

ADR for financial sector retail to start soon, but it is still flawed

Financial sector retail "trouble": a long-standing problem for banks and insurers

Inadequate protection and redress for financial sector retail consumers is, in the eyes of Japan's Financial Services Agency ("FSA"), a barrier to the development of Japan's capital markets and domestic trust in those capital markets. Retail investors or customers of banks and insurers, in particular, suffer in Japan from the lack of an independent institution outside the court system, such as that provided by the ombudsman systems in the UK and Australia, to investigate and rule on their complaints (or "trouble", to follow local usage). For example, in Japan in FY 2007, financial services provided were queried 164,400 times whilst some 31,518 complaints and 387 disputes were recorded as active¹. The majority of these problems were in general insurance and banking.

The progress made in solving this failing has been painfully slow and, even with recently enacted legislative changes with respect to financial sector ADR (alternative dispute resolution, see below), still appears to be flawed: the battle for a credible, independent and comprehensive system for dealing with consumer complaints in the retail financial sector is not finished. It is to be hoped that the DPJ will decide to make further legislative changes.

Reform started in June 2000 when the Financial System Council published a report that highlighted the need to improve ADR in the retail financial sector. On 7 September 2000, the Financial Service Dispute Resolution Liaison Group², held its first meeting. Its most recent, and 40th, session took place on 19 June 2009 - evidence of a slow rate of progress which some might take as evidence of foot-dragging on the part of the participating financial trade associations. If it is necessary to declare a winner at this stage of the contest, then the financial trade associations appear to have won over consumer groups: they now have the right to establish ADR systems based on their own trade associations.

Existing ADR legislation recently applied to financial sector

In an effort to broaden the range of solutions to all types of civil disputes, "The Law Concerning the Promotion of the Use of Alternative Dispute Resolution Procedures" (the "ADR Promotion Law") was promulgated on 1 December 2004 and came into effect on 1 April 2007. This law allows the Minister of Justice to give accreditation to private-sector organisations that help resolve civil disputes outside the Japanese public court system.

On 24 June 2008, in a characteristically slow response to this legislation, the Financial Service Dispute Resolution Liaison Group issued a Chairman's Memorandum entitled "Issues Facing Improvement of Alternative Dispute Resolution in the Financial Sector", which suggested that Self Regulatory Organisations (SROs) or trade associations in the financial sector should be accredited in line with the ADR Promotion Law. The most significant element of this report was its endorsement of a fragmented dispute resolution structure with indirect oversight by the FSA, rather than an industry-wide or "umbrella" organisation under closer control of the FSA (or some other related ministry, such as for consumer

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¹ Number of cases of consultation, complaint and dispute resolution support by financial industry and self-regulatory organisations during FY 2007, Financial Service Dispute Resolution Liaison Group, appendix to 37th meeting report.

² A consultative committee composed of consumer and industry associations, the FSA, academics, lawyers and the Foreign Non-Life Insurance Association of Japan as an observer.

affairs). However, the Foreign Non-Life Insurance Association of Japan, an observer at the proceedings of the Financial Service Dispute Resolution Liaison Group, criticised³ the fragmented structure in a dissenting report, noting that:

[the government should] *"set-up a financial ADR organization with relevant cross-industry financial sector expertise, to be accredited by the FSA. A financial ADR should be neutral and independent from financial trade associations..."* and,

"This proposal [that ADR authority be delegated to existing industry organisations] is inadequate because the power of the regulator would be usurped by delegating ADR authority to the private sector through individual trade associations."

These opinions have been overlooked and the FSA has moved ahead with legislation that matches the consensus reached by the deliberations of the Financial Service Dispute Resolution Liaison Group. On 24 June 2009, a Law on the Partial Revision of the Financial Instruments and Exchange Law for 2009 (Law No 58) was promulgated, which applies the accreditation system set up by the ADR Promotion Law to all 16 relevant financial sub-sectors by revision of laws such as the Insurance Business Law⁴. If the relevant trade associations intend to establish accredited ADR institutions, as is generally expected to be the case, they will be required to do so within 12 months of promulgation (i.e. 23 June 2010). Individual firms should contract with that institution for the provision of ADR services within 18 months (i.e. 23 December 2010). Relevant associated orders require that more than two-thirds of industry association participants approve the formation of an ADR institution for their industry. However, it seems very unlikely that such ADR institutions will not be approved by the members of their relevant association.

Accreditation for ADR institutions

In the mind of the FSA, the responsibility of the accredited ADR institution is to investigate and resolve complaints fairly and quickly. Accreditation is based on qualitative requirements that relate to the honesty, competence and fairness (and so on) of the institution and the lawyers and specialists who are expected to staff it.

Once the requisite approval from trade association members has been obtained, all trade association members are obliged to sign a contract for the provision of ADR services with the ADR institution. These services aim primarily at a negotiated solution between the parties, which is brokered by the staff of the ADR institution (primarily lawyers, where negotiations are involved). It is significant that the possibility of the ADR institution issuing its own enforceable ruling is not addressed. A dissatisfied complainant could choose to initiate or continue with legal proceedings; but a clear ruling by an ADR institution, as opposed to a suggested solution, would have underlined the independence of the ADR process, even if such rulings could subsequently be litigated by either party.

The firms are bound to facilitate the workings of the ADR institution, by, for example, supplying documents relating to the cases in dispute. Where the ADR institution has evidence that the relevant firm is not fulfilling its obligations under the contract it is obliged to make a public announcement to that effect (the frequency of such announcements will be revealing). The workings and performance of the ADR institutions are to be reviewed by the FSA.

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³ "Consumer Protection and Alternative Dispute Resolution in the Financial Sector", Foreign Non-Life Insurance Association of Japan, 18 June 2008

⁴ The financial institutions listed as obliged to participate in the ADR schemes are (i) Type 1 and Type 2 Financial Instruments Businesses; (ii) Investment Advisory and Agency Business or Investment Management Business; (iii) Registered Financial Institutions; and (iv) Securities Finance Companies.

Because industry associations have only until 23 June 2010 to obtain accreditation, the major trade associations, whose member firms generate significant numbers of disputes, have indicated that they will seek accreditation of their ADR services as soon as they are able to do so. Specifically, the ADR institutions of the Japan Securities Dealers Association, The Life Insurance Association of Japan, The General Insurance Association of Japan, and the Japanese Bankers Association and the Trust Companies Association of Japan have recently announced their intention to obtain accreditation.

Unusual features mean the system is still flawed

The proposed solution to retail "trouble" may solve the FSA's requirement that the new system of ADR management should be simple, speedy and cheap and it may be an improvement on current unsatisfactory arrangements. However, the fact that the ADR institutions will be funded by the same trade associations whose members they are to oversee represents a clear conflict of interest. In addition, the resulting patchwork of ADR standards and enforcement, which will inevitably vary by ADR institution, will be likely to undermine public credibility in the new financial ADR system. The interests of financial trade associations have, apparently, been favoured by the FSA over those of consumers at this stage. The comments of the Foreign Non-Life Insurance Association of Japan (see above) remain valid and unanswered. Other systems in other jurisdictions, such as Australia and the UK, struggle to balance the issues of fairness, cost and speed, but the independence, authority and consistency of the relevant ADR system is much less in doubt.

The optimistic view of the compromise that has been struck is that the FSA knows that the solution proposed is flawed, but that it serves as a way to lead a reluctant set of trade associations into accepting the need for an industry-wide regulator in due course. An alternative view might be that this fragmented system leaves the thorny issue of consumer disputes stuck with the industry associations rather than directly in the FSA's hands. Although the FSA continues to profess its strong desire to confirm during its inspections that senior managers of financial institutions are knowledgeable about and responsive to consumer complaints, it is not clear if it has the resources to assume an active role in financial sector ADR.

But the DPJ may build a system more friendly to consumers

The recent Law on the Partial Revision of the Financial Instruments and Exchange Law for 2009 (Law No 58), allows for the issue of ADR to be revisited within 3 years of promulgation (i.e. before 23 June 2012) based on the performance of the new scheme. Certainly, the DPJ has stated in "Index 2009"⁵, its detailed manifesto, that it intends to introduce comprehensive investor protection across all financial products, about which, Index 2009 states, "complaints are unceasing". The newly established Consumer Affairs Agency, however, does not yet extend to financial products. However, once the separate trade association-based ADR institutions exist, they could eventually be pulled together under an ombudsman system or placed under more direct FSA control.

Financial institutions need to satisfy the FSA and lobby for a more credible system

In the meantime, relevant financial institutions which are members of trade associations (or SROs) and have retail customers must respond quickly to Law No 58 and make sure they have an ADR institution to which they can adhere and with which they can sign a contract⁶. This action is now clearly a high priority, but financial institutions should consider lobbying for a system that guarantees more independence and, generates, ultimately, more trust and respect from Japan's retail financial consumers.

The content of this article does not constitute legal advice and should not be relied on as such. Specific advice should be sought about your specific circumstances.

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⁵ 民主党政策集"Index 2009" particularly section 財務。金融、page 18

⁶ Law No 58 does allow for the unlikely situation where a relevant financial institution cannot find an ADR institution with which to form a contract. Such institutions are expected to create their own credible ADR procedures.