Reorganization of Insurance Companies, Banks and Others Based Upon the Law Regarding Special Reorganization Proceedings for Financial Institutions

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Shinjiro Takagi is the chair of the Industrial Revitalization Commission for Industrial Revitalization Corporation of Japan, as well as a professor of law at the Chuo University Law School in Tokyo, Japan. He is admitted in Japanese bar in 1963 and after being in private practice for 25 years, sat at bench as a judge of the Tokyo District Court, Presidents & Chief Judges of a couple of district courts, and a Judge of the Tokyo High Court (court of appeal). After retiring the judgeship in 2000, he successfully reorganized several huge corporations. He also served as the chairperson of the Committee for Guidelines of Multi-Creditors' Out-of-Court Workouts, which had been organized by the Japanese Bankers Association and other relevant organizations in 2001. He is one of founders of Japanese Association of Business Recovery, Japanese Association of Turnaround Professionals and National Network of Bankruptcy Lawyers which were established from 2001 to 2005. He is the author of numerous books and articles on Japanese and American bankruptcy laws and civil procedure and received his doctor of laws (Ph.D) degree in 2002.
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1. Practical Changes to Handling Reorganization Cases

On May 24, 2000, “The Law to Partially Reform the Insurance Business Law and the Law Regarding Special Reorganization Proceedings for Financial Institutions” (the Law No. 92 of 2000, hereinafter referred to as “SRC”) was enacted and put into effect on June 30 of the same year. Fortunately or unfortunately, there had been no reorganization cases under the previous law, i.e., “The Law Regarding Special Reorganization Proceedings for Financial Institutions” (Law No. 95 of 1990) (hereinafter referred to as “Special Reorganization Law” or “SPL”). Three life insurance companies and one casualty (non-life) insurance company became eligible for the application of the SRC for corporate reorganization as the result of the reform. The life insurance companies were the Chiyoda Mutual Life Insurance Co., the Kyoei Life Insurance Co., and the Tokyo Mutual Life Insurance Co., and the filings of petitions to commence their corporate reorganization procedures were made on October 9, October 20, 2000 and March 23, 2001, respectively. The Kyoei Life Insurance was a stock corporation, but the other two were mutual companies. In all cases, preliminary stay orders were issued immediately after filing of the petitions, and the decisions to commence the reorganization proceedings were made within a few days thereafter. Approval of the reorganization plan was given on March 31, April 2 and September 30, 2001, respectively. The decisions to terminate the reorganization procedure for the Kyoei Life Insurance, the Chiyoda Mutual Life Insurance and the Tokyo Mutual Life Insurance were made on April 23, April 25 and October 19, 2001, respectively.

After having been engaged mainly in reorganization cases for 25.5 years as a private lawyer, I assumed the position of a judge in 1988 to make most of my specialized knowledge. However, I had little opportunity to preside over bankruptcy handling work as a judge and in 2000 I voluntarily resigned from the judge’s position to become a university professor and returned to the position of lawyer. Fortunately, I was given a chance to serve as the interim trustee and the reorganization trustee of the Kyoei Life Insurance.

That enabled me to fill in the 12 year gap through engagements in actual reorganization work. The reorganization practice during the period since the burst of the economic bubble and subsequent long depression has substantially changed from that during the growing economy in the Showa Era and will probably continue to undergo further changes in the next several years. This article will tell readers about the problems encountered in the corporate reorganization procedures for life insurance companies on the basis of the Special Reorganization Law based on my own experience of being in charge of the reorganization of the Kyoei Life Insurance. It will also address recent practical changes observed in the reorganization procedures and highlight the conceptual differences between Japan and the United States I came to recognize through this experience.

While I truly regretted that I had little opportunity to handle reorganization cases as a judge utilizing my expertise developed through my long experience of being a private and specialized reorganization lawyer, I could have opportunities as a judge to hear ordinary civil and commercial litigation cases, civil execution cases, civil mediation cases and civil and commercial appeal cases. Furthermore, while I had been engaged in judicial administrative work as the president and the chief judge of two local districts and family courts of small- and medium-scale, I had experienced local bankruptcy handling activities. Such extensive experience helped me broaden my horizons tremendously. It is not clear to me whether it is good or bad that my initial desire to focus on practical reorganization cases as a judge was not realized. What has become clear at a minimum is that specialization will be necessary not only for lawyers but also for judges going forward.

2. Causes of Trouble of Life Insurance Companies

(1) Mechanism and Features of Life Insurance

Life insurance companies invest premiums collected from policyholders in several assets to be prepared for the payment of life insurance money at the time insurance events occur (in addition to death events, cases in which the insured persons survive beyond the policy maturity date are referred to as “survival events,” and they are treated as insurance accidents requiring insurance pay-outs.). The death event insurance covers both the cases where death is compensated only when it occurs during a certain fixed period and where compensation is made for lifetime. There are a variety of insurance contracts.
Survival insurance is those where the payment of insurance money is made if the policyholder lives up to a specified time, but no payment is made if the insured person dies by then. There is a mixed insurance of the death event insurance and survival event insurance. An insurance where a pension is paid continually is also available. Premiums are calculated by forecasting the rate of occurrence of the insurance event in consideration of the average lifespan and mortality rate, based on the premise that there are groups of many insured people (i.e., “the law of great numbers”), adding forecast investment yields and subtracting business expenses. Because a variety of insurance products actually exist, complicated calculation methods combining diverse formulas are used. The qualified specialists who are in charge of these calculations are called actuaries.

The unique sources of profit/loss generation for life insurance companies are from mortality differences, expense differences and interest differences. The profit from mortality differences, which are the bases of the actuarial calculation, refers to a profit gained as a result of an extension of average lifespan or a decline in the mortality rate owing to the developments in medical treatment technology and environmental changes. The profit from expense differences means a profit stemming from fewer business expenses than originally forecast.

(2) Negative Spread

Bankruptcies in insurance companies and banks where business failure were considered unlikely have occurred one after another, beginning with the bankruptcy of the Nissan Mutual Life Insurance in 1997, followed by the insolvency of the Toho Mutual Life Insurance in 1999. In 2000, five companies, namely, the Dai-ichi Fire and Marine Insurance, the Dai-ichi Mutual Life Insurance, the Taisho Life Insurance, the Chiyoda Mutual Life Insurance and the Kyoei Life Insurance became insolvent. Furthermore, in 2001, the Tokyo Mutual Life became insolvent. In the light of these circumstances, it is yet premature to announce the end of a series of insolvency of the insurers although it has been strongly hoped for by the general public.

For a long time, people assumed insurance companies would never fail simply because an economic growth has continued. The negative spread, i.e., loss as opposed to profit resulting from interest differences, is considered to be the primary cause of the successive business failure of insurance companies. Insurance companies have concluded insurance contracts calling for payment of certain amount of insurance money based on the premise that they could profitably invest the collected premiums in assets at interest rates assumed at the time of contract. However, the subsequent movement in the investment yield continuously followed a downward trend due to a long-lasting decline in real estate prices, business stagnation, low interest rate policy, etc., resulting in accumulation of losses, thus endangering the operation of insurance companies. The Kyoei Life Insurance, for example, sold long-term endowment insurance with a guaranteed interest rate of 4% to 6.25% during the booming or bubble period, but the actual yield between 1996 and 1999 had registered a steady decline from 3.83% to 3.82%, 2.89%, 2.01% and 1.54%. The negative spread as of the end of September 2000 was reported to reach total JPY1,270 billion (according to the morning edition of Yomiuri Shimbun on March 24, 2001).

The negative spread was of no doubt the main reason for the life insurance crisis. With this background, toward the end of 2000, then Financial Services Minister Aizawa expressed an opinion that the relevant law should be reformed to enable reduction of the guaranteed interest rate which is a part of an insurance contract without resorting to insolvency procedures under the Insurance Business Law or the Special Reorganization Law. While a preliminary study was undertaken by staffs of the Government and the ruling Liberal Democratic Party, it was not realistic to assume that a change in the contents of insurance contracts can be changed against the will of policyholders without resorting to statutory insolvency procedures (Art. 135 IV, IBL).

Except for the “hengaku hoken (variable insurance)” that is sold as a high risk-high return product, people in general take out ordinary insurance contracts for risk management purposes to deal with accidents. This means the insurance money collected from policyholders must be invested safely and securely in order not to be affected by changes in the economic situation. Stock prices are considerably affected by changes in the market conditions and bonds or loans carry the risk of becoming unrecoverable. Japanese insurance companies have benefited from a favorable environment so much that they needed not to pay attention to such risks. It cannot be denied that their lack of experience of streamlining operations to win a price competition compared with other industries prevented them becoming serious about raising profit from expanding expense differences. Even under the business
recession, profits from mortality differences have increased. Insurance companies themselves may probably be feeling a need to adopt a rigorous managerial attitude rather than resting on insurance actuarial principles alone.

The discussion on the need to reform the relevant law to enable the curtailment of the guaranteed interest rate without resorting to insolvency proceedings, which was once suspended, was reopened and the reform of the Insurance Business Law toward that direction was made finally in July, 2003. The outlines of the requirements and proceedings according to the reformed law to reduce the rate are as follows (Art. 240-2—240-13, IBL). The insurance company which is not able to continue its business without making amendments of the terms of insurance contracts (mainly by mean of reducing the guaranteed interest rate) may apply to the Prime Minister (whose authority is delegated to the Director General of the Financial Services Agency; hereinafter the same) to obtain a permission for such reduction. Upon receipt of a permission from the FSA, the company may convene the stockholders' meeting to resolve the proposal (the proposed rate cut must be less than 3% annually, Art. 36-3; the Enforcement Ordinance) at the meeting with consents of more than two-thirds of attending stockholders in terms of the voting rights (for a mutual company, consents of more than three-fourths of attending stockholders or representatives are required). Upon the passage of the resolution, the company must apply for the permission again to the FSA and, with the FSA's permission, the company must send a notice to all policyholders whose rights are affected by the amendments. When more than 10% of policyholders who are entitled to insurance payments in the amount of the affected policies object to the proposal within a certain designated period (at least one month after the notice), the proposal cannot be enforced. Otherwise, the proposal will become effective. However, since the insurance company's application for the rate curtailment is virtually taken as a public announcement of its difficulty and may invite a difficult consequence such as insolvency, no application under the reformed law has been made so far.


(1) Securing Stability Based on the Insurance Business Law

The Insurance Business Law (Law No. 105 of 1995) (hereinafter referred to as the "Insurance Business Law" or "IBL") includes various provisions to ensure the safety and soundness of insurance companies, which were enhanced by the reformation made in 2000.

Firstly, it was stipulated that insurance companies must establish liability reserves at the end of each accounting period based on the coefficient set by a Cabinet Office ordinance to provide for fulfillment of future liabilities under insurance contracts (i.e., to set aside the estimated amount of future insurance money payments to be posted as liabilities on the balance sheet; Art. 116, IBL). It was also stipulated that the Prime Minister (i.e., Director General of the Financial Services Agency) may set standards for judging the adequacy of insurance companies' solvency to meet insurance claims (i.e., an index called "solvency margin" showing the ability of an insurance company to pay the excess of insurance claims over the accumulated liability reserve) as criteria for judging the safety and soundness of insurance companies (Articles 130 and 313 I, IBL).

Moreover, under the law, the Prime Minister can order an insurance company and its subsidiary to submit a report or data regarding the state of their business activities or assets, as and when deemed necessary, to secure the sound and proper operation of the insurance company and to protect insurance policyholders (Art. 128, IBL). The Prime Minister can enter a place of business, office or any other facilities of an insurance company, conduct on-site inspections, make inquiries and examine accounting books and other documents (Art. 129, IBL).

Moreover, the Prime Minister can order an insurance company to submit a plan for the improvement of its business, etc., order suspension of all or part of its business, or order depositing of its assets, as and when deemed necessary (Art. 132 I, IBL). Further, the Prime Minister can order the dismissal of a director(s) or a statutory auditor(s) or withdraw the license of the company in such circumstances as designated by the provisions of the Law (Articles 133 and 134, IBL). These are called "prompt corrective measures."

There is a worldwide trend to convert mutual companies into corporations. The Insurance Business Law was reformed in 2000 to facilitate conversion to a corporation (Article 85 and the following provisions of the IBL).

(2) Limited Guarantee for Insurance and Financial Assistance

An insurance company that has suspended or is likely to suspend payment of insurance money, or an insurance company whose debts exceed or are
likely to exceed assets, is referred to as an "insolvent insurance company" (Art. 260 II, IBL). Any life insurance contract concluded by an insolvent insurance company shall become a guaranteed contract (the original contracts in Japan minus reinsured contract), and payment of insurance money up to 90% of the liability reserve shall be guaranteed (Art. 270-3, IBL; the Order regarding special measures for protection of policyholders < the Ministry of Finance Ordinance No. 124 of 1998, hereinafter referred to as the "Protection Ordinance">, Art. 50-3). In other words, payment of insurance money up to 90% of the designated liability reserve is guaranteed (as a special measure until March 31, 2001, certain insurance contracts were to be compensated 100%, but 90% universal compensation was established after April 1 of the same year). This does not mean that 90% of insurance payment is guaranteed; the insurance payment amount shall be up to the liability reserve stipulated by the Insurance Business Law. A part of the insurance payment whose resource is from investment profit is not guaranteed by the Law. Therefore, in the Kyoei case, some policyholders may be paid only 40%, while others may be paid 90%. The mechanism is very complicated and beyond the scope of this article. By following a designated procedure, the insolvent insurance company can be eligible for financial assistance from the Life Insurance Policyholders Protection Corporation (hereinafter cited as LIPPC) (Article 259 and the following provisions of IBL), which is used to cover the deficit of assets and to pay the insurance money that was guaranteed by the IBL. (Article 268 and the following provisions of the IBL). Insurance companies are obliged to become members of the LIPPC and contribute certain amount of membership levies every year for the purpose of maintaining the policyholders protection fund for financial assistance (Art. 265-32 ~ Art. 265-35, IBL). If the LIPPC is short of available funds, it can borrow money from the Bank of Japan under the guarantee of the Government of Japan within the range of an amount approved through a Diet resolution (Art. 265-42 and 265-42-2, IBL and Attached Rules 1-5). (In comparison, no governmental guarantee is available for the Casualty Insurance Policyholder Protection Organization). Covering the necessary fund with additional contributions from membership life insurance companies would seriously deteriorate the financial conditions of the member insurance companies and potential credit uneasiness can be expected. Under such circumstances, an arrangement can be made to extend financial assistance from the National Treasury to the LIPPC (Attached Rules to the IBL, Art. 1-2-13). Financial fund of the LIPPC was once JP ¥460 billion, which was depleted due to the financial assistance of about JP ¥380 billion extended to cover the business failure of the Toho Mutual Life Insurance. On the occasion of the reformation of the Insurance Business Law in May 2000, therefore, the borrowing limit amount with the Government guarantee was raised to certain amount from JP ¥460 billion to JP ¥90 billion (The Enforcement Ordinance of the IBL, Art.57-47).

4. Insolvency Procedures Regarding Life Insurance Companies under Insurance Law and Special Reorganization Law

On May 24, 2000, "The Law to Partially Reform the Insurance Business Law and the Law Regarding Special Reorganization Proceedings for Financial Institutions" was enacted, and put into effect on June 30 of the same year. In this section, I would like to describe the current procedures for dealing with insolvency based on the reformed Insurance Business Law and discuss corporate reorganization procedure under the reformed Special Reorganization Law (hereinafter "the SRL"). The SRL provides for special bankruptcy procedure to liquidate insurance companies (Art. 490 and following provisions of the SRL), but its detail is omitted here because such liquidations are not realistic so long as measures provided by the Insurance Business Law are effectively implemented.

(1) Procedure in Accordance with the Insurance Business Law

It is stipulated that when the Prime Minister deems that in light of the state of business activities or assets of an insurance company the continuation of its insurance business is difficult, or that the operation of its activities is significantly inadequate in such a way that the continuation of its business is likely to bring about a situation where the protection of policyholders will be insufficient, then the Prime Minister may order the insurance company to suspend its business or have consultations regarding an insurance portfolio transfer, or issue a special order for the administration by an insurance administrator of its activities and assets (Art. 241 I; Art. 242; Art. 312 II, IBL). The above is the procedure for dealing with insolvency under the Insurance Business Law. The portfolio transfer of insurance contracts was considered to be most appropriate in ensuring the continuation of assurance in accordance with insurance contracts. Usually, assets of the insurance company
concerned are transferred together with insurance contracts.

According to the provisions of the IBL, it may be possible to allow the insurance company concerned to consult on the transfer of insurance contracts or merger with another company without nominating an insurance administrator even after issuance of a business suspension order (Art. 241, IBL). Past practices are as follows. A management order is issued in parallel with issuance of the business suspension order, and the Prime Minister (Director General of the Financial Services Agency) orders the insurance administrator to consult on the insurance portfolio transfer and/or work out a plan including the portfolio transfer of insurance contracts. The Prime Minister approves the formulated plan and orders its execution. In case of the portfolio transfer of all insurance contracts, it is possible to change contract terms such as reducing the amount of insurance money to be paid. The portfolio transfer of insurance contracts and changes in the contract terms are publicly announced after discussion at a general meeting of shareholders (in the case of a stock corporation) or a general meeting of representatives (in the case of a mutual company). If there is no opposition, the portfolio transfer of insurance contracts and changes in contract terms are deemed approved and put into effect (Art. 250 and following provisions; Art. 135 and following provisions; Art. 321, IBL). If more than 10% of the policyholders opposed to the portfolio transfer and contract term changes within one month after the public announcement, the portfolio transfer and contract term changes is not possible (Art. 255-4; Art. 137, IBL). In this case, the procedure to deal with solvency in accordance with the IBL becomes impossible and there would be no other choice than to shift to liquidation, including bankruptcy.

The first characteristic of using the IBL is that the procedure can only be initiated by the issuance of a business suspension order by the Prime Minister (Director General of the Financial Services Agency), and not by the insurance company's filing a petition. Because the procedure does not begin until the Prime Minister recognizes the difficulty of business continuation, it is probable that the procedure will not be commenced until the situation becomes very serious, depending on how the procedure is operated. The second characteristic is that, although changes in contract terms are possible, it is not possible to change the terms of other debts unless the individual consents of other creditors than policyholders are obtained (concerning the transfer of assets to be carried out along with the portfolio transfer of contracts, it is stipulated that assets necessary for the protection of interests of creditors other than policyholders shall be reserved (Art. 135 III, IBL)). Furthermore, life insurance policyholders have a lien on the liability reserve and policyholders who possess realized life insurance money claims have a lien on total assets (Art. 117-2, IBL) (the liability reserve is simply a statement as a liability item on the balance sheet, with no actual fund set aside for that purpose; the right related to the liability reserve is only a general lien, at any rate). The lien can be exercised only in the course of the civil execution procedure, liquidation procedure or statutory insolvency procedures.

It is stipulated that more than one insurance administrators shall be nominated (Art. 242 II, IBL). In the past cases, a troika combination of a life insurance expert, a lawyer and a certified public accountant has been chosen.

(2) Reorganization Based on the Special Reorganization Law

The most significant differences between the corporate reorganization procedure under the Special Reorganization Law and that under the general Corporate Reorganization procedure are that, under the SRL procedure, not only stock corporations but also mutual companies can be dealt with, and that the LIPPC participates in the reorganization process as the representative of policyholders and exercises the right of voting for or against a reorganization plan (Art. 432, IBL). Individual policyholders can personally participate in the reorganization process by filing an application with the reorganization court (Art. 431, SRL). However, to seek the participation of a large number of general policyholders (the total number exceeded 6 million in the case of the Kyoei Life Insurance) in the reorganization process would be unreasonable, hindering the smooth progress of the rehabilitation to lose the opportunity for rehabilitation.

It is not required to notify policyholders of the initiation of a reorganization process (Art. 423, SRL). The LIPPC produces a list of policyholders, makes the list available to the policyholders for public inspection and submits it to the court by the final day of the filing period, thus filing the policyholders' rights. The policyholders themselves need not file their rights individually (Art. 428-430, SRL). The LIPPC will notify policyholders of the content of the reorganization plan for the exercise of their voting right two weeks prior to the voting date, and exercise its voting right at a relevant meeting (Art. 438, SRL). However, policyholders can personally participate in the reorganization procedure by filing an application for his (or her) attendance at the meeting with the court (Art. 431, SRL).
An insurance contract is not classified as a bilateral non-executory contract (Art. 61, the Corporate Reorganization Law [hereinafter cited as "CRL"]), so that the trustee is unable to exercise the right to reject it (Art. 438, SRL). An exercise of the right to reject would challenge the protection of policyholders. For instance, cancellation of a life insurance contract would put policyholders at a disadvantage by making them unable to take out similar insurance contract due to age or disease limitations.

One of the advantages of resorting to the Special Reorganization Law over the procedure under the Insurance Business Law is that it is possible to alter the rights not only of policyholders but also of other general creditors' claims or shareholders through the reorganization plan. In addition, because life insurance policyholders are priority creditors with general lien (Art. 117-2, IBL; Art. 138-1 (2), CRL), exempting all claims of general creditors (including subordinated loans) and redeeming all shares without compensation through the combination of a 100% capital reduction and a new share issuance meets the principle of fairness and equity in changing the policyholders' rights. (Art. 168 and Art. 168 II, CRL).

In general, no repayment of reorganization claims shall be made without following a reorganization procedure (i.e., without following the repayment articles as approved in the reorganization plan) (Art. 47, CRL). The expectation is, when a financial assistance agreement is concluded with the LIPPC, 90% of the insurance money realized as a result of accidents (i.e., compensation-eligible insurance contracts) can be paid (Art. 440, Art. 441, SRL; Art. 245; Art. 279-3, IBL; and the Protection Ordinance, Art. 50-3). It would be too severe to prohibit the payment of compensation-eligible insurance contracts since insurance is designed to provide financial protection against accidents. Thus, insurance payment is admitted under this condition as an exception.

As to the rights of the policyholders who have not made any insurance claims because no events have occurred, the filing of these claims is not carried out in light of the nature of their rights, which is divergent from the ordinary corporate reorganization processes. Instead, the content and the amount of the voting rights of such insurance contracts are recorded in the list of insurance policyholders by the LIPPC. The list is made available for the policyholders for public inspection and is submitted to the court by the end of the final day of the filing period (Art. 428-430, SRL). The amount of policyholders' claims are evaluated against the amount of liability reserve and relevant factors. (Art. 444, SRL).

Many insurance companies, particularly life insurance companies, are mutual companies. One of the principal purposes of amending the Special Reorganization Law was to set special provisions concerning the reorganization process for mutual companies that are not covered by the Corporate Reorganization Law that provides for stock corporations only. The description of a mutual company case is omitted here, however, because I am not personally experienced in the reorganization process of a mutual company.


Seven life insurance companies and two casualty insurance companies have gone insolvent up to date. The Special Reorganization Law has been used for four companies, while the Insurance Business Law was resorted to in handling the business failure of five companies. Two companies were stock corporations, and the remainders were mutual companies. The actual practices used for dealing with these cases are explained below.

(1) Period Required for the Process, Take-over Company, etc.

The first company to be dealt with using the Insurance Business Law was the Nissai Mutual Life Insurance Co. in 1997. This was followed by the Toho Mutual Life Insurance in 1999. In 2000, the Daiichi Mutual Fire and Marine Insurance, the Daihaku Mutual Life Insurance and the Taisho Life Insurance received business suspension order from the Prime Minister to enter into the process of insolvency handling under the Insurance Business Law.

The period between the issuance of the business suspension order and the portfolio transfer of insurance contracts was slightly more than five months for the Nissan Mutual Life Insurance, nine months for the Toho Mutual Life Insurance, slightly more than ten months for Daiichi Mutual Fire and Marine Insurance, slightly more than 10 months for the Daihaku Life Insurance and slightly over seven months for the Taisho Life Insurance.

A foreign life insurance company, the GE Edison Life Insurance, took over the Toho Mutual Life, and another foreign company, the Manulife Century Life Insurance, took over the Daihaku Mutual Life Insurance. In the case of the Taisho Life Insurance, however, the Azami Life Insurance, a joint sub-
intangible assets (goodwill) such as their sales persons' associations with their customers i.e., its policyholders. As the consequence of suspending sales activities, however, these intangible assets (goodwill) deteriorate day by day. A speed is a common vital element in all corporate reorganization processes, and this is particularly true in the case of an insurance company where sales activities must be suspended until the matter is settled. In hindsight, solvency handling through the Special Reorganization Law generally proved to be speedier than through the Insurance Business Law.

(2) Changes in Insurance Contract Terms and Other Related Matters

(i) Reduction of Rights for Those Other Than Policyholders

The reorganization plans for the three companies based on the Special Reorganization Law called for discharge of all the claims owed to general creditors (including subordinated loans) which were not the rights of policyholders. As mentioned earlier, the greatest benefit of resorting to the Special Reorganization Law rather than the Insurance Business Law in solvency handling is the flexibility of making this arrangement in the reorganization plan. The Kyoei Life Insurance Co., a corporation, was able to issue new shares while totally eliminating the rights of existing shareholders through 100% capital reduction. The Chiyoda Mutual Life Insurance, a mutual company, decided to convert to a joint-stock corporation; because its liabilities exceeded its assets, the company decided not to implement any compensation for membership rights. In both cases, all new shares were allotted to the sponsor company.

(ii) Early Cancellation Deduction

In insolvency handling, it is possible to make changes in contract provisions (non-trivial alteration for disadvantages), such as reduction of insurance amounts, if an insurance company makes a portfolio transfer of insurance contracts (Art. 250 I and Art. 135 IV, IBL). Under both the Insurance Business Law and the Special Reorganization Law, changes in contract terms are set forth in reorganization plans. Specific to any plan for changing insurance contracts is the existence of an early cancellation deduction provision, which means that, if a policyholder unilaterally cancels an insurance contract relatively early prior to the maturity date, a penalty is imposed to disadvantage such a policyholder by reducing the return premium. For an insurance contract to be effective, it is critical to maintain the insured groups, but requests for cancellation will increase as rumors about credit insecurity spread. The
procedure to file the petition for reorganization based on the Special Reorganization Law is designed to deal with a situation of increasing cancellation requests. Acceptance of requests for cancellation is prohibited by the business suspension order under the Insurance Business Law; in the case of the Special Reorganization Law, accepting cancellation requests is prohibited by a court order after the issuance of a preliminary injunction order or after the start of a reorganization process without obtaining the approval of the court (Art. 28 and Art. 72 IBL, CRL). The early cancellation deduction clause is set in order that the collectivity of insurance contracts is not destroyed due to an increase in cancellation requests following the court approval of a reorganization plan or the portfolio transfer of insurance contracts under the Insurance Business Law. This arrangement is made without exception in the handling of insolvencies under the Insurance Business Law and the Special Reorganization Law (Art. 445 II, SRL). The application period for early cancellation deduction varies between seven and ten years after the portfolio transfer of contracts or the approval of the reorganization plan. The deduction rate gradually reduces as time passes, and varies between 2% and 20%.

(iii) Curtailment of the Planned Interest Rate
As stated earlier, the negative spread was the greatest cause of business failure for life insurance companies. However, it is possible to set a reduction in the guaranteed interest rate through changes in contract terms or by means of provisions in a reorganization plan, and all past failure cases include this provision. The degree of reduction in the guaranteed interest rate varies between cases. For the Nissan Mutual Life Insurance for which insolvency handling was carried out in 1997, the annual guaranteed rate was changed to 2.75% reflecting the interest rate situation at that time, which appears relatively high today. In later cases, the rate has been reduced to 1% in the case of the Daihyaku Mutual Life Insurance and the Taisho Life Insurance; 1.5% for the Toho Mutual Life Insurance and Chiyoda Mutual Life Insurance; 1.75% for the Kyoei Life Insurance; and 2.6% for the Tokyo Mutual Life Insurance. The curtailment of the guaranteed interest rate is not linked with the reduction of the readily accumulated liability reserve. However, without the reduction in the reserve, continued negative spread and associated losses may repeat insolvency, so that a reduction in reserve is effective in eliminating such an anxiety. The reduction in the guaranteed interest rate sometimes cause a larger cut in the insurance money to be paid than the curtailment of the liability reserve that will be discussed next.

(iv) Liability Reserve Reduction
Liability reserve is an amount based on actuarial calculation established for the fulfillment of future payment obligation under insurance contracts as a result of the occurrence of insurance events and is posted as a liability of the balance sheet (Art. 116, IBL; the Rule for the Enforcement of the IBL <The Ministry of Finance Ordinance No. 5 of 1996> Articles 58 and 59). Put more simply, it is matched with the future obligation of insurance money payments and constitutes an essential part of the changes in the contract terms or the rights of policyholders (Art. 445, SRL). In case of the Nissan Mutual Life Insurance, which was the first failure case, the LIPPC extended a financial assistance of ¥200 billion to receive a portfolio transfer of insurance contracts without reducing the liability reserve with a view to place a priority on the maintenance of credibility on life insurance. In all other cases apart from this and the latest case of the Tokyo Mutual Life Insurance, the LIPPC has cut the liability reserve by 10% which is the upper limit under the present system (an exception is the Kyoei Life Insurance where the rate reduction was 8%). As explained earlier, since the insurance money equivalent to 90% of the liability reserve is compensated for (Art. 270-3, IBL; the Protection Ordinance, Art. 50-3), a reduction beyond 10% is not possible, and any possible shortage must be compensated by obtaining assistance from the LIPPC or the National Treasury. As a matter of fact, all companies except for the Chiyoda, the Kyoei and the Tokyo Mutual Life Insurances received a great deal of financial assistance to limit the rate reduction to 10%, and consequently the LIPPC coffers has been exhausted.

No curtailment of the liability reserve was called for under the reorganization plan for the Tokyo Mutual Life Insurance. This may be because the degree of asset deterioration was not so serious thanks to early filing of the petition to commence the procedure and minimize successive cancellations due to rumors.

(v) Special dividends
For the Kyoei Life Insurance and the Chiyoda Mutual Life Insurance were subject to reorganization procedure under the Special Reorganization Law. If the sales or collection proceeds of operating assets exceed the evaluated value, part of the surplus will be distributed to policyholders as special dividends. In the case of the Kyoei Life Insurance, 70% of the surplus was distributed to policyholders. Setting this provision was closely related to asset
valuation that will be discussed later.

6. Financial Assistance, Sponsors and Asset Valuation

(1) Financial Assistance

In cases where insolvency procedures under the Insurance Business Law were undertaken, all failed insurance companies received large amounts of financial assistance from the LIPPC: about JT ¥200 billion for the Nippon Mutual Life Insurance; about JT ¥380 billion for the Toho Mutual Life Insurance; about JT ¥145 billion for the Daihyakko Mutual Life Insurance; about JT ¥20.2 billion for the Taisho Life Insurance; and about JT ¥40 billion for Daiichi Mutual Fire and Marine Insurance. In contrast, the Kyoel Life Insurance, the Chiyoda Mutual Life Insurance, and the Tokyo Mutual Life Insurance, which were handled under the Special Reorganization Law, received no assistance from the LIPPC, although the size of their assets and liabilities was far greater than those of the five companies mentioned above.

The major reason why the three latter cases have been handled without obtaining financial assistance was the early filing of the petition to commence the rehabilitation process and subsequent speedy handling of reorganization procedures, which were the keys to their rehabilitation.

Insolvency handling based on the Insurance Business Law commences with a business suspension order being issued by the Prime Minister (Director General of the Financial Services Agency). A hesitation is commonly observed until the situation becomes untenable in issuing the business suspension order which is an equivalent of a death penalty sentence.

In the Special Reorganization Law, it is stipulated that, if an evidence suggests a potential bankruptcy of an insurance company, the Financial Services Agency, as the regulatory agency, may file a petition to commence a reorganization procedure (Art. 377, SRL). In practice, the companies themselves have filed a petition to commence the procedure in all past reorganization cases that enabled the ailing company to apply for assistance at a relatively early stage before assets deteriorated further. Company management often misjudges the timing of application because of its wishful thinking. However, since it is the management who is fully aware of the seriousness of the situation, it is practical to give the present management a chance to initiate the reorganization process while the condition is not too serious.

A problem is the recent climate of demanding pursuit of management responsibilities. It may be a natural human nature for the incumbent management to try out the last, hopeless struggle in order to avoid statutory reorganization procedures if he/she cannot escape managerial responsibility for applying for the procedure. While it cannot be denied that managerial misjudgment or loose management or sometimes questionable attributes of the management is one of the causes of business failure, management has to make bold managerial decisions from time to time that may turn out to be unsuccessful. While the breach of trust, embezzlement, hiding of assets and unjustifiable asset accumulation are clearly guilty, it may not be adequate in some cases to pursue personal responsibility for simple managerial misjudgment or loose management. It is out of question to make the former management the scapegoats to resist criticisms of the bankruptcy victims. Management should be aware that a heavier management responsibility would be imposed by letting a chance slip away to file the reorganization petition because of his/her fear of an inquiry into managerial responsibility. In the case of the Kyoel Life Insurance which came under my charge, I announced as a result of my examination that I would not intend to bring a legal charge against the former management. The media did not welcome my announcement and emotional victims criticized me, but I did not change my opinion to go along with a popular view. It should be understood that encouraging early filing for reorganization is by far more important than pursuing small returns from surrendered personal assets.

Goodwill is an intangible asset and, in the case of the Kyoel Life Insurance, it was valued at JT ¥360 billion. If a capital injection does not count the value of an intangible asset, the burden on policyholders would be larger than would have been otherwise and may raise a need for financial assistance, a situation that must be avoided by all means. The longer the reorganization procedure and total resumption of business activity are delayed, the more capable sales personnel who have good customer base may be recruited away by competitors, the harsher the scramble for the customer base of stable group insurance becomes, thus deteriorating the value of the goodwill day by day. To overcome the disadvantage of not being able to conclude new insurance contracts until the court approval of a reorganization plan, the Kyoel Life Insurance obtained a permission for agency-entrusted sales regarding the insurance contracts of the Prudential Life Insurance (locally incorporated subsidiary of the sponsor company) within 2 months after the initiation of the reorganization procedure to partially resume sales activi-
ties, thus maintained the sales organization and the market area, minimizing a deterioration in goodwill. Since a speed is a key to success in the rehabilitation of an insolvent company, not only the efforts of the reorganizing company but also the understanding and cooperation of the court and regulatory agency are essential.

(2) Sponsor

The Kyoei Life Insurance Company was given a preliminary preservation injunction order in the evening of Friday, October 20, 2000. After negotiations with several candidate sponsors on Saturday and Sunday, the Prudential Insurance Company of the United States was provisionally nominated as the sponsor on Monday, October 23rd, and the court order was issued to commence a corporate reorganization proceeding in the evening of the same day.

Immediately after assuming the position of an interim trustee, I obtained views from various sources such as the Financial Services Agency and the LIPPC to learn that the key element of leading this reorganization case to a success was whether a financial assistance from the LIPPC and government subsidy was made possible. The LIPPC coffers have been already exhausted, so a financial assistance is not possible without government guarantee borrowings or a government subsidy. Judging from the scale and the amount of financial assistance of the past failed life insurance companies, the total fund amount required for both the Kyoei and the Chiyoda Mutual Life Insurance Company that filed a petition for a corporate reorganization proceeding 10 days before the Kyoei did is expected to reach hundreds of billions of yen or, in the extreme, a trillion yen. I was afraid that this might invite a backlash of public opinion, become politicized and subsequently hamper the reorganization of the Kyoei Life.

Since the review of the petition and other attached documents gave me sufficient confidence that the subject case can be handled without any financial assistance, I explained to several candidate sponsors that a sponsorship would only be accepted on the ground that no financial assistance from the LIPPC or a government subsidy be requested. When payments need to be made to cover at least 90% of the insured amount for the guaranteed insurance contracts and the Kyoei does not have sufficient fund, no request should be made for financial assistance to the LIPPC or any government subsidy and the prospective sponsor must fill in the gap to meet the Kyoei Life's obligation.

Among those candidate sponsors, it was only the Prudential Insurance (U.S.A.) that accepted this condition by the designated deadline after serious thoughts: all other candidates requested more time for further internal discussion. It was feared that giving them a few more days or weeks would not change the situation; or worse, an extension might cause the Prudential's withdrawal from their acceptance of those preconditions. The decision of selecting the Prudential as an interim sponsor was thus publicly announced, but I myself fell a victim of the media criticism.

The thrust of the criticism was, while the Prudential once agreed with the Kyoei to form an alliance and conducted due diligence, it broke the alliance agreement after obtaining full knowledge of the Kyoei's conditions and intended to buy it at a bargain by pushing the Kyoei in a position to file a petition for corporate reorganization procedure. It was not fair, so the critic said, to choose the Prudential without giving other candidates sufficient time to consider the deal. However, this criticism was wrong in its premise. First of all, although it was only the Prudential that made public the existence of an alliance agreement, there were actually other companies who conducted due diligence or similar investigations and had information close to the Prudential’s to form a basis for a judgment. It is not uncommon that no alliance is formed after all in spite of a provisional agreement, including confidential obligations concluded for the purpose of conducting due diligence. This practice was not well-understood.

There was another lack of understanding in the media criticisms. The criticism may be based on the premise that it should be always after filing a petition for corporate reorganization procedures and issuing a provisional stay injunction order that sponsors be selected from among candidates with public participation through fair competition. This premise is also wrong. A company who has filed a petition for reorganization procedure is just like a patient with severe disease who needs to undergo a surgical operation as quickly as possible and should not be ferried from one hospital to another in an ambulance. To be sure, under the reorganization procedures taken till today, it has been a practice to search for sponsors after a petition for the procedure was filed. We need to understand that this practice is an indication of the fact that no action has been taken for a patient whose condition has been worsening.

Information disclosure by the Japanese companies has been insufficient
and lacked transparency. Large lenders such as banks have been complacent with real estate collateral and have not paid much attention to the changes in profitability and cash flow of corporate borrowers; directors, who in fact have been representing the interest of employees and not that of stockholders, have not performed expected checking functions. In contrast, in the United States where information disclosure is far more advanced, worsening corporate profitability would become known to the outside fast, encourages management to file a petition for the Chapter Eleven. Under the Chapter Eleven, outside financial advisers are invited to draft management improvement measures in the early stage, restructuring experts or so-called "turnaround specialists" are invited from outside as new executive officers to promote business restructuring and carry out discussions with creditors, and the use of DIP finance (a system of extending loans even after the filing a petition for reorganization procedures or the commencement of the procedures as super priority claims and permitting attaching of security in preference to existing security) or majority rule are considered. Executive officers at the time of filing the petition, who may be turnaround specialists, continue to stay on a management position even after the commencement of the procedures as "debtor in possession".

As mentioned earlier, stricter transparency has been called for against insurance companies under the Insurance Business Law than for normal commercial business companies, particularly when it relates to the Financial Services Agency, their regulatory agency. With this background, measures to deal with slumping business had been taken from the early stages and the Kyoei Life had asked for assistance from several other companies including the Prudential and attempted to form an alliance with them. There was no need to search for a sponsor from scratch; what was more important was to obtain a commitment from the sponsor that the deal would be made without requesting the financial assistance by the LIPPC.

(3) Valuation of Assets

In the case of the Kyoei Life, a preparatory work for property assets valuation by the trustee progressed in parallel with that by the sponsor as two independent evaluations. A discrepancy in assets valuation standard was discovered since there was no initial agreement on assets management and disposition. It was only in the later stages of the procedure that the trustee and the sponsor entered into this discussion. While the trustee was assessing the assets assuming that the majority of assets be maintained and managed, the sponsor side was assessing them based on the assumption that the majority of assets be sold off or disposed of, which resulted in a wide difference in the assets valuation between the two parties. From the viewpoint of the sponsor, the Kyoei's operating asset structure (portfolio contents) was too risky - we learned for the first time the very strict view of US-based sponsors that are more safely-conscious than any Japanese counterparts concerning asset management of insurance companies. In the end, we agreed with the sponsor's conservative view of emphasizing safety in asset management of insurance companies, and adopted many points of the sponsor's valuation standard to be modified and used as the trustee's assets valuation.

If the LIPPC were to extend financial assistance, it must investigate into the appropriateness of the assets valuation of a failed insurance company that needs to be confirmed through the resolution of Valuation Audit Committee of the LIPPC (Art. 270-2, IIb). In the case of the Kyoei, it had been already announced that no financial assistance was requested, so that no such confirmation was necessary. However, the LIPPC was in a position to review the appropriateness of the trustee's assets valuation to judge whether it should agree to the reorganization plan. The LIPPC's property valuation standards were similar to that of the trustee assuming existing assets are to be utilized as they are. It was only natural that the view of the LIPPC's valuation team was based on the traditional views of Japanese insurance companies since its members were dispatched from member companies of the LIPPC.

After twists and turns, the LIPPC's understanding was obtained in the end. It was decided that, while the portfolio structure needs to be reconstructed into a more sound and secure one through conversion into money, on-hand operating assets should be converted into money on as favorable terms as possible and, if they can be converted at higher value than the trustee's assessment value, a portion of the excess needs to be distributed to insurance policyholders as special dividend.

We thus understood why foreign affiliated companies that offered to be bridge companies under insolvency procedures provided by the Insurance Business Law carried out the bulk sale of operating assets through a bid tender and adopted the sellout value to be an objective assessment value as a means to avoid confrontation with the LIPPC in respect of assets valuation,
7. Signs of Changes Regarding Corporate Reorganization Sponsorship

Soliciting sponsorship for a reorganizing company under a corporate reorganization procedure is a practice unique to Japan and not seen in the United States where the corporate reorganization law originated from. It has long been considered that a reorganizing of a company is not possible unless it is supported by a sponsor. Accordingly, looking for sponsorship for a reorganizing company has been considered the most important task for an interim trustee: one who can locate a potential sponsor is regarded as a competent interim trustee. In Japan, companies tend not to file a petition to commence corporate reorganization procedure until the last minute when they face a dismal condition, and it was critical to locate a credible sponsor to allow such companies to continue their businesses without impairing their values. This practice has worked effectively: a sponsor candidate has been selected during the interim trusteeship stage; a person sent from the sponsor company was appointed as a "business" administrator; a trustee who is an attorney was appointed as a "legal" administrator; and thus commencement of the corporate reorganization procedure was determined. It has been a common understanding among the court, the trustee, and the sponsor at a stage where commencement of the reorganization is determined that the sponsor becomes the new owner of the reorganizing company through allocation of new shares based on the forthcoming reorganization plan and this procedure has been accepted by the creditors and shareholders as a matter of course.

However, there have been changes in this sponsor-led method. One example is a company called "Life", a credit-card and consumer lending non-bank company, that started the corporate reorganization proceedings without determining a sponsor, and selected a sponsor by a bid tender after the reorganization proceedings commenced. The trustee of the Chiyoda Life Insurance tentatively appointed the AIG as its sponsor based on a conventional method, accepted a business administrator sent from the AIG, and continued its business under the AIG sponsorship. However, before drafting a reorganization plan, the trustee canceled the sponsorship of the AIG and decided to select a sponsor through a bidding. The AIG was subsequently reelected as a sponsor, which means the new owner, but the AIG must have ended up feeding more amount of capital than it had anticipated. This must have come out of the blue for the AIG and the trustee must have made a tough choice, but was an inevitable change of direction during a transition since it related to an issue of whether to request a financial support from the LIFPC based on the insurance business law.

The bid tendering method offers a great merit in securing fairness and the objectivity for the valuation of goodwill and other assets of the reorganizing company. The asset valuation, particularly valuation of goodwill based on a going concern value, tends to lack objectivity, so that a fair open-bid method is desirable in securing such objectivity. However, carrying out a competitive bid requires a relatively long time which is a disadvantage. At least one month will be required for due diligence by several sponsor candidates to the reorganizing company in the midst of a confusion before moving on to the bid process, that will likely impair the business value of the reorganizing company before commencement of the reorganization procedure or the selection of the sponsor.

The case of Mycal, one of General Merchandise Store giants, is a good example of how the business value can fall down due to a delay in selecting a sponsor in the absence of a bidding process. In the case of the Taisei Fire and Marine Insurance, a sponsor had been readily appointed at the time of filing a reorganization procedure. This is because a business network of a casualty insurance company comprised mostly of agents operated by independent businesses such as automobile dealers, gas stations, realty brokers, etc., that are not strongly tied to the insurance companies. In the absence of a sponsor, such agents would easily become a target for competitor casualty insurance companies immediately after the reorganizing insurance company files the reorganization procedure. Moreover, it was obvious that the Taisei's business base would deteriorate very quickly in an unstable condition in the absence of a sponsor: this is because a casualty insurance contract is usually for a short term of one year and numerous contracts are being written each day along with purchases or repurchases of new cars. Our tentative conclusion is that, while the bidding method is desirable in securing an objective appraisal of newly invested amount, it may not be appropriate when the value of the business is at stake.

Putting aside the issue of whether the bidding method should be applied, the example of the Chiyoda Life Insurance demonstrated that, even when a trustee concluded a sponsor agreement with a temporal sponsor with the
involvement of a court, the position of a new owner of the reorganizing company was not legally confirmed. Whether to accept a reorganization plan is basically a matter to be decided by the interested parties including secured creditors, unsecured creditors and stockholders, and not by an interim trustee, a trustee or a court. While the trustee is obliged to, hence is supposed to take a lead to, draft and file a reorganization plan (Art. 184, CRL), the right to file the reorganization plan is also granted to secured creditors, unsecured creditors and stockholders (Art. 184 II, CRL). There is no legal assurance that a sponsor can obtain shares after the reorganization.

Moreover, as the debt equity swap becomes more popularly used and the concept that a creditor should capture the upside merits of a reorganized company becomes more pervasive, it would become a common practice that new shares be obtained not by a sponsor who is planned to be a new owner but by a reorganization creditor who becomes the owner after the reorganization. In the United States, the usual method employed to obtain a reorganized company is either through a purchase of a sufficient number of debts of reorganizing companies to be converted to shares by debt equity swap, or buying up shares from a creditor who purchased shares through debt equity swap, or a combination of both. However, there seems no firm method to secure a purchase of a company that is in the process of reorganization prior to the completion of reorganization.

In the case of the Kyoei Life Insurance, a sponsor was determined at the initial stage of the reorganization procedure, and the predetermined sponsor funded the insurance company to become a new owner as planned in the reorganization plan. At the same time, so as not to arouse suspicions that the trustee and the sponsor evaluated the assets of the Kyoei arbitrarily to enable the sponsor to buy the Kyoei at a lower cost, a system was introduced in the reorganization plan that if the Kyoei's assets were sold at a higher price than the assessed amounts, the excess would be allocated to the policyholders proportionally. This was another inevitable compromise for the transitory period.

In the near future, it is expected that creditors, especially the secured creditors and large exposure creditors, would play important roles in reorganization processes, and the methods such as debt equity swap would be more widely used. Under this scenario, a very unique Japanese method of preselecting a sponsor in company reorganizations would not be suitable; or the practice of appointing an interim trustee, who is a private lawyer but an amateur for business operation, to run the business operation would be deemed inappropriate even if such an appointment extends for only several months. Professionals, not necessarily specialists, who can turn distressed companies around would become essential.

8. Future Prospects of the Applicability of the Special Reorganization Law to Banks and Other Financial Institutions

After the removal of the full deposit guarantee in April 2005, the insolvency procedures not only under the Deposit Insurance Law but also those under the Special Reorganization Law are likely to be applied because it is necessary to forcefully modify the rights of creditors against financial institutions. The Special Reorganization Law stipulates special rules for financial institutions with respect to the corporate reorganization proceedings, the civil rehabilitation proceedings, and the bankruptcy proceedings. The Civil Rehabilitation Law provides that the rights of secured creditors with statutory liens cannot be impaired without their consents (Art. 122, Civil Rehabilitation Law). Since bank depositors are unsecured creditors without any statutory lien, their rights could be impaired through the civil rehabilitation proceedings. The corporate reorganization proceedings that are intended for large corporations are more appropriate to handle restructuring cases of financial institutions, but the recent trend of preferring civil rehabilitation proceedings to corporate reorganization proceedings suggests the chance is high that civil rehabilitation proceedings would be chosen. According to the press, the current thinking of the Financial Services Agency and the Deposit Insurance Corporation is to appoint a trustee(s) according to the Deposit Insurance Law to file for the commencement of the civil rehabilitation proceedings and to be engaged in the business after the commencement of proceedings as a debtor(s) in possession.

The government has repeatedly announced that public money will not be injected into failed banks to fill out their capital insufficiency after the removal of the full deposit guarantee is removed. However, towards the end of 2001, the government gradually modified their stance and, from the beginning of 2002, began to announce that it would use public money so as not to let the city banks and major regional banks fail. In reality, the government infused nearly 2 trillion Japanese yen into the Resona Bank to strengthen its
capital and obtained its newly issued equities in March of 2003 under the Subsection 1, Section 1, Article 102 of the Insurance Deposit Law. The government also nationalized the insolvent Ashikaga Bank temporarily by designating it as a special crisis-management bank in November of the same year under the Subsection 3 of the same Section and Article of the same Law.

In addition, the Law Regarding Emergency Measure for Quick Recovery of the Soundness of Financial Functions (the Law No. 143 of 1998), which is the successor of the Law Regarding Emergency Measure to Stabilize Financial Functions (the Law No. 5 of 1998) and the Law for Special Measure to Strengthen Financial Functions (the Law No. 128 of 2004) were enacted to facilitate speedier and earlier infusing of public money. This means the likelihood has become lower, if not zero, that banks may file a petition for the insolvency procedures using the Special Reorganization Law based on the aforementioned laws and policies after the removal of the cap of government protection of deposits in April 2005.

9. Depositors without Statutory Lien

Under the Deposit Insurance Law, the liquidity deposits (in current and saving accounts) are protected in full until the end of March 2005, and the principal and interest of other deposits and bank debentures are protected for the principal amount of 10 million yen per person. After April 2005, repayment of all or a part of the debts, including deposits not protected by the Deposit Insurance Law, are to be stayed with the commencement of the insolvency proceedings, or with the preliminary preservation order issued prior to the commencement of the proceedings. These debts may become subject of impairment in conjunction with other debts according to the reorganization or rehabilitation plans.

For a life insurance company, the largest merit of following the corporate reorganization procedures by the Special Reorganization Law instead of an insolvency proceeding by the Insurance Business Law is that the rights of not only policyholders but also of other creditors (including the secured creditors) can be impaired. In addition, the life insurance policyholders have statutory liens on liability reserves (Art. 127-2, IBL), so that they have general priority over other unsecured creditors. As a result, when the liability reserve is reduced and the guarantee rate of return is cut according to the reorganization plan to reduce the rights of the life insurance policyholders with lien, the rights of the general unsecured creditors will naturally become null and wiped out. There is a substantial merit of relieving burdens of life insurance companies.

However, the rights of casualty insurance policyholders do not come with such general statutory liens (the reversal of the Article 117-2, IBL). Accordingly, the rights of the casualty insurance policyholders will be substantially reduced along with those of other general unsecured creditors, unless differential treatment is justified as being more equitable. The optional insurance for compensation of vehicle accident or fire insurance for individuals and small-scale businesses are protected for the amount up to 90% of the claim, similar to the life insurance, by the Insurance Business Law and the related rules and regulations.

Similarly, for the deposits and bank debentures that are not to be protected, no general statutory liens exist. It is an open question whether the claims such as deposits should be treated on a par with the claims of creditors or their priority right should be approved. The U.S. federal law grants a priority status to depositors. The Japanese financial authorities have decided, after intensive study and discussions, that not to grant a priority right to the claims of depositors, which I think needs to be revisited.

Since life insurance companies operate the business of selling financial products, a failed life insurance company has to get out of the reorganization proceedings as soon as possible and recover its credibility. For casualty insurance companies, deterioration of the value of the business with the passage of time is far more significant than that of life insurance companies, even more significant than banks. Specifier proceedings are required for banks and other financial institutions, especially when rehabilitation is intended. Since we have no experience in this area, thorough preparations and bold decisions need to be required.

10. Application of the Special Reorganization Law for Casualty (Non-Life) Insurance Companies

In the face of the increased likelihood of large reinsurance payment obligations following the terrorist attacks on the World Trade Center on September 11, 2001, the Taihei Fire and Marine Insurance Company filed a petition with the Tokyo District Court to commence a corporate reorganization procedure under the Special Reorganization Law on November 22, 2001.
The decision to commence the procedure was granted on the 30th of the same month and the procedure was closed before the end of 2002.

For casualty insurance companies, a number of difficulties were noted regarding the proceedings of the Special Reorganization Law that were not seen in the life insurance companies. As mentioned previously, the sales networks of casualty insurance companies primarily rely on the facilities of agencies, who are independent businesses such as auto dealerships, gas stations and realty brokers, which do not have strong ties with insurance companies. Hence there is a serious threat of having their sales networks literally extirpated by competitors soon after a motion is filed unless there emerges a strong sponsor for the failed insurance company that applied to the case. Furthermore, because casualty insurance contracts are for the short-term of one year and numerous contracts are being signed daily as new cars are purchased or old cars are replaced, it is obvious that the customer base would be lost consistently in the absence of a sponsor. For this reason, the Taisei Fire and Marine Insurance Company had no choice but to declare the Yasuda Fire Insurance Company and the Nissan Fire Insurance Company (which were merged later) as its sponsors at the time of filing. After the commencement of the reorganization proceedings, the Taisei signed a mutual agency contract with the Yasuda Fire in order to preserve its sales network. With no other option available, the Taisei's customer base was de facto transferred to the sponsor at the outset of the reorganization proceedings, which undoubtedly has given the sponsor too strong a say in the proceedings of asset evaluation and the preparation of reorganization plans in later days. Unfortunately, this has led to a feud with the casualty insurance industry over whether a financial assistance should be granted by the Casualty Insurance Policyholders Protection Corporation. This might have further delayed the progress of reorganization proceedings and could have had a negative impact on the reorganization of the casualty insurance company.

As explained previously, in the case of car accident insurance or individual fire insurance, 90% of the coverage is guaranteed by the Insurance Business Law and other related regulations, while the remaining 10% is not. Because it is not unusual these days to be charged with a substantial amount of monetary liability in a physical damage claim resulting from an auto accident, it is a common practice to purchase optional insurance that provides unlimited coverage. In these cases, if a person has caused an auto accident and is charged with a 100 million-yen liability, he would have to pay the uncovered 10 million yen out of his own pocket. Were this reality known to the general public, a panic situation might arise to threaten the reorganization efforts of the casualty insurance company in the reorganization proceeding. This was one of the primary reasons why in the Taisei case the Yasuda Fire was selected as a sponsor at an early stage. As a condition for becoming a sponsor, the Taisei required the Yasuda Fire and others to guarantee an unconditional payment of the unprotected 10%. This was an inevitable choice the Taisei had to make but, as mentioned earlier, it might have had a negative impact for potential reorganization of casualty insurance companies.

Another significant difference between casualty insurance companies and life insurance companies is that the right of casualty insurance policyholder is neither secured by a statutory lien nor has a priority (reversal of Art. 117-2, IBL), a situation similar to bank deposits. Unless a differential treatment is justified, the casualty insurance policyholders will receive a significant reduction in compensation like other general unsecured creditors. This became a subject of debate at the time of the revision of the Insurance Business Law in 2000. The reason for a differential treatment, which I think is questionable, is that while a life insurance contract is generally longer-term, of savings nature and a security for one's life, a casualty insurance is not, hence needs to be treated differently.

For the above three reasons, the Special Reorganization Law is not well suited for reorganization of a casualty insurance company.

It is reported that the Financial Advisory Council for the Prime Minister to reform the Insurance Business Law is going to present a report which includes a recommendation to reform the Insurance Business Law enabling the aforementioned guarantee to cover up to 100%, instead of limited to 90%, during the three months after the initiation of an insolvency proceeding for a casualty insurance company (Mainichi Shinbun, 30 November 2004, Page 13).

(Reorganized by Takeda K.)

(The original article was written in 2002 in Japanese and translated in English in 2004 at the request of foreign colleagues with revisions to make it up to date. In this article, a "casualty" insurance means an non-life insurance which is not covered by a life insurance.)