wish to stay in the same line of work for a long time. This is a major topic of discussion at boards and senior management but now is the time to take action. We need to stop talking about the future of work, skills required, etc. and start talking about maximizing the return on talent.

Some practical steps Japanese insurers can implement to start addressing this issue include:

- Establishing a clear workforce strategy—one that is clear on what skills are required, where these will be sourced from (and how), what are the opportunities to redeploy talent (and the training required to achieve this), and how to build flexibility in the workforce
- Digital and leadership training for all staff to upskill them for the Fourth Industrial Revolution and facilitate navigation in an ambiguous and changing future

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## WHAT DOES THE FUTURE LIFE INSURER LOOK LIKE?

One thing that will not change is the core purpose of life insurance: to protect customers and offer them peace of mind in their time of greatest need. To do this, the successful insurer of the future will combine skillsets, processes, mindsets, and technology to create unique capabilities to provide customers with a clear point of difference – they will have a compelling way to play. If they fail to integrate these into a coherent customer offering, they will struggle in the new, ultra-competitive environment. In Japan, insurers also have a societal obligation, not just as large employers but also as corporations that are supporting some of the most important aspects of people's lives. Choices that customers make around how and how much to save and providing for medical emergencies are often influenced by insurers.

We have already discussed the challenges in today's life insurance markets: new customer demographics, ongoing trust issues, heightened regulation, new value pools, technology and innovation exacerbating competition. All these point to pressure on profitability and retaining a positive balance sheet may simply be too challenging for smaller players, who may be forced to exit the market.

For those that remain, establishing and retaining the trust of their customers, and figuring out how to play in new arenas will be critical to their success. Regulatory oversight will continue to intensify, as regulators focus on conduct risk (further increasing the cost of compliance). Those who innovate around customer solutions and co-create distinctive propositions in partnership with policy setters and third-party providers will earn the customers' keep. At the very least, insurers need to be much more disciplined on aligning how and where they deploy capital with their business model.

### Proposition Focused and Analytically Driven

Gone are the days when an insurer could be all things to all people. The successful insurer of the future must be extremely focused, both in terms of which markets/segments they compete in and the specific capability set they will need to differentiate themselves in those markets. When competing in new arenas like value-added services, health, and wealth propositions, they will bring focus through clarity on target customers and propositions.

They will take advantage of the new opportunities that arise from the blurring of traditional market boundaries as well as the capabilities that can be imported from other markets. Already we have seen the Asian financial services industry draw on the technologies and innovations of companies to build direct-to-customer models and customer engagement platforms. How much longer before they borrow from the likes of Lemonade and Ant Financial to disrupt the health and wealth industries?

Furthermore, the successful insurer of the future will be analytically driven. To differentiate in what is increasingly becoming a table stakes capability, they will invest in data and analytics partnerships that extend the scope of what they can access and how they use it. Tying this together will be customer and staff experiences that provide specific opportunities to deploy the analytical insights. Lastly, insurers that can work with policymakers and third parties to co-develop changes to their distribution and pricing models will be better positioned to gain the trust of their customers and establish an advantage over their competitors. To do so, they

must be much more proactive.

Japanese insurers must operationalize their existing analytics investments such that all parts of the business can benefit from them. Practical approaches include selecting some of the most critical use cases and putting them into action, upskilling their data-based decision-making capability in teams, and having data champions who focus on ensuring that key business decisions are made with the right decision-making criteria.

## Engagement Matters

Insurers across the world have embraced the power of superior experiences to bring differentiated propositions to customers, whether by disrupting the health market (e.g., Lemonade), delivering a brand experience unique to those with military backgrounds (e.g., USAA), or by simply making their existing way of doing business more engaging. In a world where products are rapidly becoming commoditized, engagement is one of the few avenues open to create differentiation in the market.

The Japanese market is not yet at the same level of sophistication from a customer engagement as other countries—but this too is changing. Just in the last ~12–18 months we have seen several insurers make the customer a central part of their strategy and invest in different ways to bring forward the engagement component of the proposition (e.g., creating dedicated innovation centers, establishing new subsidiaries, etc.).

To be successful at this, Japanese insurers must rethink how they introduce products and services to market and the support they provide to their agents in enabling this. Practical approaches like using actual customer input into designing new services, adopting a design thinking approach to sequentially address known customer pain points, and providing agents with pragmatic training to improve the experience they deliver to customers can help Japanese insurers shift the engagement dial with their customers.

## Distribution Evolves

While much has been said about the customer, we believe that, especially in Japan, more attention needs to be paid to agents, given the prevalence of agent-led distribution models. Several structural trends mean that insurers must rethink the agent experience and value proposition they offer.

First, the number of quality agents entering the agent pool has been steadily decreasing. Second, agent productivity remains a persistent issue with large groups of agents struggling to diversify beyond a core group of friends and families with new products. Third, given the long-term shift away from traditional life products (and toward health and wealth propositions), agents will need different skills to remain effective with customers.

To respond, Japanese insurers need to re-examine their distribution models holistically:

- Shift from a recruiting lead model to build up the agent force to one that takes more of a life-cycle view with equal emphasis on training and career progression—i.e., a holistic agent value proposition.
- Digitalize distribution significantly to improve productivity—For many core insurance sales activities (e.g., leads distribution, customer management, customer communications, policy issuance, etc.), there are many off-the-shelf digital tools available to accelerate capability building.
- Retrain the agent force to enable them to have the health- and wealth-related

customer conversations that will drive the next generation of growth. By nature, these are more emotional, less technical discussions that will require agents to improve their soft skills.

- Multi-channel matters—while experiences are becoming more digital, it is also clear that customers are demanding human engagement and, therefore, distribution models must evolve to enable effective handoffs between channels.

## Ecosystems Emerge

As insurance shifts from being a product-led business to one that increasingly focuses on holistic solutions, partnerships and ecosystems will become more prevalent. Everyone looks at Chinese ecosystem players as successful models—these were businesses that were built as greenfield with substantial investments in technology, i.e., conditions that are difficult to replicate for established insurers.

That said, we believe there are three main ways for Japanese insurers to create their own version of partnerships and ecosystems that are appropriate for the local market:

- **Customer Solutions Focused:** This approach focuses on addressing customer needs throughout their journey including with solutions where the insurer may not be the most logical manufacturer of the product (e.g., services to support a broader health proposition). The insurers who will be successful in this area are those with a clear customer proposition.
- **Distribution Focused:** This approach focuses on building distribution partnerships to extend into areas where insurers are currently not participating. Areas where we see this developing are in new arenas like wealth, where insurers could accelerate growth by partnering with others.
- **Customer Engagement Focused:** In this case, more than a product or service, the insurer would partner with others to improve the engagement of their own customers. While they may not be able to monetize this proposition directly, they would seek to capture value through better customer retention or acquisition. The insurers who pursue this approach are those most worried about their agents' ability to evolve to meet customer expectations.

## What Capabilities Will Insurers Need

In the past, insurers have typically defaulted to product excellence or the breadth of their distribution or new technology investments to try and differentiate themselves. We believe these asset-based advantages will decrease in individual prominence and those who can connect these better will be able to win. Sustainable advantage lies in a company's ability to systematically out-execute competition where crucial, and this comes from leveraging an advantaged capability system. Once built, these capability systems are very difficult to replicate, especially from less coherent companies that are unfocused in their capability choices.

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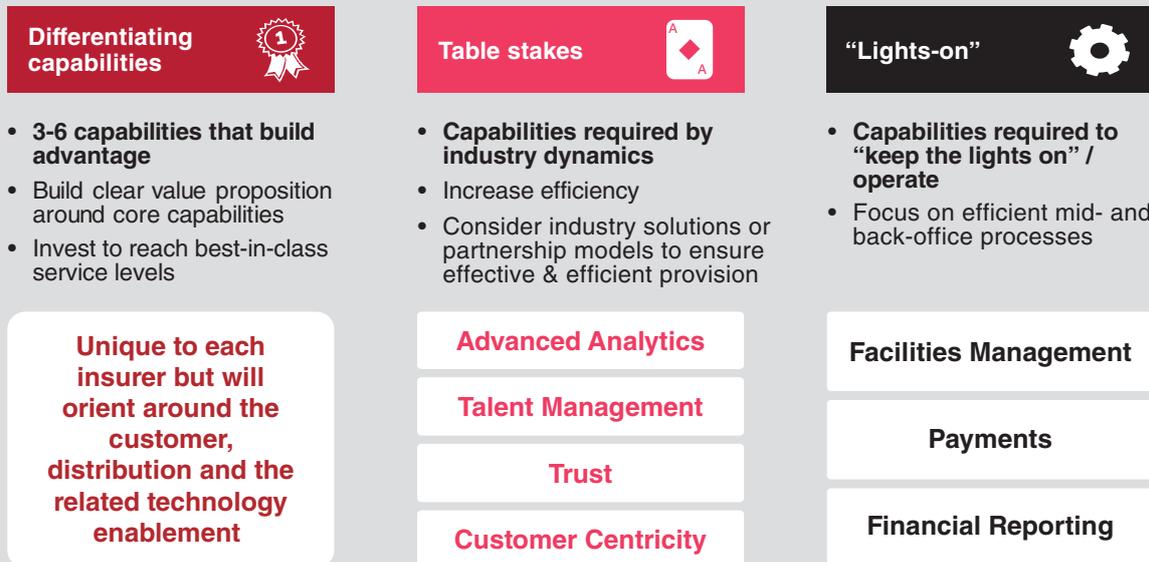
A “capability” is something a company does to execute its strategy, not something it has such as a resource or asset

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Outlined below (Exhibit 2) is our view of the capability model that will help insurers win in the Japan market. In defining these, we have deliberately focused on the areas that will aid differentiation (vs. areas that will support efficiency). The differentiating capability for each

## EXHIBIT 2

### Capability model for Japanese insurers



Source: Strategy& Fit for Growth\* framework

\* Fit for Growth is a registered service mark of PwC Strategy& LLC in the United States.

insurer will be unique to their business and their customer value proposition—i.e. what are the elements that will make a customer give their business to that particular insurer? Given the secular shifts in the insurance industry—trust, digital, adjacencies—the required differentiating capabilities will be customer- and distributor-oriented and linked by the technology that is required to deliver the right engagement. Notably, there will be a gradual shift away from product and actuarial driven points of differentiation.

We have also identified four “table stakes” capabilities that are essential to competing successfully in this market and mitigating the operational and structural challenges that can drag on sector performance. These are not in themselves a prescription for creating sustainable competitive differentiation, and every insurer possesses these to some degree. However, most have struggled to master the execution of each and any insurer hoping to compete effectively must achieve at least a moderate degree of competence in each of these “table stakes” capabilities. There is no “right” configuration, as the degree of competence (and degree of focus) will vary according to the strategic choices of the insurer.

- **Advanced Analytics:** Insurance has changed to become a fundamentally data- and analytics-driven business. A world which has historically relied on actuarial averages now faces the opportunities provided by advanced analytical methods like micro-segmentation, propensity modeling, and mechanistic modeling (which reduce reliance on historical data). However, many Japanese insurers still have excessively rely on paper-based, manual processes. The first imperative here is to digitize the largest processes so the data can be used more effectively.
- **Managing Return on Talent:** The struggle to acquire talent is real in the insurance sector—it is not viewed favorably by new graduates and those with the skills that are most needed typically favor the tech sector. An aging population with an increasing number of retirees only compounds the issue. Japanese insurers need to have a clear workforce strategy covering demand, supply, and career paths. They must also upskill

their employees to be more digitally savvy and augment leadership skills to lead in a changing world.

- **Trust:** If insurers are to maintain their presence in the traditional insurance business or tap into emerging markets like health and wealth, they must build trust with customers. This will be driven by transparency and clear communications at every customer touchpoint—something that can only be achieved through upskilling staff to focus more on outcomes (vs. processes).
- **Customer Centricity:** Japanese insurers have a far way to go in terms of truly understanding their customers. Beyond simple customer surveys and VoC analysis, they need to invest in the infrastructure to consistently capture customer insights, drive a common understanding with the customer, and ensure a clear proposition for different types of customers.

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## THE WAY FORWARD

More than by products or processes, the successful life insurer of the future will be defined by their identity and purpose, how they choose to participate in the market, and the capabilities they invest in to create sustainable differentiation. Undoubtedly, this will entail some strategic repositioning and a combination of the many tools that insurers continue to explore (digital, analytics, risk management, etc.).

What is critical is that each insurer aligns with an identity and focuses on how they will participate in the market and build specific capabilities to aid differentiation—i.e., what is the right combination of a process, supporting tools, the right talent and information flows to drive differentiation with customers? This is a difficult process but one that you can start by asking some simple questions:

- **What is our strategy and is it differentiating?**  
Going forward, insurers must ask themselves “How will we differentiate in a changing market?” In a market where large players are acquiring capability, many are investing into distribution and new players threaten the status quo. Why do you believe your current customers will continue to give you their business, and how confident are you in this answer?
- **Are we clear on how to capture value?**  
Are you clear on where to focus in the market? New markets like health and wealth capture value very differently from the ANP centric view of life businesses. Japanese insurers need to understand the full set of value drivers (conversion at acquisition, new types of revenue streams, reduced capital requirements, improved cross-sell, etc.) before dismissing these businesses.
- **Are our people up for the challenge?**  
Engaged staff are at the heart of a successful life insurer. Future models place a higher emphasis on talent and staff collaboration in service of the customer, and changing strategy places a huge burden on your staff. Given the talent issues that already exist in the Japan life insurance market, what is your plan to manage people through this change and how does that link to your workforce strategy?

Once the leadership is aligned on these questions, focus can shift to addressing current challenges in the context of long-term strategic intent. We believe that these answers will help drive more focus (i.e., less wasted investment, better execution) on key decisions such as:

- Which parts of our business do we want to simplify or re-engineer (vs. differentially invest)?
- Which functions, systems, and activities should be insourced vs. managed vs. outsourced (including back book decisions)?
- Which partnerships and joint ventures are key to accelerating our capability builds?
- What talent and capabilities are required to lead through change toward a refocused

business?

- What data is critical, and how can it be captured, maintained, and used with agility to the best advantage to support your strategy?

We are convinced that the Japan life insurance sector is inherently attractive, yet for incumbents, successful ongoing participation will require challenging long-held beliefs. The successful insurers of the future will be those who are able to link their identity, their unique “right to win,” the differentiating capabilities they develop, and the specific markets in which they choose to compete.



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