NEW INSURANCE ACT

I. INTRODUCTION

In April 2010, the Insurance Act of Japan (Act No. 56 of 2008; the "New Act") will come into effect. The New Act comprehensively amends the insurance rules currently set forth in Articles 629 through 683 of the Commercial Code of Japan (Act No. 48 of 1899), which have remained substantially the same since 1911. The New Act is comprised of the following chapters: Chapter I - general provisions (purposes and definitions); Chapter II - casualty insurance; Chapter III - life insurance; Chapter IV - injury and disease fixed-sum insurance; and Chapter V - miscellaneous provisions (statute of limitations and bankruptcy of an insurer). The New Act expands the scope of its application and enhances the protection of policyholders or the insured. Some rules under the New Act are "unilaterally mandatory" (which, for the purposes of the New Act, means mandatory protection of the policyholder or the insured)[i]. Certain provisions of the New Act are stipulated as "unilaterally mandatory", meaning that any agreement between the insurer and the policyholder that is different from those provisions shall be impermissible and invalid if such agreement is less favorable to the policyholder, the insured or the beneficiary (as applicable). By contrast, any agreement that does not have such unilaterally mandatory provisions shall be permissible if such agreement is more favorable to the policyholder, the insured or the beneficiary (as applicable).

This Letter outlines some of the contents of the New Act. Please note that a separate related statute is also in place, called the Insurance Business Act of Japan (Act No. 105 of 1995). The New Act covers the rights and obligations of the relevant parties (such as the insurer, the policyholder, the insured and the beneficiary[ii]) under an insurance contract. On the other hand, the Insurance Business Act provides licensing requirements and various industrial regulations which are applicable to companies engaging in the insurance business.

As a matter of practice, each insurance company has established standard terms and conditions of insurance, which apply to insurance contracts entered into by that insurance company. Insurance companies need to review their current standard terms and conditions of insurance and consider revising them if any provisions thereof may conflict with unilaterally mandatory provisions of the New Act.

In addition, the "Comprehensive Guidelines for Supervision of Insurance Companies," (the "FSA Supervisory Guidelines") which have been promulgated by the Financial Services Agency of Japan, stipulates that insurance companies adjust their business operation to be in compliance with the New Act well before the formal implementation thereof.

II. SCOPE OF INSURANCE ACT

The New Act defines an "insurance contract" in terms of the following three elements:

(i) one party to the contract agrees to provide monetary or other benefits on the condition that a specified event has occurred;

(ii) the counterparty to the contract agrees to pay a premium in consideration for item (i) above; and

(iii) the premium is calculated on the basis of the probability or risk of occurrence of the event referred to in item (i) above.

While the current law provided in the Commercial Code is not intended to apply to a mutual aid contract, the New Act applies to a mutual aid contract as well if it meets the above three elements for an insurance contract.

Also, the New Act stipulates provisions for injury and disease insurance, which are not dealt with by current legislation. The New Act provides for three types of insurance contracts: (1) casualty insurance contracts; (2) life insurance contracts; and (3) injury and disease fixed-sum insurance contracts. Injury and disease insurance contracts that compensate the victim or patient for damages (rather than pay a fixed sum) are considered to be a type of casualty insurance contract.

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III. MATTERS COMMON TO EACH TYPE OF INSURANCE CONTRACT

(1) Duty to Provide Material Information

Under current legislation, a prospective policyholder or prospective insured (a "prospective policyholder/insured") is obligated to notify an insurer of material information (such as the insured's health conditions and history of illness or other matters relating to the risk of occurrence of an insured event) when entering an insurance contract. If the prospective policyholder/insured fails to provide any material information or provides incorrect information in any material respect due to willful misconduct or gross negligence, the insurer may cancel the insurance contract. Sometimes, a dispute arises when an insurance claim is filed, as to whether material information was duly provided to the insurer; if the insurer determines that such information was not duly provided, it may result in a refusal by the insurer to pay the insurance benefit.

The New Act prevents the need for the prospective policyholder/insured to determine, at his or her own risk, what information is material and should be provided to the insurer. Namely, the New Act requires the prospective insurer, at the time of the execution of an insurance contract, to ask questions about material information relating to the probability of occurrence of an insured event to the prospective policyholder/insured. When the prospective policyholder/insured fails to provide answers or gives false answers in response to those questions due to willful misconduct or gross negligence, the insurer may cancel the insurance contract[iii]. However, the insurer may not cancel the insurance contract unless the insurer had asked the prospective policyholder/insured to provide such information at the time of the execution of the contract; this is the case, even if material information was not provided to the insurer. In other words, the insurance contract cannot be cancelled due to the policyholder's or the insured's failure to provide material information, if neither of them failed to provide answers nor stated false answers in response to the insurer's questions.

Furthermore, even if the prospective policyholder/insured failed to provide answers or stated false answers, the insurer may not cancel the insurance contract if: (i) at the time of the execution of the insurance contract, the insurer was aware that the answer was incorrect or it was not aware thereof due to its own negligence; (ii) an intermediary for the insurer interfered with the prospective policyholder/insured from providing a response; or (iii) if an intermediary for the insurer suggested to the prospective policyholder/insured that the latter should either not provide answers or give false answers. However, the insurer may cancel the insurance contract if it is found that the prospective policyholder/insured failed to provide answers or stated false answers, irrespective of whether the intermediary for the insurer committed an act referred to in item (ii) or (iii) above.

The foregoing rules relating to the prospective policyholder/insured's duty to provide material information are "unilaterally mandatory" (as defined above). For example, the insurance contract may not stipulate that the prospective policyholder/insured must provide the insurer with all material information relating to the risk of occurrence of the insured events (whether or not the insurer has asked the prospective policyholder/insured questions thereon).

Also, the FSA Supervisory Guidelines expect insurance companies to make the material information clearly understandable to the prospective policyholder/insured, while bearing in mind that the material information that will be provided is dictated solely by the insurer.

If the insurance contract is cancelled due to failure by the policyholder or the insured to provide correct responses, the insurer is not liable for any insured event that may have occurred prior to the cancellation, provided that the insurer must pay the insurance benefit with respect to any insured event that would have been covered irrespective of such failure to provide correct responses. In connection with this proviso, Japanese driver's licenses have gradations depending on the history of traffic offences, and drivers holding a preferred "golden" grade may enjoy a lower premium rate for automobile casualty insurance. If a policyholder misrepresents the grade of his or her driver's license when he or she purchases insurance, an issue arises as to whether an insured event (i.e., a traffic accident) was caused by such misrepresentation. It may be argued that such a misrepresentation would be causally-linked to the insured event, given that drivers holding a license with a non-preferred grade tend to drive less carefully than those holding a license with a preferred grade.

(2) Disclosure Document

The New Act provides that if the insurer executes an insurance contract, it must promptly deliver a document describing the fundamental terms (as enumerated by the New Act) of the insurance contract to the policyholder.

(3) Exemption of Insurer

The New Act provides for several circumstances where the insurer is not responsible for paying insurance benefits. For example, an insurer of a casualty insurance contract shall not be liable to cover (a) any damages caused by the willful misconduct or gross negligence of the policyholder or the insured or (b) any damages arising from wars or other revolts.

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For liability insurance, however, the insurer is not exempted even if the policyholder or the insured was grossly negligent. Further, an insurer of a death insurance contract is not responsible for paying insurance benefits if: (a) the insured commits suicide, (b) the policyholder or the beneficiary willfully causes the insured to die, or (c) the insured dies from wars or other revolts.

The foregoing rules are not mandatory, and the insurer may provide for additional exemptions in the insurance contract. Thus, the insurers may flexibly design the coverage of insurance products they offer to keep premium rates at reasonable levels. However, insurers may not provide exemptions that would effectively circumvent the unilaterally mandatory provisions of the New Act.

(4) Due Date of Payment of Insurance Benefits

The New Act provides the following rules in relation to the timing of the payment of insurance benefits (whereby rules (i) and (iii) below are unilaterally mandatory):

(i) Even if the timeframe for paying insurance benefits is stipulated in the insurance contract, in the event that such timeframe exceeds the period that would reasonably be necessary for the insurer to verify: (a) the insured event; (b) (in the case of casualty insurance) the damages to be compensated; (c) any cause of exemption; and (d) other relevant matters, the insurer must pay the insurance benefit by the end of such timeframe.

(ii) If no timeframe is stipulated in the insurance contract for the payment of insurance benefits, the insurance benefit is not due and payable until after the lapse of the period that would reasonably be necessary for the insurer to verify the insured event and (in the case of casualty insurance) the damages to be compensated.

(iii) In the event that the policyholder, the insured or, if applicable, the beneficiary, unduly interferes with or does not cooperate with the investigation by the insurer to verify the matters referred to in items (i) and (ii) above, the insurance benefit would not be due and payable during any additional period of investigation caused by such interference or non-cooperation.

The standard terms and conditions of insurance contain provisions related to the timing of payment of insurance benefits, which need to be consistent with the foregoing rules. The FSA Supervisory Guidelines expect the standard terms and conditions to provide a general timing for payment of insurance benefits (e.g., five business days for life insurance, and thirty days for casualty insurance, etc.) and, in the case where any investigation or reference requires longer timing, a reasonable number of days for each category of such investigation or reference.

(5) Cancellation by Policyholder

Under the New Act, the policyholder may cancel the insurance contract at any time. This rule is not unilaterally mandatory. So, the insurer would not be prohibited from restricting the policyholder from cancelling the insurance contract for a specified period, so long as there is a good reason for such restriction.

(6) Cancellation by Insurer Due to Increased Risk

Under the New Act, if the risk[iv] of insured events occurring increases after the insurance contract is executed, and such increased risk cannot be undertaken by the insurer, the insurer may cancel the insurance contract. The circumstances under which the insurer will not undertake an increase of risk must be described in the insurance contract. In other words, the insurer may not arbitrarily determine whether or not it will undertake an increase of risk.

On the other hand, if an insurer can undertake such an increase of risk, the insurance contract should be continued with an upward adjustment of insurance premiums. However, in cases where the insurance contract requires that the policyholder or the insured promptly notify the insurer of any change in the material information relating to the increased risk, the insurer may cancel the insurance contract if the policyholder or the insured fails to do so[v]. This rule is unilaterally mandatory.

If the insurance contract is cancelled due to an increase of risk, the insurer is not liable for any insured event that may have occurred after such increase and prior to the cancellation, provided that the insurer must pay the insurance benefit with respect to any insured event that would have occurred irrespective of such increase. This rule is unilaterally mandatory.

(7) Cancellation by Insurer for Significant Reasons

An insurance contract has a speculative element, and thus, mutual reliance between the insurer and the policyholder, the insured, or the beneficiary is indispensable. Should the policyholder, the insured, or the beneficiary commit any act that betrays the insurer's confidence, the insurer should be able to cancel the insurance contract. The New Act provides that the insurer may cancel the insurance contract in any of the following circumstances (these rules are unilaterally mandatory):

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(i) if the policyholder, the insured or the beneficiary (as applicable) intentionally causes or attempts to cause an insured event for the purpose of having the insurer pay the insurance benefit;

(ii) if the person entitled to receive the insurance benefit (i.e., the insured, in the case of casualty insurance, or the beneficiary, in the case of life insurance or injury and disease fixed-sum insurance) commits a fraudulent act in connection with the insurance benefit claim; or

(iii) if any serious circumstance occurs that would impair the insurer's confidence in the policyholder, the insured or (if applicable) the beneficiary and would make it difficult for the insurer to maintain the insurance contract.

If the insurer intends to cancel the insurance contract on account of item (iii) above, the circumstance must be as serious as item (i) or (ii) above. For example, if a policyholder purchases duplicate insurance policies in a very large aggregate benefit amount during a very short time period, such conduct may be considered to impair the insurer's confidence and justify the cancellation of the insurance contract.

If the insurance contract is cancelled due to any of the circumstances (i) through (iii) above, the insurer is not liable for any insured event that may have occurred after the occurrence of such circumstance and prior to the cancellation. This rule is unilaterally mandatory. In connection therewith, for example, if the insured of casualty or injury and disease insurance illegally claims insurance benefits by declaring an unduly large amount of damages caused by an actual accident, or declares that he or she has been hospitalized for a longer period than reality, such conduct would constitute item (ii) above and the insurer may cancel the insurance contract. In such case, the cancellation would take effect as of the time that the insured illegally claimed insurance benefits by false declaration; however, the cancellation cannot be made retroactively as of the time that the insured event (the accident or hospitalization, in the above-mentioned example) occurred. This means that the insurer could not be exonerated from the insured event itself and would have to pay insurance benefits (to the extent of the actual insured event) even if the insurer cancels the insurance contract due to item (ii) above. Some scholars believe, however, that such interpretation would be problematic.

(8) Restriction on Refund of Insurance Premiums

Generally, if an insurance contract is cancelled or invalidated, the insurer must refund insurance premiums to the policyholder. The New Act provides that an insurer does not need to return insurance premiums in the following cases only (these rules are unilaterally mandatory):

(i) the insurance contract is cancelled due to fraud or duress on the part of the policyholder or the insured; or

(ii) (in the case of an insurance contract which covers an insured event that may have occurred prior to the execution of the contract) the contract is held to be invalid because the policyholder[vi] had knowledge of the occurrence of such insured event, provided that the insurer did not enter into the insurance contract with the knowledge of the occurrence of such insured event.

IV. <u>MATTERS RELATING TO CASUALTY INSURANCE CONTRACTS ONLY</u>

(1) Statutory Lien on Liability Insurance

The New Act has the following mandatory provisions purporting to protect the victims of an accident covered by liability insurance:

(i) A person who has a claim for damages against one insured by liability insurance has a statutory lien on the insured's claim for insurance benefits.

(ii) A person insured by liability insurance may exercise his or her claim for insurance benefits to the extent that such person has compensated any victims for damages or the victims have allowed such person to exercise such a claim.

(iii) The insured's claim for insurance benefits under the liability insurance contract may not be assigned, pledged or attached (except where (x) assignment is made to the person who has a claim for damages that is referred to in item (i) above or attachment is made with respect to such claim for damages, or (y) a person insured by liability insurance may exercise his or her claim for insurance benefits in accordance with item (ii) above).

(2) Subrogation Rights

Under the New Act, if the insurer of a casualty insurance contract has paid the insurance benefit upon the occurrence of an insured accident, it may exercise subrogation rights to the insured's claim for damages against the person who caused the insured accident; provided, such subrogation rights may only be exercised to the extent that it is the smaller of (a) the amount of the insurance benefit paid by the insurer, or (b) an amount equal to the insured's claim for

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damages. (If item (a) above, is insufficient to cover the compensatory damages under the casualty insurance contract, the deficit shall be deducted therefrom.) Also, if item (a) above, is insufficient to cover the compensatory damages under the casualty insurance contract, the insured may exercise his claim for the remaining damages prior to the insurer's claim on account of subrogation. These rules are unilaterally mandatory.

V. MATTERS RELATING TO LIFE INSURANCE CONTRACTS OR INJURY AND DISEASE FIXED-SUM INSURANCE CONTRACTS ONLY

(1) Consent of the Insured

The New Act provides special rules for the effectiveness of a death insurance contract, which is a life insurance contract wherein the insurer agrees to pay an insurance benefit if the insured dies. If a death insurance contract names a person (other than the parties to the contract) to be the insured, the contract shall not take effect unless the insured gives consent. This rule also applies to an injury and disease fixed-sum insurance contract, provided that the consent of the insured is not required if the insured (or his or her successor) is named to be the beneficiary (excepting those cases in which only the death caused by injury or disease is an insured event, in which case the insured's consent is required). The foregoing rules are intended to prevent moral hazard or insurance gaming and are mandatory.

(2) Change or Death of Beneficiary

Under current law it is not completely clear how the policyholder may reassign a beneficiary. The New Act expressly provides that the policyholder may, by giving notice to the insurer, change the beneficiary before any insured event occurs. Also, the beneficiary may be changed by the policyholder's will. Any change of the beneficiary in a death insurance contract shall not take effect unless the insured gives consent to the change.

In the event that the beneficiary dies before an insured event occurs (and the beneficiary is not changed by the policyholder), all of the beneficiary's successors become the beneficiaries.

(3) The Insured's Right to Demand Cancellation of Insurance Contract

As mentioned above, the insured's consent is required for the valid execution of a death insurance contract that names a person (other than the parties to the contract) to be the insured. After such a death insurance contract takes effect with the insured's consent, the insured may demand that the policyholder cancel the contract if any of the following events occurs:

(i) the policyholder or the beneficiary intentionally causes or tries to cause the insured to die for the purpose of having the insurer pay the insurance benefit;

(ii) the beneficiary commits a fraudulent act in connection with the claim for the insurance benefit;

(iii) the occurrence of any serious circumstance which would impair the insured's confidence in the policyholder or the beneficiary and which would make the continuance of the insurance contract difficult; or

(iv) the policyholder ceases to be a relative of the insured or a substantial change has occurred, which would undermine the circumstances by which the insured had originally given consent to the execution of the contract.

If the policyholder receives a demand from the insured, the policyholder has to cancel the insurance contract. In the event that there is any dispute between the policyholder and the insured as to whether the insured may legitimately make the demand, the insured may sue the policyholder, seeking a judgment ordering the policyholder to cancel the insurance contract. If the policyholder is ordered to follow the insured's demand, the policyholder must cancel the insurance contract (notwithstanding any provisions to the contrary that may be contained in the insurance contract). The foregoing rules are mandatory. Similar rules apply to an injury and disease fixed-sum insurance contract as well.

(4) Right to Intervene

Under a life insurance contract or an injury and disease fixed-sum insurance contract, (depending on the type of the contract) the policyholder may be entitled to receive a cancellation refund upon early termination of the contract. Creditors of the policyholder may consider attaching the policyholder's claim for the cancellation refund and cancelling the insurance contract. Also, if the policyholder goes bankrupt, the trustee in bankruptcy may want to cancel the insurance contract in order to receive the cancellation refund. However, if the insurance contract is terminated, it may be difficult (depending on the age or health condition of the insured) to secure a replacement insurance contract. Also, life insurance or injury and disease fixed-sum insurance serves to give financial support to the family of the insured. Thus, the beneficiary should be able to continue the insurance contract in the event that any levying creditor or the bankruptcy trustee (collectively the "Cancelling Creditors") of the policyholder cancels the

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contract.

If any Cancelling Creditor is going to cancel the death insurance contract or injury and disease fixed-sum insurance contract, which in each case has a premium reserve, the New Act allows the beneficiary to prevent the insurance contract from being cancelled by paying the Cancelling Creditor an amount equal to the cancellation refund. This right of the beneficiary is called a "right to intervene". In order for the beneficiary to be able to exercise the right to intervene, he or she must be the insured or a relative of either the policyholder or the insured. Also, the exercise of the right to intervene requires the policyholder's consent. To ensure the opportunity for the beneficiary to exercise the right to intervene, any purported cancellation of the insurance contract by the Cancelling Creditor shall not take effect until one month passes after the insurer receives the notice of cancellation, during which period the qualified beneficiary may pay the Cancelling Creditor the required amount to prevent the cancellation. In connection therewith, if any insured event occurs during the one-month period and the insurance contract terminates as a result thereof, the insurer must pay the insurance benefit to the beneficiary and the Cancelling Creditor will not receive the cancellation refund. Due to the hardship of such a consequence for the Cancelling Creditor, the New Act provides that in such a case, the insurer must pay (to the extent of the amount of the insurance benefit payable) the Cancelling Creditor an amount equal to the cancellation refund calculated as of the date of the notice of cancellation and pay the beneficiary any remaining amount of the insurance benefit. The foregoing rules relating to the right to intervene are of a mandatory nature.

VI. STATUTE OF LIMITATIONS

Under the New Act, the statute of limitations, which is applicable to claims for insurance benefit, refund of premiums, and refund of premium reserves, is three years. In contrast, the statute of limitations applicable to the insurer's claim for premiums is one year.

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[i] With respect to corporate insurance, it may be difficult for insurers to undertake casualty insurance for business activities if the unilaterally mandatory provisions under the New Act strictly apply. In view of this, the New Act provides that the unilaterally mandatory provisions shall not apply to maritime insurance, aircraft insurance, atomic power insurance and other casualty insurance covering damages that may be caused in relation to business activities.

[ii] As for a casualty insurance contract, "the insured" is the person who is entitled to exercise a claim for insurance benefits if an insured event occurs. As for a life insurance contract or injury and disease fixed-sum insurance contract, "the insured" is the person whose death, injury or disease is insured, and "the beneficiary" is the person who is entitled to exercise a claim for insurance benefits if an insured event (i.e., death, injury or disease of the insured) occurs.

[iii] The right of the insurer to cancel the insurance contract shall extinguish if (x) it does not exercise the right to cancel during the one-month period after it becomes aware of a cause for cancellation or (y) five years have passed since the execution of the insurance contract.

[iv] The risk (an increase of which could be a basis for the cancellation of the insurance contract) is limited to material information related to the probability of insured events occurring, that the insurer asked the prospective policyholder/insured to provide at the time of execution of the insurance contract.

[v] The right of the insurer to cancel the insurance contract shall extinguish if (x) it does not exercise the right to cancel during the one-month period after it becomes aware of a cause for cancellation or (y) five years have passed since the increase of the risk.

[vi] With respect to casualty insurance- the insured, or with respect to life insurance or injury and disease fixed-sum insurance- the beneficiary.

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