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The International Comparative Legal Guide to:

Insurance & Reinsurance 2014

3rd Edition

A practical cross-border insight into insurance and reinsurance law

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Email: info@glgroup.co.uk
URL: www.glgroup.co.uk

GLG Cover Design
F&F Studio Design

GLG Cover Image Source
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Printed by
Ashford Colour Press Ltd
February 2014

ISBN 978-1-908070-88-3
ISSN 2048-6871

Strategic Partners

MIX
Paper from responsible sources
FSC® C011748

General Chapters:

Country Question and Answer Chapters:

Chapter 19

Japan

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1 Regulatory

1.1 Which government bodies/agencies regulate insurance (and reinsurance) companies?

The Financial Services Agency (FSA) is the main governing body regulating insurance and reinsurance businesses.

1.2 What are the requirements/procedures for setting up a new insurance (or reinsurance) company?

There are two ways to establish a presence in Japan: (a) establish a branch office in Japan, then subsequently obtain an insurance business licence to engage in insurance business (the "Branch Model"); and (b) incorporate a subsidiary in Japan, then subsequently cause such subsidiary to obtain an insurance business licence to engage in insurance business (the "Subsidiary Model").

As a result of the heavy regulatory burdens and procedures, the insurance business licensing effort under either model will generally take approximately 12 to 18 months to complete. In addition, the costs associated with obtaining an insurance business licence could be substantial. Inasmuch as the FSA requires most of the requisite documents to be filed either in Japanese or to be accompanied with a Japanese translation thereof, considerable drafting and translation costs must likewise be taken into account.

The following is a brief summary of the requirements/procedures for setting up a new insurance/reinsurance business presence in Japan.

(a) Branch Model

Under the Branch Model, a sufficient amount of capital must be brought into and kept in Japan in order for the Japan branch to maintain adequate levels of solvency. A deposit in the amount of JPY200 million must also be made with the local governmental deposit office. The FSA may require an increase in the deposited amount if the FSA determines that such an increase is necessary to protect the policyholders in Japan. Moreover, the Japan branch must have a representative in Japan with a general power of attorney to represent its Japan business. Such representative is generally prohibited from engaging in the daily affairs of any other company. In addition to the appointment of a representative, the branch must, in practice, show that it will employ at least (i) a compliance officer; and (ii) a person that has the requisite insurance business-related skills and expertise to carry out the insurance business.

(b) Subsidiary Model

Under the Subsidiary Model, the minimum capital requirement for the subsidiary is JPY1 billion. In contrast to maintaining a branch, however, the subsidiary is not required to make a deposit with the local governmental deposit office. The subsidiary must take the corporate form of a Japanese corporation (*kabushiki kaisha* or *sogo kaisha*) with a board of directors, a board of auditors, and an accounting auditor. The board of directors must consist of three or more persons, and the directors engaging in the ordinary business of an insurance company must have (i) the knowledge and experience to be able to manage and control an insurance company appropriately, fairly and efficiently; and (ii) sufficient social credibility. Similar to the prohibition applicable to a branch's representative in Japan, the directors in charge of the ordinary business of an insurance company would be generally prohibited from engaging in the daily affairs of any other company. The board of auditors must also consist of three or more persons. The board of auditors must conduct an audit regarding the legality of the subsidiary's business and accounting-related matters. The accounting auditor is generally an external, independent accounting firm, which will conduct an audit of the relevant financial statements of the subsidiary.

1.3 Are foreign insurers able to write business directly or must they write reinsurance of a domestic insurer?

Under Japanese law, a foreign insurer is generally prohibited from engaging in insurance business without first obtaining an insurance business licence in Japan. A foreign insurer may, however, rely on a certain exemption from the aforementioned general prohibition and directly underwrite the following insurance contracts (the "Exempted Insurance Contracts") without obtaining an insurance business licence:

(i) reinsurance;
(ii) marine insurance;
(iii) aircraft insurance;
(iv) satellite insurance;
(v) international cargo insurance; and
(vi) travel insurance.

As noted above, reinsurance is one type of insurance that falls under the Exempted Insurance Contracts. Relying on such exemption, reinsurance fronting arrangements ("RFA") are often made with the local Japanese insurance companies (each such local fronting insurance company, an "FCO"). Under an RFA, the FCO will underwrite risks as the direct insurer and cede a substantial portion of such risks (or even 100 per cent of the risks) to the unlicensed foreign insurer. Since the foreign insurer ultimately assumes such risks, it may wish to control the Japan business to the extent permitted by Japanese law, including controlling various aspects of

the business relating to (i) the features of the FCO's products; (ii) decision-making with respect to underwriting; and (iii) payments made upon the occurrence of insured events. With respect to the features of the FCO's products, the foreign insurer may, through a licensing arrangement or otherwise, provide specific product know-how to the FCO. The FCO will then develop and tailor the products for the Japanese market.

1.4 Are there any legal rules that restrict the parties' freedom of contract by implying extraneous terms into (all or some) contracts of insurance?

The Insurance Act of Japan ("IA"), which took effect on 1 April 2010, introduced some fundamental changes to the rules of private law concerning insurance contracts, including, *inter alia*, the introduction of compulsory provisions which render policy provisions null and void if such provisions are unfavourable to the customers as compared to the standards set forth under the IA.

1.5 Are companies permitted to indemnify directors and officers under local company law?

Under the Company Act of Japan, the liability of the directors owing to the company cannot, in principle, be released except by the unanimous consent of all the shareholders of the company. Accordingly, where a director is found liable to the company (whether in a shareholders' derivative suit or otherwise), such director has to discharge the liability on his own, the implication of which is that the company is statutorily prohibited from indemnifying the director for the damage suffered by him/her under such circumstances. The rationale behind this is that if a company could, at its discretion, indemnify the director for such damage suffered, the strict procedural limitation on the release of the director's liability would be meaningless.

1.6 Are there any forms of compulsory insurance?

Automobile liability insurance is compulsory.

2 (Re)insurance Claims

2.1 In general terms, is the substantive law relating to insurance more favourable to insurers or insureds?

As noted in our response to question 1.4 above, the IA sets forth compulsory provisions which render policy provisions null and void if such provisions are unfavourable to the customers (i.e., policyholders, insureds, or beneficiaries, as the case may be) as compared to the standards set forth under the IA.

2.2 Can a third party bring a direct action against an insurer?

Under current Japanese law, there is generally no mechanism that would allow a third party claimant to make a claim directly against an insurer. During discussions prior to the promulgation of the IA in 2008, legislators attempted to set forth general provisions allowing a third party claimant to make a direct claim against the insurer of a liability policy. Such legislative efforts, however, proved futile due to certain technical issues. Instead, a statutory lien was introduced in favour of a third party claimant. Even where the insured (i.e., the wrongdoer who has caused damages to such third party claimant) becomes bankrupt, the statutory lien would allow the third party claimant to exercise his/her rights against the insured (i.e., a claim for damages against the insured), which will be given priority over the claims of other claimants in respect of the insurance claims held by the insured against the insurer under liability policies.

2.3 Can an insured bring a direct action against a reinsurer?

No. See our discussion in response to question 2.2 above.

2.4 What remedies does an insurer have in cases of either misrepresentation or non-disclosure by the insured?

If, at the time of the conclusion of the policy, the policyholder or the insured intentionally or with gross negligence omits or misrepresents facts regarding matters that the insurer asked them to disclose, the insurer is entitled to cancel the policy by serving a notice to the policyholder, except in the event that the insurer knew or reasonably should have known such facts (including cases where an intermediary or an agent acting for and on behalf of the insurer is found to have prevented such facts from being disclosed or is found to have suggested that such facts be misrepresented or not disclosed). Upon the policy's cancellation, the insurer shall owe no liability to pay for any loss caused by the omitted/misrepresented facts, but the surrender value must be returned.

2.5 Is there a positive duty on an insured to disclose to insurers all matters material to a risk, irrespective of whether the insurer has specifically asked about them?

No. Unless the insurer asks questions related to the matters material to a risk, the insurer shall not be entitled to cancel the policy as stated in our response to question 2.4 above.

2.6 Is there an automatic right of subrogation upon payment of an indemnity by the insurer or does an insurer need a separate clause entitling subrogation?

Yes. Under the IA, if, as a result of the occurrence of a loss, the insured acquires the right to claim compensation from (or any other claims against) a third party, and if the insurer pays the insured for such loss, the insurer shall be automatically subrogated to the rights and remedies of the insured against such third party. In this connection, Japanese insurers often stipulate clauses requiring the policyholder and the insured to cooperate with the insurer in preserving and enforcing such claims, including obtaining any evidence and documents that the insurer may need.

3 Litigation - Overview

3.1 Which courts are appropriate for commercial insurance disputes? Does this depend on the value of the dispute? Is there any right to a hearing before a jury?

There are no special courts in Japan that are dedicated to resolving commercial insurance disputes. Rather, insurers stipulate in the general policy conditions a jurisdiction clause, whereby the court located in the area of the insurer's head office is designated as having jurisdiction over any lawsuit arising out of, or in connection with, such policy. Please note that there is no jury system in Japan.

3.2 How long does a commercial case commonly take to bring to court once it has been initiated?

It would generally take at least 6 months, and depending on the complexity of the relevant case, it may take even longer (possibly one year or more).

4 Litigation - Procedure

4.1 What powers do the courts have to order the disclosure/discovery and inspection of documents in respect of (a) parties to the action and (b) non-parties to the action?

Historically, under Japanese litigation procedures, a party's obligation to disclose private, internal information to an adversary, either by way of oral testimony or production of documents, has been extremely limited, especially when compared to the broad disclosure obligations under United States discovery procedures. Under the Code of Civil Procedure implemented in 1998, however, a person holding documents (a "Holder") has a general obligation to produce such documents upon a court order, irrespective of whether such Holder is a party to the action or not. Once a court order is issued directing a Holder to produce a document, the Holder must comply with such order unless otherwise exempted from doing so. The failure to comply with such court order could result in the following:

(i) in cases where the non-compliant Holder is a party to the action, a determination by the court accepting the truth of the adverse party's argument; or

(ii) in cases where the non-compliant Holder is not a party to the action, an administrative fine of up to JPY200,000.

A court order may be issued even before a case has commenced, provided that the court finds it necessary to preserve the evidence in advance.

4.2 Can a party withhold from disclosure documents (a) relating to advice given by lawyers or (b) prepared in contemplation of litigation or (c) produced in the course of settlement negotiations/attempts?

There are currently no express statutory provisions under Japanese law exempting clients from disclosing any advice or information (either testimonial or documentary) that they obtained through confidential communications with their attorneys, whilst in contrast, Japanese attorneys (*bengoshi*) are exempted from such disclosure under the Code of Civil Procedure. Should a client wish to invoke a right to refuse to release confidential information, the client may base such right on the statutory exemption, i.e., that such information was prepared for the sole use of the client and no other party. Otherwise, there are no special exemptions regarding the documents prepared in contemplation of litigation or produced in the course of settlement negotiations/attempts.

4.3 Do the courts have powers to require witnesses to give evidence either before or at the final hearing?

Yes, the court may, in principle, examine any person as a witness. If a witness does not appear without justifiable grounds, the court will issue an order requiring such witness to bear any court costs incurred as a result of his/her failure to attend the court hearing, and imposing an administrative fine of up to JPY100,000. In respect of a witness outside Japan, a Japanese court has no power to compel such non-resident witness to testify in Japan and must instead rely on the competent government agency of a foreign state or the Japanese ambassador, minister or consul stationed in that state to examine the relevant evidence.

4.4 Is evidence from witnesses allowed even if they are not present?

The court may, if it finds it appropriate and no objection is raised by the parties, allow a witness to submit a written testimony/witness statement *in lieu* of such witness being examined in open court (please note that the examination of a witness may take the form of a video conference if the witness lives in a remote place).

4.5 Are there any restrictions on calling expert witnesses? Is it common to have a court-appointed expert in addition or in place of party-appointed experts?

The court-appointed expert must, in principle, be independent and should not have any material interest in the result of the relevant disputes. A party may challenge the appointment of an expert if there are circumstances that would prevent such expert from giving an objective and a non-prejudiced expert testimony. The expenses associated with the court-appointed expert, such as the cost of travel, accommodation expenses and *per diem* allowance, are included in the court costs, which will be borne by the defeated party.

Apart from the court-appointed expert, a party may appoint an expert of its choosing privately, at its own initiative and costs, and produce that expert's testimony as documentary evidence. This is often called a "private" expert testimony, which will be treated in much the same way as other documentary evidence produced by the litigant parties.

4.6 What sort of interim remedies are available from the courts?

An examination of the evidence may be initiated by the court at the request of the party even before the commencement of the litigation if the court finds it necessary to do so in advance, such as when the failure to conduct the examination would result in the loss of evidence or other difficulties in securing such evidence. A provisional attachment may be allowed if it is likely that the rights held by the claimant will be impossible or extremely difficult to execute but for such interim measures.

4.7 Is there any right of appeal from the decisions of the courts of first instance? If so, on what general grounds? How many stages of appeal are there?

There are generally two stages of appeal. The party dissatisfied with the decision of the court of first instance may, in principle, appeal to the higher court based on any grounds – whether they are related to the facts of the case or interpretation of the law. In contrast, the final appeal may only be filed in certain limited circumstances, e.g., on the ground that a judgment contained a misconstruction of the Constitution of Japan. However, even if the case does not fall under such limited circumstances, the Supreme Court may, upon petition, accept an appeal if it finds that the higher court's judgment is contrary to the precedents rendered by the Supreme Court or otherwise contains material issues concerning the interpretation of laws and regulations.

4.8 Is interest generally recoverable in respect of claims? If so, what is the current rate?

The winning party can recover interest on its claims at a rate of 5 per cent *per annum* in respect of a non-commercial dispute and 6 per cent *per annum* in respect of any commercial dispute.

4.9 What are the standard rules regarding costs? Are there any potential costs advantages in making an offer to settle prior to trial?

The general rule is that the defeated party will bear the court costs. Note that attorney's fees are not included in the court costs, and each party will bear its own attorney's fees (unless such fees are also litigated successfully during the course of the action).

4.10 Can the courts compel the parties to mediate disputes? If so, do they exercise such powers?

No. Under the Code of Civil Procedure, a court does not have the power to compel disputing parties to mediate (*wakai*). However, the Code of Civil Procedure stipulates that a court may recommend mediation to disputing parties. It is very common under civil procedure in Japan for a court to recommend mediation. The timing of such recommendation differs from case to case. A court makes such recommendations in the early stages of a case as well as in the final stages when a court is almost ready to render its judgment.

A court is generally inclined to recommend mediation. This is because of the courts' belief that mediation is a measure which enables the expedited and reasonable resolution of a case. In some cases, a court would encourage mediation through suggestions that the terms of judgment may be more unfavourable than those of a mediated settlement.

4.11 If a party refuses to a request to mediate, what consequences may follow?

A party will often refuse to agree to requests (whether by the court or the counterparty) for mediation if it is dissatisfied with the terms of such request. A party will not be sanctioned or prejudiced (including being imposed with any cost penalties) for refusing to follow such request.

5 Arbitration

5.1 What approach do the courts take in relation to arbitration and how far is the principle of party autonomy adopted by the courts? Are the courts able to intervene in the conduct of an arbitration? If so, on what grounds and does this happen in many cases?

As long as the arbitration clauses are properly drafted, party autonomy effectively excludes intervention by the courts. In the unlikely event that the relevant party seeks judicial intervention, the court may exercise the powers explicitly permitted under the Arbitration Act (e.g., appointment of an arbitrator).

5.2 Is it necessary for a form of words to be put into a contract of (re)insurance to ensure that an arbitration clause will be enforceable? If so, what form of words is required?

No special wording is required; rather, it would generally be sufficient if the parties' intention to be bound by the result of the arbitration is clearly expressed in the contract.

5.3 Notwithstanding the inclusion of an express arbitration clause, is there any possibility that the courts will refuse to enforce such a clause?

Yes. In cases where consumers agreed to an arbitration clause with a business operator, such consumers may, in principle, rescind such arbitration clause at any time. Furthermore, an arbitration clause included in an employment agreement will be held null and void if it relates to the resolution of a dispute associated with the employment relationship. These rules are intended for the protection of consumers and other weaker-positioned parties.

5.4 What interim forms of relief can be obtained in support of arbitration from the courts? Please give examples.

The court will dismiss an action that is brought in breach of an effective arbitration clause. However, the court may, upon the request of a party, conduct an examination of the evidence, including examination of a witness, expert testimony and documentary evidence, to the extent necessary to assist the arbitral tribunal.

5.5 Is the arbitral tribunal legally bound to give detailed reasons for its award? If not, can the parties agree (in the arbitration clause or subsequently) that a reasoned award is required?

Unless otherwise agreed upon by the parties, the arbitral tribunal must give reasons for its award. The arbitral tribunal's failure to indicate the reasons for its award may result in the effectiveness of the award being challenged in court by the dissatisfied party.

5.6 Is there any right of appeal to the courts from the decision of an arbitral tribunal? If so, in what circumstances does the right arise?

The parties may not appeal to the courts in respect of the merits of the arbitration case. However, the effectiveness of the award may be challenged by reasons associated with certain procedural issues such as illegality, lack of legal capacity of the relevant party(ies), failure to comply with the relevant notice requirements and so forth.

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