A fresh alternative?

Naoki Iguchi from Anderson Mori & Tomotsune analyses the development of financial ADR practises in Japan

Even in Japan, which is well-known as the most non-litigious society in the world, disputes related to financial instruments increased after the Lehman Shock in 2008. As a result, legislators amended the existing Financial Instruments and Exchange Act (Act No. 109 of 2006; as amended; the FIEA, or *kinyu shohin torihiki ho*) to add a new set of provisions which require financial instruments business operators to set up an alternative dispute resolution mechanism to handle customers' claims and to resolve financial disputes.

As the new provisions came into force in October 2010, it has been almost a year since many of those dispute resolution organisations commenced resolving claims and financial disputes.

Although this FIEA amendment has been reported on several times since having taken effect, it should be considered from a wider perspective, because this amended FIEA dispute resolution system coexists with traditional ADR procedures, and financial instrument business operators should know the pros and cons of each.

Alternative dispute resolution services

Court-assisted mediation services

Historically, in Japan, alternative dispute resolution (ADR) services were provided by national courts, and their services have been recognised as a great success. The most popular court-administered ADR in Japan is mediation of family matters, which is provided by the Family Courts (*katei saiban sho* – 50 courts nationwide plus several branch courts in every prefecture). However, financial instruments disputes may not go to Family Courts.

The second most popular system is Civil Mediation services provided by Summary Courts (*kan I saiban sho* – 50 courts nationwide plus several branch courts in every prefecture). This court-assisted mediation is conducted under the Civil Mediation Act (Act No. 222 of 1951, as amended – *minji chotei ho*).

It is not necessary for parties to have a mediation agreement before a case is referred to mediation. Furthermore, there is no restriction as to nature of the case or the amount in controversy. Even a commercial dispute may be referred for a Summary Court's mediation.

More specifically, cases are referred to a panel of three mediators, which usually consists of a judge, a lawyer, and a non-lawyer who are nominated by the court. It should be noted that judges rarely come to the hearings and the lawyer-mediator leads the discussion with the parties.

Most of the lawyer-mediators are experienced senior private-practitioners, and the majority of them are general practitioners (though they might not have experience with complicated trans-

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actions or complicated financial instruments disputes). The parties are not allowed to appoint a mediator nor allowed to designate a particular mediation committee.

Accordingly, many commercial lawyers hesitate to go to Summary Court for business-to-business disputes. Nevertheless, since court-assisted mediation is so popular with the general public, some litigants are inclined to go to Summary Court instead of other alternative dispute resolution services.

In addition to Summary Court mediation, the Tokyo District Court (*Tokyo chiho saiban sho*) handles mediation if either party refers a dispute to its mediation. The most typical cases which District Court's mediation division handles are construction disputes. Accordingly, while the court has a list of experts in the area of construction, it might not have a list of experts in financial instrument disputes.

The most advantageous point of court-assisted mediation is, in addition to its reliability, the ability to enforce a mediation committee's decision. The mediation committee may make a decision if it finds it difficult for the parties to reach an amicable settlement. Such a decision shall become final and binding on the parties unless either party objects to the decision within two weeks (Article 17 and 18 of the Civil Mediation Act).

Once such a decision becomes final and binding, it can be executed under the procedure of the Civil Enforcement Act (Act No. 4 of 1979, as amended – *minji shikko ho*). However, in reality, most mediation committees hesitate to make such a decision if the parties' positions are far from each other. Accordingly, it is not always advisable to use Summary Court's Civil Mediation for complicated financial instruments disputes.

"Finmac is now applying to be qualified as a Designated Type I Financial ADR"

Private mediation organisations

Apart from court-assisted mediations conducted under the Family Matter Mediation Act and Civil Mediation Act, there are no statutes applicable to mediation procedures.

Accordingly, several dispute resolution organisations have formed their own mediation rules. Such organisations include the Japan Commercial Arbitration Association, bar association mediation centres (there are 52 local bar associations, half of which have mediation centres), judicial scriveners (*shiho shoshi*) associations, registered real-estate surveyors associations, and the like.

The Japan Commercial Arbitration Association's rules are intended to handle international and large-scale commercial disputes, and some bar association mediation centers also desire to handle such international and commercial cases. The remainder consists of dispute resolution organisations for small claims and family matters.

Their mediation or conciliation services can be commenced upon the request of either party; in other words, a mediation agreement or conciliation agreement may not be necessary.

About the author

Naoki Iguchi is a partner at Anderson Mori & Tomotsune. He has represented various multinational corporations in international arbitrations. He is fluent in English, Spanish and Mandarin Chinese.

Iguchi serves as arbitrator in international arbitration. He is also an expert of international private law, arbitration and investment law, teaching at the law schools of Saint Paul's, Waseda and Keio Universities. He is an active member of the ICC Japan, the Japan Association of Arbitrations (former Deputy Secretary General), Co-chair of Investment Law Division (Japan), Asia International Law Association, and Japanese government's investment treaty workforce.

Iguchi is a graduate of Tokyo University (LLB; LLM.), Stanford Law School (LLM), and the legal training provided by the Supreme Court of Japan. He also associated with Taiwanese and the US firms. He is admitted to the Japanese bar and he passed the New York bar.

Contact information

Naoki Iguchi
Anderson Mori & Tomotsune

Izumi Garden Tower
6-1, Roppongi 1-chome
Minato-ku, Tokyo 106-6036
Japan

Tel: +81-3-6888-1000
Web: www.amt-law.com

One disadvantage of private mediation organisations concerns the enforceability of their decisions. Since there are not statutes providing for the enforceability of their decisions, amicable settlements, mediators' decisions, and recommendations/proposals may not be legally executable.

However, such decisions can be transformed into an arbitral award by amicable settlement (Article 38 of the Arbitration Act – *chusai ho*) and registration of the amicable settlement with a Summary Court (Article 275 of the Code of Civil Procedure – *minji sosho ho).*

The primary advantage of private mediation organisation is that parties may choose mediators who are most suitable for the case. The mediation rules for private mediation organisations allow the parties to nominate or appoint one or more mediators. Unless the parties agree otherwise, each party is entitled to nominate or appoint at least one mediator to form a three-mediator panel.

Accordingly, in some business-to-business disputes, or even in business-to-consumer disputes, the parties and their lawyers often try to agree to appoint one or more experienced mediators. It is reported that large-scale business-to-business financial instruments disputes were settled by mediation under the regular rules of bar association mediation centers.

As of January 2011, none of those existing private dispute resolution organisations have any special rules for financial instruments disputes.

Promotion of ADR by a new statute

In 2004, the Act on Promotion of Use of Alternative Dispute Resolution (Act No. 51 of 2004, as amended; the ADR Act, or *saiban gai funsou kaiketsu tetsuzuki no riyo no sokushin ni kansuru horitsu*) was enacted. The ADR Act introduced a type of organisation called a Certified Dispute Resolution Organisation (Certified ADR, or *ninsho funsou kaiketsu jigyo sha*).

This new certification shall be given by the Minister of Justice (*Homu daijin*), and the Ministry shall examine an application for certification by examining the compliance status of such organisation. Although compliance standards provided by the ADR Act are simple, the ADR Act contains disclosure policies, prevention of connection with antisocial forces (for example organised crime), obligations to provide explanations to users, etc.

Alternative dispute resolution authorities

As of 25 January 2011	Certified ADR	Designated F ADR
Finmac	Yes	No (Expected from early 2011)
LIAJ	No	Yes
JBA	No	Yes
TCAJ	No	Yes
GIAJ	No	Yes
SASTIAJ	No	Yes

Although an alternative dispute resolution organisation may conduct, upon the request of a party, mediation and/or conciliation by its appointed mediator/conciliator without obtaining a certification, a Certified ADR organisation may enjoy certain advantages, including tolling of the statute of limitation and suspension of existing court procedures (at the court's discretion).

The ADR Act is applicable to all types of dispute resolution organisations. As of January 2011, approximately 90 organisations, which vary from bar association mediation centres, judicial scriveners mediation centres, consumer associations, to claim handling organisations of several industries (electronic appliances, automobiles). Even the Finmac (Financial Instruments Mediation Assistance Centre) obtained this certification.

Regulatory perspective

Before the FIEA was enacted, the operation of a financial instruments business was separately regulated by the Securities and Exchange Act, the Foreign Securities Business Act, the Investment Advisory Business Act, and the like. Those acts all prohibited financial instruments business operators from compensating customers from losses (*sonshitsu hoten*) not having a legitimate basis.

Legitimate grounds consisted of judgments and amicable settlements, but those amicable settlements were limited to those essentially obtained through regular and summary court procedures and civil mediation procedures. Furthermore, there were some discrepancies among the acts, which caused troublesome situations.

Remedying such situations, the FIEA and its amendments expanded the scope of legitimate grounds, including outcomes of private mediation procedures.

New provisions of the FIEA

Regulatory obligations of Financial Instruments Business Operators

Article 37-7 of the amended FIEA stipulates that financial instruments business operators shall (i) enter into a dispute processing agreement with a Designated Dispute Resolution Organisation (Designated Financial ADR – *shitei dai I/II shu funsou kaiketsu kikan*); or, (ii) in case there is no such Designated Dispute Resolution Organisation in the operator's business area, shall ensure that its employees handling claims are advised or instructed by lawyers (having more than five years practice experiences), persons well-experienced in financial instruments business operations with more than 10 years of experience, and the like (designated by relevant Cabinet Order).

For securities businesses, financial dispute resolution services are also classified as Type I or Type II, in accordance of the classification of Type I and Type II financial instruments business operators. Furthermore, new Chapter 5-5 stipulates procedures for designation as qualified dispute resolution organisations, their operational principles, disclosure policies, prevention of connection with antisocial forces (for example organised crime), procedural principles of dispute resolution services, and the like.

The Designated Financial ADRs are new categories introduced by the amended FIEA. The amended FIEA provides supplementary guidelines for establishing and operating the

Designated Financial ADRs for financial instruments disputes; such organisations must meet standards of the FIEA rules, and thereafter they can be qualified as designated by the Financial Agency Commissioner (*Kinyu cho chokan*). Those frameworks and the new dispute resolution institutions are expected to emulate the Finance Ombudsman Service (FOS) under the supervision of the Financial Services Authority in UK.

As for financial instruments business operators, if they fail to arrange such requested dispute processing agreement, then they may be penalised by the Financial Agency Commissioner. Designated Financial ADRs are also regulated by the Financial Agency Commissioner; if they fail to observe principles of the amended FIEA, then they shall be disqualified.

Designated Financial ADRs shall provide consultation services, claim handling services and mediation support services for disputes arising out of or in connection with the financial instruments provided by member financial instruments business operators.

Apart from the above Designated Financial ADRs, the FIEA (and the Securities and Exchange Act, its predecessor) had adopted a category of Certified Investor Protection Organisation (*nintei toushisha hogo dantai*). Certified Investor Protection is an entity (i) to resolve complaints filed with regard to Financial Instruments Business conducted by a Financial Instruments Business Operator or a Financial Instruments Intermediary Service Provider; (ii) to mediate in the case of disputes arisen from Financial Instruments Business conducted by a Financial Instruments Business Operator or a Financial Instruments Intermediary Service Provider; and (iii) in addition to what is listed in the preceding two items, activities that would contribute to the sound development of Financial Instruments Businesses and protection of investors. Certification shall be given by the Financial Agency commissioner.

> **"The number of cases which the LIAJ receives has been increasing as a result of its flexible and creative case management"**

Response

Preparing for amended FIEA, several industry associations in the area of financial instruments business operators applied and obtained the qualification of Designated Type I/II Financial ADR. Those associations are: the Life Insurance Association of Japan (LIAJ) (*seimei hoken kyokai*), the Japanese Bankers Association (JBA) (*zenkoku ginko kyokai*), the Trust Companies Association of Japan (TCAJ) (*shintaku kyokai*), the General Insurance Association of Japan (GIAJ) (*nihon songai hoken kyokai*), the Insurance Ombudsman (*hoken ombudsman*), the Small Amount & Short Term Insurance Association of Japan (SASTIAJ) (*nihon shogaku tanki hoken kyokai*), and the Japan Financial Services Association (nihon kashikingyo kyokai).

Those associations provide dispute resolution services for the member associate companies, so that such associate companies meet regulatory requirements under the amended FIEA provisions.

On the other hand, Type I Japanese financial instruments business operators took leadership to establish a neutral dispute resolution organisation. More specifically, five key industry associations; the Japan Securities Dealers Association (*nihon shokengyo kyokai*), the Investment Trust Association of Japan (*toushi shintaku kyokai*), the Japan Securities Investment Advisers Association (*nihon shoken toushi komongyo kyokai*), the Financial Futures Association of Japan (*kinyu sakimono torihikigyo kyokai*), and the Japan Commodities Fund Association (*nihon shohin toushi hambaigyo kyokai*) jointly established a specified non-profit corporation titled the Finmac (*shoken kinyu shohin assen center*).

Finmac provides (i) consultation services, (ii) claim handling services and (iii) mediation support services for disputes arising out of or in connection with financial instruments offered by member companies, which are members of the five founding associations. Furthermore, Finmac also provide similar services for disputes related to financial instruments offered by Type II financial instruments business operators, which registered with Finmac.

Registered in this context means that such Type II operators registered before the dispute arose and paid registration fees to Finmac. Finmac does provide these services to Type II operators and their customers as a Certified Investor Protection Organisation.

In addition, Finmac is now applying to be qualified as a Designated Type I Financial ADR, and it is expected to start dispute resolution serv-

ices as Designated Type I Financial ADR from April 1 2011. Eventually, Finmac will obtain all three qualifications in the area of financial instruments dispute resolution. The foregoing clearly shows Finmac's affirmative and active approach in taking a leading role in Financial ADRs.

Too many qualifications?

It is becoming increasing difficult to follow the development of dispute resolution mechanisms for financial instruments disputes. In the area of ADR for financial instruments disputes, there are at least three qualifications of dispute resolution organisations: Certified ADRs (*ninsho funsou kaiketsu jigyo sha*); Designated Type I/II Financial ADRs (*shitei dai I/II shu funsou kaiketsu kikan*); and a Certified Investor Protection Organisation (*nintei toushisha hogo dantai*).

Substantially, a qualification of Certified Investor Protection Organisation was almost substituted with a new qualification, Designated Financial ADR by the enactment of amended FIEA. Accordingly, most of industry associations including the JBA, TCAJ, GIAJ, and SASTIAJ switched their qualifications from Certified Investor Protection Organisation to Designated Financial ADRs (and the LIAJ shall complete its changeover in the mid of 2011). Only the Finmac is expected to maintain its position as Certified Investor Protection Organisation, for its services for non-member businesses.

From a customers' perspective, it is not mandatory to use either of the above mentioned dispute resolution services. Furthermore, financial instruments business operators do not incorporate a mediation agreement in their contract forms (actually, in most of the contract forms, there still is a provision which submits all disputes to the jurisdiction of Tokyo/Osaka District Court).

However, the number of cases which used those dispute resolution services has increased. For example, at Finmac, consultation cases added up to more than 5,000 cases and more than 200 cases were referred to mediation only in nine-month period in the year of 2010.

This is an amazing development, considering that Finmac provide mediations services for fee.

As of January 2011, Finmac provides with a panel of approximately 40 lawyer-mediators nationwide. Meantime, number of member Type I financial business operators and registered Type II financial business operators concurrently increased. As of December 2010, more than 1,500 Type I business operators entered into agreements and more than 900 Type II business operators registered as potential users.

Also, the number of cases which the LIAJ receives has been increasing as a result of its flexible and creative case management; it facilitated the use of handy conference call tools to hear cases remotely. It is without doubt that such great efforts of dispute resolution organisations enabled this successful creation of the new system.

However, considering a size of Japanese economy and financial instruments businesses, even Finmac's case number is small. It is very important for financial ADRs to keep their qualities and promote their services to potential users nationwide. The year 2011 shall be another key year for the development of financial ADRs.