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**Information Duties**

Japanese and German Private Law

Edited by

Marc Dernauer / Harald Baum / Moritz Bälz

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# Information Duties under Japanese Capital Markets Law

*Toshiaki Yamanaka*\*/*Gen Goto* \*\*

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## I. INTRODUCTION

This chapter provides an overview of information duties under Japanese capital market law.<sup>1</sup> Relevant rules regarding information duties on financial instruments are incorporated into the Financial Instruments and Exchange Act (*Kin'yū shōhin torihiki-hō*, hereinafter, “FIEA”),<sup>2</sup> the Act on Sales, etc. of Financial Instruments (*Kin'yū shōhin no hanbai-tō ni kansuru hōritsu*, hereinafter, “ASFI”)<sup>3</sup> and general tort law provisions of the Civil Code (*minpō*).<sup>4</sup>

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1 For an informal English translation of Japanese acts and related legal rules referenced in this chapter, see the website of Japan's Ministry of Justice (<http://www.japaneselawtranslation.go.jp/>). For a more detailed comparative analysis with Germany, see H. BAUM/T. YAMANAKA, *The Information Model as a Means of Investor Protection: A Comparative Analysis of Secondary Markets Regulation in Germany and Japan* (forthcoming, draft on file with the authors). For an overview of the capital market regulation in Japan, see H. BAUM/H. KANDA, *Financial Markets Regulation in Japan*, *Journal of Japanese Law* 44 (2017) 65.

2 Act No. 65/2006 amended Act No. 25/1948.

3 Act No. 101/2000.

4 Act No. 89/1896. See *infra* note 11.

The basis of Japanese capital market law is laid out by the FIEA, the purpose of which is to ensure fairness in the issuance of securities and transactions of financial instruments and to facilitate a smooth distribution of securities. It also seeks to achieve fair price formation for “Financial Instruments”<sup>5</sup> through the full implementation of capital market functions, thus contributing to the sound development of national economy and the protection of investors.<sup>6</sup> To achieve this aim, the FIEA sets rules regarding disclosure of corporate affairs and regulates “Financial Instruments Businesses”<sup>7</sup> and “Financial Instruments Exchanges”.<sup>8</sup>

The ASFI also plays an important role in protecting customers of “Financial Instrument Providers” (*kin'yū shōhin hanbai gyōsha*)<sup>9</sup> by modifying general tort law and providing strict liability for Financial Instrument Providers and the presumption of causation and damages for “Sales of Financial Instruments”.<sup>10</sup>

In addition, investors or customers are able to collect damages from the financial institutions from which they bought financial products pursuant to the general tort law,<sup>11</sup> regardless of whether information duties are imposed on financial institutions under the FIEA or the ASFI.

The remainder of this chapter will first provide a brief overview of the FIEA regarding disclosure requirements and the regulation of Financial Instruments Businesses, with an analysis of recent regulatory discussions on how Financial Instruments Businesses should operate (Part II), and then describe civil liability for violations of information duties under Japanese law (Part III).

## II. FIEA REGULATIONS ON INFORMATION DUTIES

### 1. *Disclosure Requirements*

The FIEA provides disclosure rules for both the primary and the secondary markets. For disclosures in the primary market, the FIEA mandates the issuers of securities to file a notification of public offerings and secondary

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5 “Financial Instruments” include securities, securities or certificates indicating claims based on a deposit contract, currencies and commodities (Article 2 para. 24 FIEA).

6 Article 1 FIEA.

7 For the definition of “Financial Instruments Business”, see Article 2 para. 8 FIEA.

8 For the definition of “Financial Instruments Exchange”, see Article 2 para. 16 FIEA.

9 The term “Financial Instrument Providers” is defined as a person carrying out sales, etc. of financial instruments as a conduct of its business (Article 2 para. 3 ASFI).

10 For the definition of “Sales of Financial Instruments”, see Article 2 para. 1 ASFI.

11 Article 709 Civil Code.

distributions of securities with the Commissioner of the Financial Services Agency by submitting a registration statement.<sup>12</sup> The issuer is also obliged to prepare a prospectus for any public offering and secondary distribution.<sup>13</sup> For disclosures in the secondary market, an issuer is obliged to submit annual reports<sup>14</sup> and quarterly<sup>15</sup> or semiannual reports.<sup>16</sup> The requirements for the registration statement, prospectus and periodic reports are further specified in the Cabinet Office Ordinance on Disclosure of Corporate Affairs (*Kigyō naiyō-tō no kaiji ni kansuru naikaku-fu-rei*).<sup>17</sup>

In some cases, issuers are exempted from the above disclosure obligations. One example is when only “Qualified Institutional Investors” (*tekikaku kikan tōshika*)<sup>18</sup> are solicited to acquire securities, and the likelihood of these securities being transferred to any person other than Qualified Institutional Investors is small.<sup>19</sup> Another exemption arises when the number of persons other than Qualified Institutional Investors being solicited to acquire securities is less than fifty.<sup>20</sup> There is also a deregulated market called “TOKYO PRO Market”,<sup>21</sup> which limits participation to professional investors called “Specified Investors” (*tokutei tōshika*).<sup>22</sup>

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12 Articles 4 and 5 FIEA.

13 Article 13 FIEA. See also Article 15 FIEA (duty to deliver prospectus to purchaser of securities).

14 Article 24 FIEA.

15 Article 24-4-7 FIEA.

16 Article 24-5 FIEA. Ad hoc disclosure is also required under Rule 402 of the Securities Listing Regulations (*Yūka shōken jōjō kitei*) by Tokyo Stock Exchange (hereinafter, “TSE”) for the listed companies on the TSE. See website of Japan Exchange Group at <http://www.jpx.co.jp/english/rules-participants/rules/regulations/index.html>.

17 Ordinance of the Ministry of Finance No. 5/1973.

18 For the definition of “Qualified Institutional Investors”, see of Article 2 para. 3 item 1 FIEA and Article 10 of the Cabinet Office Order on Definitions under Article 2 Financial Instruments and Exchange Act (*Kin'yū shōhin torihiki-hō dai-ni-jō ni kitei suru teigi ni kansuru naikaku-fu-rei*, Order of the Ministry of Finance No. 14/1993).

19 Article 2 para. 3 item 2(a) FIEA.

20 Article 2 para. 3 item 1 FIEA, Articles 1-4 and 1-5 of the Order for Enforcement of the Financial Instruments and Exchange Act (*Kin'yū shōhin torihiki-hō sekō-rei*), Cabinet Order No. 321/1965, Article 10-2 para. 1 of the Cabinet Office Order on Definitions under Article 2 of the Financial Instruments and Exchange Act.

21 See Articles 27-31, 27-32 and 117-2 FIEA.

22 See Article 45 FIEA. For the definition of “Specified Investors”, see Article 2 para. 31 FIEA. They include Financial Instruments Business Operators and listed companies. Regulations exempted include Article 37-3, Article 38 items 4 through 6 and Article 40 item 1 FIEA, which are referenced below.

## 2. Regulation of Financial Instruments Business Operators' Activities

In addition to disclosure requirements, the FIEA regulates activities by “Financial Instruments Business Operators” (*kin'yū shōhin torihiki gyōsha*).<sup>23</sup>

To begin with, Financial Instruments Business Operators and their directors and employees must act in good faith and be fair to their customers in the course of their operations.<sup>24</sup> When Financial Instruments Business Operators receive orders from a customer for a purchase or sale of securities, they must notify the customer clearly in advance whether they will conclude the purchase or sale with the customer as the counterparty, or whether they will act as a mediator, a broker or an agent for the transaction.<sup>25</sup> Financial Instruments Business Operators must establish and disclose their policy on how they will execute orders from customers to achieve the best terms and conditions.<sup>26</sup>

With regard to information duties, Financial Instruments Business Operators seeking to conclude “Financial Instruments Transaction Contracts” (*kin'yū shōhin torihiki keiyaku*)<sup>27</sup> are required to deliver documents describing the summary of the contract, applicable fees, the nature and the extent of risks that will be borne by the customer and other relevant information to their customers in advance.<sup>28</sup> Financial Instruments Business Operators and their directors and employees are prohibited from concluding a Financial Instruments Transaction Contract, without explaining the above information to customers other than Specified Investors in a manner and to the extent necessary for the customer to understand, considering the customer's knowledge, experience, the status of the customer's properties and the purpose of concluding the contract.<sup>29</sup>

Financial Instruments Business Operators, their directors and employees are also prohibited from engaging in certain practices, such as: providing a

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23 Chapter 3 of the FIEA. “Financial Instruments Business Operators” are clarified as persons who carry out as a conduct of its business, including among others, sale and offer of securities, providing management and advisory on assets and providing administration and maintenance of assets (Article 2 paras. 8 and 9 and Article 29 FIEA).

24 Article 36 para. 1 FIEA.

25 Article 37-2 FIEA.

26 Article 40-2 para. 1 FIEA.

27 For the definition of “Financial Instruments Transaction Contract”, see Article 34 FIEA.

28 Article 37-3 para. 1 FIEA. Details of the required information are stipulated at Articles 79 through 96 of the Cabinet Office Order on Financial Instruments Business, etc (*Kin'yū shōhin torihiki-gyō-tō ni kansuru naikaku-fu-rei*), Cabinet Office Order No. 52/2007.

29 Article 38 item 9 FIEA, Article 117 para. 1 item 1 of the Cabinet Office Order on Financial Instruments Business, etc.

customer with false information in connection with the conclusion of a Financial Instruments Transaction Contract or in connection with the solicitation thereof;<sup>30</sup> providing a customer with a conclusive assessment of a matter that is uncertain or with information that could mislead the customer into believing that a matter that is uncertain is actually certain, thereby soliciting the customer to conclude a Financial Instruments Transaction Contract;<sup>31</sup> unsolicited contacting of a customer inducing the conclusion of a Financial Instruments Transaction Contract;<sup>32</sup> soliciting a customer to conclude a Financial Instruments Transaction Contract without obtaining confirmation from the customer, prior to solicitation, regarding whether or not the customer is willing to be solicited;<sup>33</sup> and continuing to solicit a customer to conclude a Financial Instruments Transaction Contract despite the customer having indicated an unwillingness to conclude such a contract (including an intention that indicates unwillingness to continue to be solicited) after being solicited.<sup>34</sup>

The FIEA also provides that Financial Instruments Business Operators shall conduct their business in such a manner that any solicitation for a “Financial Instruments Transaction Activity” (*kin’yū shōhin torihiki-kōi*)<sup>35</sup> would not be inappropriate in light of a customer’s knowledge, experience, assets and the purpose for which a Financial Instruments Transaction Contract is concluded.<sup>36</sup> This requirement is known as the suitability rule.

### 3. *Soft-law Principles on Recent Regulatory Discussions*

In addition to the above regulations, the Financial Services Agency published a document titled “The Principles for Customer-Oriented Business Conduct” on 30 March 2017.<sup>37</sup>

The background for this initiative was a view that some financial service providers only formalistically follow the regulations under the FIEA and do not respect the interests of their customers. For example, some banks were said to have promoted particular mutual funds to their customers based on the amount of commission they receive, not on the suitability of that mutual

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30 Article 38 item 1 FIEA.

31 Article 38 item 2 FIEA.

32 Article 38 item 4 FIEA.

33 Article 38 item 5 FIEA.

34 Article 38 item 6 FIEA.

35 For the definition of “Financial Instruments Transaction Activity”, see Article 34 and Article 2 para. 8 FIEA.

36 Article 40 item 1 FIEA.

37 Financial Services Agency, The Principles for Customer-Oriented Business Conduct [*Kokyaku hon’i no gyōmu un’ei ni kansuru gensoku*] (30 March 2017) (available at <http://www.fsa.go.jp/news/28/20170330-1/02.pdf>, in Japanese).

fund to the customer. On other occasions, some banks recommended products of asset management companies belonging to the same financial group over those of asset management companies outside of the group.

To correct this, the Principles request financial service providers, for example, to disclose, in understandable manner, information regarding the reason for recommending particular financial products and sources of conflict of interests, such as commissions they receive from third parties. It must be noted, however, that this requirement is not a mandatory regulation but a soft-law recommendation and that the decision to accept these principles is left to individual financial service providers.

### III. CIVIL LIABILITY FOR BREACH OF INFORMATION DUTIES

#### *1. Civil Liability for Breach of Information Duties under the FIEA*

Civil liability plays an important role in ensuring that information duties are fulfilled and correct information is provided to customers. The FIEA however, does not stipulate civil liability of Financial Instruments Business Operators for violation of regulations described in Section 2 of Part II.<sup>38</sup>

While it is generally accepted in Japanese law that violation of administrative regulations does not necessarily give rise to civil liability of the offender, the Supreme Court has held that a Financial Instruments Business Operator is liable to its customer under general tort law when its employee clearly deviated from the suitability rule, for example by aggressively soliciting the customer to make a clearly excessively risky investment against the will and the circumstances of that customer.<sup>39</sup>

When Financial Instruments Business Operators fail to follow other information duties under the FIEA, it is also likely that such failure is considered as a breach of the duty of one contracting party to provide explanation to the other party, which is recognized as one form of the principle of good faith,<sup>40</sup> and that the Financial Instruments Business Operator will be held liable under tort law.<sup>41</sup>

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38 For civil liability for violation of disclosure rules described in Section 1 of Part II, see G. GOTO, *Growing Securities Litigation Against Issuers in Japan: Its Background and Reality*, in: Huang/Howson (eds.), *Enforcement of Corporate and Securities Law: China and the World* (Cambridge 2017) 416.

39 Supreme Court Case of 14 July 2005, Minshū 59-6-1323.

40 Article 1 para. 2 Civil Code.

41 See Supreme Court Case of 22 April 2011, Minshū 65-3-1405 (holding that one contracting party who violated the duty to explain under the principle of good faith by failing to provide information, which would have influenced the decision of the other contracting party whether or not to conclude the contract, before the conclu-

## 2. *Civil Liability under the ASFI*

In a lawsuit claiming compensation for damages based on general tort law under the Civil Code, the plaintiff is required to establish the amount of the damage caused, and that the defendant caused such damage intentionally or by negligence.<sup>42</sup> The ASFI seeks to ease this burden of customers of Financial Instrument Providers by specifying matters that must be explained by Financial Instrument Providers at or before the time that the Sales of Financial Instruments was carried out,<sup>43</sup> imposing a special liability on Financial Instrument Providers when they failed to provide the required explanation, regardless of whether that failure was intentional or negligent,<sup>44</sup> and assuming the amount of loss of principal suffered by customers as the amount of damage caused by such failure, thereby shifting the burden of proof to Financial Instrument Providers.<sup>45</sup>

## 3. *Recent Cases*

Traditionally, most lawsuits claiming compensation for loss caused by a failure to provide an explanation of financial instruments were filed by retail investors.

While similar lawsuits have also recently been filed by non-retail investors, the Supreme Court seems to be reluctant to grant relief in such cases. For example, in a case where an unlisted company brought an action against a major bank insisting a breach of information duties regarding a plain-vanilla interest rate swap transactions, the Supreme Court denied the breach by the defendant bank because the fundamental structure is so simple that it is generally understandable without difficulty, at least for a director of a company.<sup>46</sup> In another case, a large listed company in consumer loan business sued Merrill Lynch International and its Japanese subsidiary for a huge amount of loss arising from the purchase of structured bonds,

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sion of the contract to the other party could be liable under tort law, but not under contract law for non-performance of a contractual obligation).

42 See *supra* note 11.

43 Article 3 para. 1 ASFI. The matters required to be explained include, for example, a risk, if any, of incurring a loss of principal or suffering a loss that exceeds the amount of principal, the sources of such risk, such as the fluctuation of interest rates, currency exchange rates or market value of financial instruments, and the important portions of the structure of transactions pertaining to the sales which generate such risk. Article 3 para. 1 items 1 and 2 ASFI.

44 Article 5 ASFI.

45 Article 6 ASFI.

46 Supreme Court cases of 7 March 2013, Shūmin 243-51 and 26 March 2013, Shūmin 243-159.

which was arranged and sold by the defendants to enable the plaintiff to offset its own bond, when the value of the structured bonds plummeted after the bankruptcy of Lehman Brothers in 2008. While the Tōkyō High Court held the defendants partially liable for failure to provide sufficient explanation,<sup>47</sup> the Supreme Court reversed and overruled the decision based on a view that the plaintiff, itself a listing company engaging in the finance industry, must have been able to understand the explanation given by the defendants, even if the employee of the plaintiff in charge of the purchase did not have detailed knowledge of financial transactions.<sup>48</sup>

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47 Tōkyō High Court Case of 27 August 2014, 2239 Hanrei Jihō 118.

48 Supreme Court case of 15 March 2016, Shūmin 252-55. See TOSHIAKI YAMANAKA, *Han'hi* [Case Note], 1509 Jurisuto 107 (2017).