Insurance & Reinsurance

Contributing editors
William D Torchiana, Mark F Rosenberg and Marion Leydier

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GETTING THE DEAL THROUGH

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Japan

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Regulation

1 Regulatory agencies

Identify the regulatory agencies responsible for regulating insurance and reinsurance companies.

The Financial Services Agency (FSA) is the government agency that is responsible for regulating insurance and reinsurance companies under the legal and regulatory framework of the Insurance Business Law, Law No. 105 of 1995, as amended (IBL). The FSA has broad authority to set rules, and to supervise and penalise insurance and reinsurance companies as well as their major shareholders or insurance brokers and agents.

The FSA is charged with the supervision of broker-dealers and asset managers as well as banks primarily under the Financial Instruments and Exchange Law (Law No. 25 of 1948, as amended) and the Banking Law (Law No. 59 of 1981, as amended).

Certain administrative functions, such as the insurance broker registration, are delegated to regional financial bureaux subordinated to the FSA.

2 Formation and licensing

What are the requirements for formation and licensing of new insurance and reinsurance companies?

Foreign companies that are considering establishing a vehicle in Japan to acquire an insurance business licence from the FSA may choose either a subsidiary or a Japanese branch. The subsidiary must take the form of a stock company under the Company Law (Law No. 86 of 2005, as amended). The IBL requires a minimum capital of ¥1 billion.

During the licensing procedure, the FSA examines the company's documents, including the general policy conditions; the business method statement and the premium and reserve calculation method statement; the business projections (generally for 10 years); and the CVs of directors. A licence is not issued unless the FSA is convinced of the credibility of the applicant in terms of sufficient financial assets, human resources and business projections.

Formation of a Japanese branch is simpler, but the same licensing requirements apply. In lieu of the minimum capital requirement, the IBL requires the Japanese branch to make a deposit of at least ¥200 million prior to commencing insurance business in Japan.

The foregoing applies generally to reinsurance companies as well.

3 Other licences, authorisations and qualifications

What licences, authorisations or qualifications are required for insurance and reinsurance companies to conduct business?

The IBL sets forth three types of insurance business licence, namely life insurance, general insurance and small-amount short-term insurance. The latter is intended for small mutual association-type businesses, which presumably is not an option for foreign entrants into the Japanese mainstream insurance market.

There is no additional licence specifically for the reinsurance business. Foreign reinsurance companies that intend to carry out reinsurance in Japan must acquire a general insurance business licence, regardless of whether the Japanese vehicle assumes the portfolio of general insurance or life insurance from the ceding companies. The licence is not required if foreign reinsurance companies assume reinsurance offshore without reinsurance activities in Japan.

4 Officers and directors

What are the minimum qualification requirements for officers and directors of insurance and reinsurance companies?

There are no specific examinations or other qualification requirements. It is expected that the management as a whole has sufficient capability to run insurance or reinsurance companies with each director or officer having the background relevant to the duties assigned; for example, the compliance officer should have experience as such.

5 Capital and surplus requirements

What are the capital and surplus requirements for insurance and reinsurance companies?

In addition to the minimum capital requirement noted above, insurance and reinsurance companies are required to meet the solvency margin ratio of 200 per cent. If the ratio goes below 200 per cent, the FSA may issue an order to direct appropriate measures to improve the solvency. Due to practical considerations, such as avoidance of risk to the company's reputation, insurance and reinsurance companies generally maintain much higher solvency margin ratios.

6 Reserves

What are the requirements with respect to reserves maintained by insurance and reinsurance companies?

Insurance companies must set forth their method of reserve calculation in respect of each line of their insurance business in the premium and reserve calculation method statement, which is subject to review and approval by the FSA during the licensing procedures. Insurance companies must set aside reserves in accordance with the approved premium and reserve calculation method statement and the regulations set by the FSA from time to time.

Under the IBL, the chief actuary hired by the insurance or reinsurance company is responsible for checking the adequacy of the reserves and recommending that the management takes appropriate actions (eg, capital increase) if any deficiency or other problem is found or expected based on the business projections. The FSA and the chief actuary have meetings to discuss the adequacy of the reserves and other financial matters after the end of each fiscal year and from time to time as necessary.

7 Product regulation

What are the regulatory requirements with respect to insurance products offered for sale? Are some products regulated by multiple agencies?

Insurance products must generally be reviewed and approved by the FSA before they are offered for sale to customers. Certain insurance products for corporate customers are exempted from the approval requirements. The FSA examines the products from the standpoint of protection of

customers as well as public policy. The FSA is the sole agency in charge of insurance product approval.

Certain securities regulations in respect of public distribution (for instance, the suitability test) are built into the IBL and apply to the offer for sale of investment-type insurance products like variable annuities. Compliance with these regulations is supervised by the FSA like any other regulations under the IBL.

8 Regulatory examinations

What are the frequency, types and scope of financial, market conduct or other periodic examinations of insurance and reinsurance companies?

Based on the supervisory authorities, the FSA conducts on-site examinations of financial service providers, including licensed insurers and reinsurers doing business in Japan. Typically, each insurer and reinsurer is visited by the FSA examination team once every three to five years. Depending on the nature, scale and complexity of the insurers and reinsurers, the on-site examination period varies, but typically it takes two to three months, followed by off-site monitoring and progress reporting obligations. The scope of examination extends to all functions of insurers and reinsurers, including their market conduct, claims, asset liability management or enterprise risk management (ERM) (or both), and governance and internal control generally, as well as their financial status. From time to time, the FSA also requires reporting on specific matters by individual companies or across the industry.

9 Investments

What are the rules on the kinds and amounts of investments that insurance and reinsurance companies may make?

The permissible types of investment assets are broad; moreover, on 18 April 2012 the FSA lifted the limitations on certain specified asset types, such as a 30 per cent cap on domestic stocks, a 30 per cent cap on any foreign-denominated assets, and a 20 per cent cap on real property where 'xx per cent' means the percentage of the sum invested into that asset category against the total general account assets of the insurer or reinsurer. As such, there is no specific set of regulations or guidelines binding insurers and reinsurers as to investment types in terms of amounts. There are credit limit restrictions that are intended to achieve control over exposure to concentration risks in terms of limitations on capital infusion or other investment into one person or a group of persons.

10 Change of control

What are the regulatory requirements on a change of control of insurance and reinsurance companies? Are officers, directors and controlling persons of the acquirer subject to background investigations?

Prior to the change of control, the acquirer of the majority stock shares in the insurance or reinsurance company must obtain FSA approval to become either an insurance major shareholder or an insurance holding company depending on the asset size of the acquirer: that is, if the value of the acquired stock shares in the insurance company, together with any other Japanese subsidiaries, exceeds 50 per cent of the total assets of the acquirer, the acquirer is deemed to be an 'insurance holding company' for the purpose of the IBL. Otherwise, the acquirer constitutes an 'insurance major shareholder' for the purpose of the IBL. The FSA will examine the background of the directors and controlling persons of the acquirer during the approval procedures.

11 Financing of an acquisition

What are the requirements and restrictions regarding financing of the acquisition of an insurance or reinsurance company?

There are no specific restrictions, but the FSA will review the financing of the acquisition while assessing the application for approval (see question 10).

12 Minority interest

What are the regulatory requirements and restrictions on investors acquiring a minority interest in an insurance or reinsurance company?

Acquisition of a minority interest less than the 'major shareholder threshold' (see question 13) lies outside the scope of the regulatory requirements. However, acquisition of more than 5 per cent of the voting share, and any fluctuation of 1 per cent or greater of the voting share ownership thereafter, must be notified to the FSA within five days, in principle.

13 Foreign ownership

What are the regulatory requirements and restrictions concerning the investment in an insurance or reinsurance company by foreign citizens, companies or governments?

Foreign investment in insurance businesses is not considered to have national security implications. There are no requirements or restrictions from the standpoint of foreign investment control.

All the same, if the foreign investor is to constitute an 'insurance major shareholder', as noted above, it must obtain the FSA's approval before making its investment into the insurance or reinsurance company in Japan. The FSA will conduct a background check on the acquirer, such as an examination of the purpose of the investment and the acquisition finance during the application processing to see whether the investment could hamper the sound management of the insurance or reinsurance company. Ownership of a 20 per cent (or 15 per cent in certain circumstances) voting share in an insurance or reinsurance company is the threshold to qualify as an 'insurance major shareholder'.

14 Group supervision and capital requirements

What is the supervisory framework for groups of companies containing an insurer or reinsurer in a holding company system? What are the enterprise risk assessment and reporting requirements for an insurer or reinsurer and its holding company? What holding company or group capital requirements exist in addition to individual legal entity capital requirements for insurers and reinsurers?

The insurance holding company approval (see question 10) is rendered on the assumption that the holding company is capable of establishing, implementing and maintaining governance and control across its group companies. In addition, a group-wide ERM is a key framework that must be implemented by the holding company in an appropriate manner, and the FSA expects that each holding company will establish its ERM framework depending on the nature, scale and complexity of its group-wide businesses. In light of the group-based ERM, each holding company is expected to establish a group-wide policy regarding enterprise risk and solvency assessment and management, while the group insurers and reinsurers are expected to implement solo risk and solvency assessment and management policies, and to make reports to the holding company in an appropriate fashion in accordance with the group-wide policy.

15 Reinsurance agreements

What are the regulatory requirements with respect to reinsurance agreements between insurance and reinsurance companies domiciled in your jurisdiction?

Other than financial reinsurance, parties may execute reinsurance contracts, either treaty or facultative, without obtaining the FSA approval. In the case of financial reinsurance, it is the obligation of the ceding company, not the assuming company, to make prior notification to the FSA, which will examine the purpose of the transaction and its effect on the finances of the ceding company.

16 Ceded reinsurance and retention of risk

What requirements and restrictions govern the amount of ceded reinsurance and retention of risk by insurers?

There are no anti-fronting or other regulations that specifically restrict the amount or ratio of ceded business against the retention. Within the broad powers assigned to the FSA, it may direct the ceding companies to

reconsider their risk-taking and reinsurance practice if it believes that the reinsurance is excessive or otherwise not appropriate from the risk management standpoint.

17 Collateral

What are the collateral requirements for reinsurers in a reinsurance transaction?

There are no collateral requirements. Ceding companies may take credit as to the portfolio ceded to qualified reinsurance companies, such as insurance or reinsurance companies with the general insurance business licence in Japan. Collateral is irrelevant to the qualification (see question 18).

18 Credit for reinsurance

What are the regulatory requirements for cedents to obtain credit for reinsurance on their financial statements?

If the business is ceded to insurers or reinsurers licensed in Japan, the ceding companies may generally obtain reinsurance credit. As to businesses ceded to offshore reinsurers without a licence in Japan, there are no concrete requirements for taking on reinsurance credits, such as a collateral requirement or the reinsurer's credit ratings.

19 Insolvent and financially troubled companies

What laws govern insolvent or financially troubled insurance and reinsurance companies?

Insolvent or financially troubled companies are governed primarily by the IBL and the Reorganisation Law for Financial Institutions, Law No. 95 of 1996, as amended (Reorganisation Law). The IBL sets forth the administrative procedures governing insolvent or financially troubled insurance and reinsurance companies. The procedures under the IBL are supervised by the FSA. The Reorganisation Law governs the legal procedures to revitalise insolvent insurance and reinsurance companies under the supervision of the court. After the enactment of the Reorganisation Law, the administrative procedures under the IBL are virtually superseded by the court-sponsored procedures set out in the Reorganisation Law. Reorganisation allows for a number of different methods of business combination, such as stock purchases, asset purchases and mergers involving the insolvent companies.

Laws subordinate to the IBL set forth the policyholder protection funding structure for the purpose of protecting the interests of the holders of insurance policies issued by insolvent insurance companies.

20 Claim priority in insolvency

What is the priority of claims (insurance and otherwise) against an insurance or reinsurance company in an insolvency proceeding?

In the event of the insolvency of life insurers, the holders of life policies and the beneficiaries have a statutory lien over the total assets, and not over specific assets ring-fenced as security for them. In cases of insolvency of property and casualty insurers, no such priority is granted to the policyholders or beneficiaries.

21 Intermediaries

What are the licensing requirements for intermediaries representing insurance and reinsurance companies?

The IBL sets forth two types of intermediaries in insurance distribution or execution of reinsurance contracts, namely insurance agents and insurance brokers. Insurance agents distribute insurance products on behalf of the insurance companies under their direction. They are required to be registered as such at the competent regional financial bureaux. The registration procedures for insurance agents are much simpler than those for insurance brokers, which are described below. Practically speaking, the administration of the insurance agent registration is delegated to the insurance industry associations.

Intermediary activities of banks are regulated under special provisions of the IBL, but they are subject to the same registration requirements.

Insurance brokers intermediate in their capacity as an independent broker. They also are required to be registered at the competent regional financial bureaux. The brokers must have passed the examination sponsored by the brokers' association, which is conducted only once a year, prior to their filing of the application for registration with the regional financial bureaux. The brokers were required to make a guarantee deposit of at least ¥40 million prior to commencement of the broking business. This minimum deposit sum was reduced to ¥20 million during 2014. Reinsurance broking from offshore without conducting broking activities in Japan does not require the insurance broker to register.

Registration under the IBL is required when the person engages in insurance soliciting, but the term 'insurance soliciting' is not clearly defined for practical purposes. (For instance, it is not clear how far telephone receptionists at a call centre contracted by an insurance company can go without needing to register to act as its insurance agent when they talk to customers about the products of that insurance company.)

Finally, claims adjusters may provide services to insurance companies without any licence or registration under the IBL.

Insurance claims and coverage

22 Third-party actions

Can a third party bring a direct action against an insurer for coverage?

Third parties generally may not bring direct coverage actions against insurance companies unless it is specifically provided that they may (eg, victims of automobile accidents against automobile liability insurers). Victims are generally protected against insolvency of the insured to the extent that section 22 of the Insurance Act (Law No. 56 of 2008) provides the victims with statutory lien over the insured's claims for indemnification against their liability insurers.

23 Late notice of claim

Can an insurer deny coverage based on late notice of claim without demonstrating prejudice?

An insurer may deny coverage if it has successfully demonstrated extraordinary bad faith on the part of the policyholder in respect of the late notice in breach of the agreed policy wording. Otherwise, the insurer may reduce its claim payment obligation only to the extent of the actual damage suffered due to the late notice, and only after successfully demonstrating the actual damage.

24 Wrongful denial of claim

Is an insurer subject to extracontractual exposure for wrongful denial of a claim?

The insurer will owe a tort liability in respect of wrongful denial of a claim. The insurer may also incur an administrative penalty from the FSA, such as a temporary business suspension order. Punitive damages are not available in Japan.

25 Defence of claim

What triggers a liability insurer's duty to defend a claim?

Liability insurers do not have a duty to defend a claim. Liability insurers indemnify policyholders from expenses incurred by them to defend a claim in accordance with the terms of liability insurance policies.

26 Indemnity policies

For indemnity policies, what triggers the insurer's payment obligations?

The triggers can be occurrence of losses, discovered losses, claims made, risk attaching or otherwise as agreed in the indemnity policy.

27 Incontestability period

Is there an incontestability period beyond which a life insurer cannot contest coverage based on misrepresentation in the application?

A life insurer may not allege misrepresentation in the application after the expiration of five years from the execution date of the policy. Moreover, a life insurer may not allege misrepresentation if it fails to contest within one month from the time when it is known to the life insurer.

28 Punitive damages

Are punitive damages insurable?

It is generally thought that punitive damages are not insurable. (Punitive damages are generally not awarded or enforceable by courts in Japan.)

29 Excess insurer obligations

What is the obligation of an excess insurer to 'drop down and defend', and pay a claim, if the primary insurer is insolvent or its coverage is otherwise unavailable without full exhaustion of primary limits?

The law does not impose such an obligation on the part of the excess insurers. In practice, it is not unusual for the parties to specifically set forth in the excess of loss cover contract wording as to whether the excess insurers owe such an obligation.

30 Self-insurance default

What is an insurer's obligation if the policy provides that the insured has a self-insured retention or deductible and is insolvent and unable to pay it?

If an insurer agrees with the insured that it shall absorb the first layer of loss and the insurer shall pay the excess, the subsequent insolvency of the insured where it may not bear a retention or deductible would not affect the insurer's obligation to cover the excess as agreed with the insured.

31 Claim priority

What is the order of priority for payment when there are multiple claims under the same policy?

There are no statutorily or judicially determined rules.

32 Allocation of payment

How are payments allocated among multiple policies triggered by the same claim?

Section 20 of the Insurance Act provides that if a risk is covered by policies issued by multiple insurers, the insured person may recover from any such policies up to their respective full insured sum, up to the full amount of the loss. Once the payment is made by one insurer, the allocation will be made among the multiple insurers on a pro rata basis.

33 Disgorgement or restitution

Are disgorgement or restitution claims insurable losses?

Restitution as compensation for damage in tort or breach of contract generally is covered by liability insurance, while disgorgement is excluded.

34 Definition of occurrence

How do courts determine whether a single event resulting in multiple injuries or claims constitutes more than one occurrence under an insurance policy?

The courts would follow the definition of 'occurrence' as specified in the relevant policies. For instance, if a policy sets out that an 'occurrence' includes an occurrence in respect of bodily injury, an accident, or a continuous, intermittent or repeated exposure to substantially the same general harmful conditions that causes or allegedly causes the bodily injury, then the multiple injuries or claims allegedly caused by such 'an accident or a continuous, intermittent, or repeated exposure to substantially the same general harmful conditions' would be deemed to constitute a single 'occurrence' for the purposes of the policy. The question for the court would then come down to fact finding on such 'accident' or 'exposure', rather than counting the injuries or claims.

35 Rescission based on misstatements

Under what circumstances can misstatements in the application be the basis for rescission?

If the misstatements are made with knowledge or with gross negligence on the side of customers without any inducement or other intervention by the intermediating sales agents and without the insurer's knowledge of the misstatements, the policy may be cancelled by the insurer. As to the incontestability period, see question 27.

Reinsurance disputes and arbitration

36 Reinsurance disputes

Are formal reinsurance disputes common, or do insurers and reinsurers tend to prefer business solutions for their disputes without formal proceedings?

Given the nature of the reinsurance market (where risks are transferred to each other in what is a small community), formal reinsurance disputes are rare. Quite often, insurers opt to reach business solutions without formal proceedings.

37 Common dispute issues

What are the most common issues that arise in reinsurance disputes?

Typically, disputes relate to the scope of coverage, which sometimes is written in vague terminology or industry jargon, the meanings of which are not necessarily clear.

38 Arbitration awards

Do reinsurance arbitration awards typically include the reasoning for the decision?

If the arbitration clause in a reinsurance contract sets forth that the arbitration panel shall issue a written and reasoned award, the panel will include the reasoning for the decision in the arbitration award. Otherwise, it is up to the arbitrators whether to include the reasoning of the decision in the arbitration awards.

39 Power of arbitrators

What powers do reinsurance arbitrators have over non-parties to the arbitration agreement?

Arbitrators do not have any powers over non-parties to the arbitration agreement in respect of the arbitration proceedings.

40 Appeal of arbitration awards

Can parties to reinsurance arbitrations seek to vacate, modify or confirm arbitration awards through the judicial system? What level of deference does the judiciary give to arbitral awards?

Japanese courts will generally honour arbitration clauses in reinsurance contracts (like any other commercial agreements) and arbitration awards issued by the agreed panel. Foreign awards may be brought to the Japanese courts for enforcement in Japan.

Reinsurance principles and practices

41 Obligation to follow cedent

Does a reinsurer have an obligation to follow its cedent's underwriting fortunes and claims payments or settlements in the absence of an express contractual provision? Where such an obligation exists, what is the scope of the obligation, and what defences are available to a reinsurer?

Without express contractual provision, the reinsurer is not obliged to 'follow the fortunes' of the ceding company unless the circumstances demonstrate that such a practice is established (and, therefore, the parties are deemed to have agreed to cede and assume the risks based on that practice in addition to the express terms and conditions in the reinsurance contract). Even if such an obligation exists on the part of the reinsurer, it may try to refuse payment based on gross negligence in claims settlements on the part of the ceding company if there is material deviation from the generally accepted prudent and professional manner.

Update and trends

The 2014 Law amending the Insurance Business Law (Law No. 45, 2014) has been enacted in several steps, and the last part will take effect as of 29 May 2016. The amended law will clarify or strengthen the obligations inherent in insurance distribution, such as agents' obligations to secure internal control systems regarding solicitation conducts, customer data protection and service vendor management. In civil lawsuits where the plaintiffs accuse insurers of 'mis-selling', the plaintiffs would have to establish negligence on the part of the insurers. Failure to observe the administrative obligations under the amended law, generally by insurance agents, would be considered as a fact to establish negligence in 'mis-selling' lawsuits, although it should not be decisive in establishing negligence against an individual plaintiff.

42 Good faith

Is a duty of utmost good faith implied in reinsurance agreements? If so, please describe that duty in comparison to the duty of good faith applicable to other commercial agreements.

The ceding company is expected to take reasonable care in claims settlements, and the level of such reasonable care will be determined based on the industry standard, not the notional ordinary commercial standard. The ceding company is also expected to act in good faith in entering into reinsurance contracts. However, it is not considered to be a duty of utmost good faith.

43 Facultative reinsurance and treaty reinsurance

Is there a different set of laws for facultative reinsurance and treaty reinsurance?

There is no different set of statutes for facultative reinsurance and treaty reinsurance, but the court will consider the difference of the two types in deciding reinsurance disputes.

44 Third-party action

Can a policyholder or non-signatory to a reinsurance agreement bring a direct action against a reinsurer for coverage?

A policyholder or non-signatory may not bring a direct action against the reinsurer.

45 Insolvent insurer

What is the obligation of a reinsurer to pay a policyholder's claim where the insurer is insolvent and cannot pay?

The reinsurer must discharge its own liability against the insolvent ceding company under the terms and conditions of the reinsurance contracts, regardless of whether the liability of the ceding company against its policyholders is reduced in the reorganisation proceedings. Practically speaking, the reinsurers will have the opportunity to negotiate commutation of the assumed portfolio with the reorganisation trustee of the insolvent ceding company in charge of collection from the reinsurers.

46 Notice and information

What type of notice and information must a cedent typically provide its reinsurer with respect to an underlying claim? If the cedent fails to provide timely or sufficient notice, what remedies are available to a reinsurer and how does the language of a reinsurance contract affect the availability of such remedies?

The ceding company must provide notice and information as set forth in the reinsurance contract that will vary depending on the type of the reinsurance; for example, treaty versus facultative or the reinsured risks.

It is not unusual that the reinsurance contracts require timely delivery of all material claim-related information, including the information about the contested claims, together with reasonable supporting documents, and also set forth the consequence of failure by the ceding company to make timely delivery of the required notice and information.

47 Allocation of underlying claim payments or settlements

Where an underlying loss or claim provides for payment under multiple underlying reinsured policies, how does the reinsured allocate its claims or settlement payments among those policies? Do the reinsured's allocations to the underlying policies have to be mirrored in its allocations to the applicable reinsurance agreements?

There are no statutorily or judicially determined rules other than section 20 of the Insurance Act (see question 32). Reinsurance contracts can set forth the manner of claim allocation among multiple reinsurance contracts differently from section 20. If such an agreement is made, the agreed manner of allocation will govern the relevant reinsured and the reinsurers.

48 Review

What type of review does the governing law afford reinsurers with respect to a cedent's claims handling, and settlement and allocation decisions?

There are no specific rights of review afforded to reinsurers by statutes. There are no judicially established rules.

49 Reimbursement of commutation payments

What type of obligation does a reinsurer have to reimburse a cedent for commutation payments made to the cedent's policyholders? Must a reinsurer indemnify its cedent for 'incurred but not reported' claims?

There are no specific statutorily or judicially established rules. Practically speaking, the reinsureds will advise the reinsurers of the terms of commutation prior to its execution and obtain their consent.

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50 Extracontractual obligations (ECOs)

What is the obligation of a reinsurer to reimburse a cedent for ECOs?

ECOs of a ceding company are typically specifically excluded from the reinsurance liability.

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