

Financial Services Compliance 2021

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Financial Services Compliance 2021

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Lexology Getting The Deal Through is delighted to publish the fourth edition of *Financial Services Compliance*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Egypt, Indonesia, Ireland and Italy.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Zachary J Zweihorn of Davis Polk & Wardwell LLP, for his assistance with this volume.



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REGULATORY FRAMEWORK

Regulatory authorities

1 | What national authorities regulate the provision of financial products and services?

Financial products and services in Japan fall principally under the regulatory oversight of the Financial Services Agency of Japan (JFSA). The JFSA is authorised to propose and coordinate laws and regulations relating to the provision of financial products and services, and to inspect and supervise business operators providing such products and services.

The Securities and Exchange Surveillance Commission of Japan (SESC), a sub-division of the JFSA, is delegated with the authority to perform both on- and off-site inspections of business operators providing financial products and services. Local finance bureaux (LFBs) in Japan are similarly authorised to inspect and supervise such business operators operating within the ambit of their jurisdiction and to review disclosure documents (such as securities registration statements, annual, semi-annual and quarterly securities reports, and large shareholding reports) submitted to them under the Financial Instruments and Exchange Act of Japan (FIEA).

Products and services that are linked to commodities and commodities derivatives are regulated by the Ministry of Economy, Trade and Industry of Japan and the Ministry of Agriculture, Forestry and Fisheries of Japan, depending on the type of commodities involved. As a practical matter, however, such products and services generally are not considered financial products and services. Accordingly, this chapter does not discuss the regulatory framework surrounding such products and services in detail.

2 | What activities does each national financial services authority regulate?

Activities regulated by the JFSA are generally those governed by the FIEA. The FIEA categorises these activities into four types of business (each a Financial Instruments Business):

- Type I Financial Instruments Business (Type I Business);
- Type II Financial Instruments Business (Type II Business);
- Investment Advisory and Agency Business (IAA Business); and
- Discretionary Investment Management Business (DIM Business).

Type I Business includes the following activities:

- 1 sale and purchase of, or dealing in, exchange-traded derivatives related to Type I Securities (as defined below);
- 2 provision of intermediary, brokerage and proxy services in respect of the activities described in (1);
- 3 provision of consignment services in respect of the activities covered under (2);
- 4 provision of brokerage services for the clearing of Type I Securities;

- 5 secondary distribution of Type I Securities; and
- 6 dealing in public offerings, private placements or secondary distributions of Type I Securities;
- 7 securities underwriting;
- 8 acting as principal or provision of intermediation, brokerage or proxy services in over-the-counter (OTC) derivatives transactions; and
- 9 acceptance of fund, securities or certificate deposits from customers in connection with any securities-related business, and transfer of bonds and other instruments into customers' accounts.

Type II Business includes the following activities:

- 1 sale and purchase of, or dealing in, exchange-traded derivatives related to Type II Securities (as defined below);
- 2 provision of intermediary, brokerage and proxy services in respect of the activities described in (1);
- 3 provision of consignment services in respect of the activities described in (2);
- 4 provision of brokerage services for the clearing of Type II Securities;
- 5 secondary distributions of Type II Securities;
- 6 dealing in public offerings, private placements or secondary distributions of Type II Securities;
- 7 public offerings or private placements (as the issuer) of certain securities related to investment funds; and repurchase of such issued securities, for purposes other than the resale of such securities;
- 8 dealing in exchange-traded derivatives that are not related to securities;
- 9 providing intermediary, brokerage and proxy services in respect of the activities described in (8);
- 10 providing consignment services in respect of the activities described in (9); and
- 11 providing brokerage services for the clearing of non-securities related transactions.

IAA Business includes the following activities:

- provision of non-discretionary investment advice in relation to securities or derivative transactions, for which advisory fees are payable based on a non-discretionary investment advisory contract; and
- provision of intermediary or agency services for the execution of a non-discretionary investment advisory contract or DIM contract.

DIM Business includes the following activities in relation to investment in securities or derivative transactions:

- managing the assets of an investment corporation established under the Investment Trusts and Investment Corporations Act of Japan (ITICA) based on an asset management contract with the investment corporation;
- managing the assets under a DIM contract;
- managing the assets of an investment trust established under the ITICA and acting as a settlor for such investment trust; and

- managing the assets of a collective investment scheme (such as a limited partnership established under the laws of Japan or any other jurisdiction) as a general partner of such a scheme.

3 | What products does each national financial services authority regulate?

The JFSA regulates products related to securities and derivative transactions.

Securities are defined in the FIEA as comprising:

- liquid securities, including but not limited to bonds, stocks, beneficial interests in investment trusts established under the ITICA or the laws of any other jurisdiction, shares in investment corporations established under the ITICA or the laws of any other jurisdiction, and security tokens that constitute electronically recorded transferable rights (Type I Securities); and
- illiquid securities, including but not limited to interests in partnerships established under the laws of Japan or any other jurisdiction (Type II Securities).

Derivatives are defined in the FIEA as comprising:

- exchange-traded derivatives; and
- OTC derivatives transactions. This definition covers a broad range of derivative transactions (such as transactions involving foreign exchange (FX), currency, interest rate, credit and crypto asset), but exclude:
 - physically settled FX forward and FX swap transactions; and
 - OTC derivative transactions that are not linked to financial instruments.

However, certain commodities derivatives are regulated under the Commodities Futures and Exchange Act.

Further, high-frequency traders (including foreign traders) conducting regulated algorithmic trading (including both the sale and purchase of securities and exchange-traded derivatives) at local financial instruments exchanges or proprietary trading system markets based in Japan are subject to registration requirements. Prerequisites for such registration do not include establishment of an office in Japan. However, having a representative or agent in Japan is necessary. Local securities firms are prohibited from accepting orders from unregistered high-frequency traders.

Authorisation regime

4 | What is the registration or authorisation regime applicable to financial services firms and authorised individuals associated with those firms? When is registration or authorisation necessary, and how is it effected?

Registration requirements

A business operator wishing to engage in the Financial Instruments Business is, in principle, required under the FIEA to be registered as a financial instruments business operator (FIBO) beforehand. To successfully register as a FIBO, a business operator has to meet certain conditions, including, but not limited to:

- having a business office and representative in Japan (inapplicable to an IAA Business);
- meeting minimum capital and net worth requirements (specifically, at least ¥50 million (or more, in certain cases) in respect of Type I Business, at least ¥10 million in respect of a Type II Business, and ¥50 million (or less, where certain conditions apply) in respect of a DIM Business, but inapplicable to an IAA Business); and
- meeting certain internal system requirements, such as having an appropriate organisational structure in place.

Applications for FIBO registration have to be filed with the relevant LFB. In practice, applicants are generally required to consult with the relevant LFB to discuss the details of their proposed businesses, the appropriateness of their organisational structure and internal business rules, and other matters, and to obtain informal regulatory approval for filing before submitting a formal application. Assuming this informal consultation process (which may take a few months) is observed, two months will typically be required from the date of submission of a formal application to the date of completion of registration, unless amendments to the application forms or supporting documents are necessary, in which case more time would be needed.

Foreign entities engaging in a business similar to an IAA Business, a DIM Business or certain Type II Businesses in its home jurisdiction, and certain entities and persons associated therewith (such as its parent and subsidiaries), may receive English-language support in their applications for registration as an IAA Business, a DIM Business and the relevant Type II Business from the Financial Market Entry Office (*kyoten kaisetsu* support office) (FMEO). The FMEO was jointly established by the JFSA and LFBs in January 2021 to handle registration (including the aforementioned informal consultation process) and supervision of foreign asset management firms that are new to the Japanese market. The FMEO will function as a single point of contact with the capacity to conduct communications in English. Foreign entities (or their local affiliates in Japan, as applicable) may, with the support of the FMEO, prepare and file applications for registration as an IAA Business, a DIM Business and the relevant Type II Business in English.

Exemption from registration requirements

Under the FIEA, business operators who satisfy certain requirements are permitted to engage in certain Financial Instruments Businesses without registration as a FIBO. The main registration exemptions are discussed below.

Article 63 business exemption

Registration exemptions are available under article 63 of the FIEA to general partners of partnerships with:

- at least one qualified institutional investor (such as a FIBO engaging in a Type I or DIM Business, a bank or an insurance company); and
- less than 50 eligible non-qualified institutional investor investors (which are limited to persons such as the general partner itself, a parent or a subsidiary of the general partner, officers and employees of the general partner, its parent or subsidiary, and certain high net worth individuals). Specifically, such general partners may:
 - solicit Japan residents for investments in interests in their partnerships without registration as a Type II Business; and
 - manage the assets of their partnerships for investors resident in Japan without registration as a DIM Business (the article 63 Business Exemption).

However, an article 63 Notification has to be filed with the relevant LFB before commencement of any investment solicitation activities.

De minimis exemption

A general partner of a partnership established under the laws of a foreign jurisdiction is permitted to manage the assets of such partnership, without registration as a DIM Business or filing an article 63 Notification, if all of the following conditions are met:

- all the Japan-resident investors who have directly and indirectly invested in the partnership are qualified institutional investors;
- the partnership has less than 10 Japan-resident investors; and

- the total partnership contributions from such Japan-resident investors is less than one-third of the total contributions from all investors in the partnership.

Foreign securities firm exemption

A foreign entity engaging in the securities business in a foreign jurisdiction in accordance with the laws of such foreign jurisdiction is permitted, without registration as a Type I or Type II Business, to engage in certain securities-related activities, provided such activities are carried on from offices outside Japan and with limited categories of counterparties (the Foreign Securities Firm Exemption). This is discussed in further detail in the questions on cross-border regulation below.

Foreign investment adviser and manager exemption

A foreign entity licensed to engage in a non-discretionary investment advisory business or a discretionary investment management business in its home jurisdiction is permitted, without registration as an IAA Business or DIM Business, to provide a FIBO engaging in the DIM Business with non-discretionary investment advisory services or discretionary investment management services.

However, such foreign investment advisers and managers are still prohibited from providing non-discretionary investment advisory services and DIM services to FIBOs registered to engage in the IAA Business.

Non-securities related OTC derivatives exemption

A person will not be deemed to be engaging in the Financial Instruments Business merely by acting as a principal or providing intermediation, brokerage or proxy services in non-securities-related OTC derivative transactions (except in cases where such derivative transactions are subject to certain statutory requirements), where the counterparties are limited to:

- Type I Business FIBOs;
- financial institutions registered to conduct securities-related business under the FIEA;
- qualified institutional investors;
- stock corporations with paid-up capital of at least ¥1 billion; and
- an overseas equivalent of any of the above.

Registration as sales representative

Under the FIEA, the officers and employees of a FIBO who engage in marketing activities such as the sale and purchase of Type I Securities, or dealing in the public offering, private placement or secondary distribution of Type I Securities, are required to be registered as a sales representative with the Japan Securities Dealers Association (JSDA), a self-regulatory body delegated with the authority to handle registration affairs by the JFSA. Persons seeking to be registered as a sales representative are required to pass a qualification examination administered by the JSDA.

Legislation

5 | What statute or other legal basis is the source of each regulatory authority's jurisdiction?

The JFSA, SESC and LFBs derive their regulatory authority over financial instruments businesses from the FIEA, and cabinet orders and ordinances issued thereunder (together with the FIEA: the FIEA Regulations).

6 | What principal laws and financial service authority rules apply to the activities of financial services firms and their associated persons?

The financial services industry in Japan is principally regulated by:

- the FIEA Regulations; and
- the Comprehensive Guidelines for Supervision of FIBOs, etc (the Supervisory Guidelines), issued by the JFSA.

The Supervisory Guidelines set forth the supervisory and inspection principles adopted by the relevant regulator toward FIBOs and the like. Accordingly, FIBOs and persons associated therewith are compelled, as a matter of practice, to comply with the Supervisory Guidelines.

Additionally, FIBOs and persons associated therewith are required to comply with the Civil and Criminal Codes of Japan.

Scope of regulation

7 | What are the main areas of regulation for each type of regulated financial services provider and product?

The main areas of FIEA Regulations in respect of FIBOs relate to:

- continuing registration requirements;
- codes of conduct; and
- the requirement to maintain proper books and records. These are briefly discussed in turn, as follows. To maintain the validity of their registrations:
 - FIBOs registered as Type I Businesses are required to maintain both capital and net worth of at least ¥50 million (or more, in certain cases), respectively, as well as keep their capital adequacy ratios at 120 per cent or more;
 - FIBOs registered as Type II Businesses are required to maintain capital of at least ¥10 million; and
 - FIBOs registered as DIM Businesses are required to maintain both capital and net worth of ¥50 million (or less, where certain conditions apply), respectively.

These continuing registration requirements have been put in place to ensure the continued financial soundness of the registered FIBOs.

All FIBOs are also required to adhere to certain codes of conduct that seek to protect the interests of investors, including, but not limited to, the duty of loyalty, the duty of care of a good manager, and the prohibition against compensating customers for their losses, as applicable to the services provided by the FIBOs.

Additionally, all FIBOs are required to prepare and maintain books and other records on their Financial Instruments Business, based on which their annual business reports will be prepared and submitted to the regulator.

These regulations do not apply to business operators relying on certain exemptions in the authorisation regime. However, a general partner, who files an article 63 Notification with the regulator, is subject to certain codes of conduct in relation to the business within the scope of the article 63 Business Exemption, including, but not limited to, refraining from:

- engaging in transactions between funds that are managed by the same general partner; and
- compensating customers for their losses.

Such a general partner is also required to prepare and maintain books and records on its business under the article 63 Business Exemption, based on which its annual business reports will be prepared and submitted to the regulator.

Additional requirements

- 8 | What additional requirements apply to financial services firms and authorised persons, such as those imposed by self-regulatory bodies, designated professional bodies or other financial services organisations?

The self-regulatory bodies in Japan's financial services industry include:

- the JSDA;
- the Type II Financial Instruments Firms Association;
- the Japan Investment Advisers Association; and
- the Investment Trusts Association.

These organisations regulate the activities of their members, and registration as a FIBO under the FIEA is generally a prerequisite of membership in these organisations. A FIBO is not legally obliged to be a member of any such organisations. In practice, however, FIBOs (other than those engaging in the IAA Business) are required to establish internal business rules that are in line with the rules and regulations established by a self-regulatory body. Driven by their need to establish appropriate alternative dispute resolution measures, FIBOs also find it necessary to join self-regulatory bodies, membership of which gives the right to utilise the facilities of the Financial Instruments Mediation Assistance Center of Japan.

The rules imposed by such self-regulatory bodies mainly regulate the conduct of FIBOs from the perspective of investor protection. The rules of a self-regulatory body only apply to its members. Such rules do not have the force of law, and violations would not necessarily result in official sanctions by the JFSA.

ENFORCEMENT

Investigatory powers

- 9 | What powers do national financial services authorities have to examine and investigate compliance? What enforcement powers do they have for compliance breaches? How is compliance examined and enforced in practice?

The Financial Instruments and Exchange Act of Japan (FIEA) gives the Financial Services Agency of Japan (JFSA) the power, when necessary and appropriate for the public interest or protection of investors, to order a financial instruments business operator (FIBO) to submit reports or materials on the business and assets of the FIBO, and to inspect the FIBO's business operations, assets, books of accounts and other documents. The Securities and Exchange Surveillance Commission of Japan (SESC) is also empowered to perform on- and off-site inspections of a FIBO. Similarly, local finance bureaux (LFBs) have the right to conduct inspections of FIBOs and to provide them with regulatory supervision. Where a FIBO is deemed to have misconducted itself based on the findings in such inspections, the JFSA may impose administrative sanctions on the FIBO for the purpose of remedying such misconduct.

Disciplinary powers

- 10 | What are the powers of national financial services authorities to discipline or punish infractions? Which other bodies are responsible for criminal enforcement relating to compliance violations?

The FIEA empowers the JFSA to impose administrative sanctions on FIBOs that violate applicable statutory requirements. However, none of the JFSA, SESC or LFBs have the power to impose criminal sanctions on financial business operators. Criminal sanctions are instead imposed by the Public Prosecutors Office through criminal procedures.

Tribunals

- 11 | What tribunals adjudicate financial services criminal and civil infractions?

Japanese law does not provide for a separate tribunal for the adjudication of crimes or civil infractions related to financial services. Such wrongdoings are adjudicated by ordinary courts of law.

Penalties

- 12 | What are typical sanctions imposed against firms and individuals for violations? Are settlements common?

FIBOs that violate applicable laws and regulations would typically be subject to administrative sanctions imposed by the JFSA for the purpose of remedying the relevant violation. Where the violation is serious and malicious, the FIBO may have its registration revoked or be ordered to suspend all or part of its business for a period not exceeding six months. Depending on the nature of its violation, a FIBO may also be subject to criminal sanctions.

A non-exempt financial service business operator that operates without registration as a FIBO is punishable with a fine not exceeding ¥500 million. Additionally, the responsible officers and employees of such business operator are punishable with imprisonment for a term not exceeding five years or a fine not exceeding ¥5 million, or both.

Japanese law does not provide for a system of settlement in respect of violations of the FIEA. In practice, when determining the appropriate administrative action to take, the JFSA will take into account any voluntary remedial efforts made by the FIBO (based on prior consultation with the JFSA) before imposing any administrative sanction.

COMPLIANCE PROGRAMMES

Programme requirements

- 13 | What requirements exist concerning the nature and content of compliance and supervisory programmes for each type of regulated entity?

Every financial instruments business operator (FIBO) is required to establish internal compliance programmes that are in line with the Supervisory Guidelines. Such compliance programmes involve the following (among others):

- establishment of a concrete plan for the implementation of a legal compliance system;
- development and implementation of a compliance manual on the applicable code of conduct;
- provision of compliance training for staff;
- periodical review of the effectiveness of the compliance programme; and
- periodical assessment of the compliance programme by way of internal audit.

Further, a FIBO is required to put a corporate governance framework in place that enables its chief and other compliance officers to perform their compliance functions independently from the influence of departments handling business operations. Typically, legal and compliance risks will be subject to the review of the legal and compliance department.

Gatekeepers

- 14 | How important are gatekeepers in the regulatory structure?

Every FIBO is required to establish a system of proper checks and balances. As the effectiveness of such a system rests with the gatekeepers, their independence from the influence of departments handling

business operations is essential to their ability to perform their gate-keeping functions effectively.

An independent internal audit department will usually also be established to audit the business activities of the FIBO, and to assess the effectiveness of the FIBO's internal control functions. An internal audit department would usually report directly to the FIBO's board of directors.

Directors' duties and liability

15 | What are the duties of directors and senior managers, and what standard of care applies to the boards of directors and senior managers of financial services firms?

The board of directors of a stock corporation is given authority under the Companies Act of Japan to make decisions on all matters related to the corporation's business, other than matters that are expressly subject to shareholders' approval. Every director on the board assumes duties of a fiduciary nature with regard to the corporation. The following are some of the main duties assumed by a director in a stock corporation:

- Duty of loyalty, which requires the director to comply with applicable laws, the corporation's constitutional documents, and board and shareholder resolutions, and to perform his or her duties faithfully for the benefit of the corporation.
- Duty of care of a good manager, which requires the director to abide by the terms of his or her mandate and to perform his or her duties with the care of a good manager.
- Duty of monitoring and supervision, applicable to the board of directors as a whole, which requires the board to monitor and supervise directors in the performance of their duties. As part of such duty, the board will make suggestions and take action to prevent any director from engaging in any illegal or other activity that may be detrimental to the corporation.
- Duty of reporting, which requires a director to report to the board of directors upon discovery of any fact that may be detrimental to the corporation.

A director who breaches any of his or her duties is liable to the corporation for the resulting damages sustained by the corporation. Directors who are deemed jointly in breach will be jointly and severally liable.

The Companies Act of Japan provides for criminal fines of up to ¥10 million or penal servitude for periods of up to 10 years in cases of serious and deliberate breaches of trust against the corporation and causing damages to the corporation. Further, non-penal, administrative fines in amounts not exceeding ¥1 million are, in principle, assessable for failure by directors to discharge certain obligations stipulated in the Companies Act.

Non-director senior managers do not assume the duties of directors as described above. The scope of the duties of each senior manager will be governed by the contract between the corporation and the senior manager. If the relevant contract is an employment contract, the senior manager would assume the duties as an employee (subject to applicable labour laws).

16 | When are directors and senior managers typically held individually accountable for the activities of financial services firms?

A director would typically be held individually accountable if any violation of applicable laws and regulation is attributable to such a director, such as where the director has authorised any falsification of accounts or entry into fraudulent transactions.

Japanese courts are generally understood to have demonstrated in judicial precedents to date that directors are recognised as being vested

with broad discretion in the performance of their duties and, accordingly, that judicial post-factum intervention should not be excessive. As a result, Japanese courts tend not to hold directors individually liable for business decisions made in accordance with the following principles:

- when making decisions, the board has used efforts to avoid mistakes through adequate preliminary investigations and consultation with professionals, as necessary;
- the relevant decision made by the director was not materially unreasonable in light of the standard of care of a good manager typically expected of managers in the same industry; and
- the board has sought to avoid violation of applicable laws and the corporation's constitutional documents and internal rules through consultation with legal counsel or others.

Non-director senior managers could also be held individually accountable under similar circumstances. However, it is usually more difficult to establish individual accountabilities of a senior manager than a director, as a result of differences in the scope and nature of their duties.

Private rights of action

17 | Do private rights of action apply to violations of national financial services authority rules and regulations?

Whether a person is permitted to institute legal action against a FIBO for violation of applicable Financial Services Agency of Japan (JFSA) rules depends on the circumstances of each case. In this regard, the Supreme Court held in a decision dated 14 July 2005 that a breach of the principle of suitability under the FIEA does not automatically lead to tort liability under private law, but added that tort liability may result where securities transactions deviating significantly from such principle are solicited and entered into. Accordingly, a FIBO may be subject to private rights of action in limited circumstances.

Additionally, a FIBO that breaches its duty to explain the nature of the relevant financial product to its customers pursuant to the Act Concerning the Sale of Financial Products (ACSFP), as discussed in further detail in the questions regarding standard of care for customers below, is subject to private causes of action. In such cases, the burden of disproving causality between violation of the duty of explanation and the loss incurred by the customer will be sustained by the FIBO pursuant to the ACSFP.

Standard of care for customers

18 | What is the standard of care that applies to each type of financial services firm and authorised person when dealing with retail customers?

FIBOs and their staff are required to provide financial services to their customers in good faith, in accordance with the principle of fairness. The ACSFP also requires a FIBO, before selling a financial product to a customer, to explain the nature of the product, the risks involved in purchasing such product, and key aspects of the structure of the transaction.

19 | Does the standard of care differ based on the sophistication of the customer or counterparty?

Yes, FIBOs are exempt from compliance with some of the key provisions on conduct in the Financial Instruments and Exchange Act of Japan (FIEA) (such as the principle of suitability, the requirement to deliver written statutory disclosures to customers, and advertising regulations) where the counterparties are professional investors. 'Professional investors' include qualified institutional investors, listed stock corporations, stock corporations with stated capital of at least ¥500 million, special purpose

companies established pursuant to the Act on Securitization of Assets of Japan (TMKs) and foreign corporations. Individuals with trading experience of at least one year and net and invested assets of at least ¥300 million, as well as other corporations, may apply to change their status from general investors to professional investors.

On the other hand, FIBOs have to follow the principle of suitability when marketing financial instruments to non-professional investors. The principle of suitability requires FIBOs to adjust their manner of solicitation as appropriate in light of the customer's sophistication (as determined from the customer's knowledge, experience, assets and purpose for purchasing the product, among other factors).

Further, the degree of a FIBO's duty to explain the nature of a financial product under the FIEA is generally understood to vary, depending on the level of sophistication of the relevant customer or counterparty. For example, the FIEA prohibits a FIBO from selling financial products or otherwise providing financial services to a customer without first providing sufficient explanation through delivery of a statutory pre-contract disclosure document in such manner and to such extent necessary for the customer to understand the nature of the relevant product, in light of the customer's sophistication (as determined from the factors mentioned above).

Finally, the duty of a FIBO under the ACSFP to explain the nature of a financial product and the other information described in the questions regarding private rights of action above does not apply where the customer is a professional investor.

Rule making

20 | How are rules that affect the financial services industry adopted? Is there a consultation process?

National law

Bills affecting the financial services industry are usually prepared by the Strategy Development and Management Bureau and the Policy and Markets Bureau of the JFSA. In preparing a major bill, the JFSA customarily seeks the advice of the Financial System Council, a statutory advisory body. The final bill is often consistent with the advice of, and supported by a report issued by, the Financial System Council. A bill that is approved by the Diet will become national law.

Subordinate regulation

Under certain laws, such as the FIEA, responsibility for preparing subsidiary legislation (such as cabinet orders and ordinances) that affects the financial services industry is delegated to the JFSA. When preparing subsidiary legislation, the JFSA will, in most cases, commence a public consultation process requesting members of the public to provide feedback on the JFSA's proposals. Upon finalising the relevant subsidiary legislation, the JFSA will usually also publish its response to the public feedback it has received.

Guidelines

The JFSA are also tasked with establishing supervisory guidelines, and questions and answers (collectively, guidelines) that affect the financial services industry. These guidelines are not statutes and accordingly have no force of law. Instead, they seek to clarify the JFSA's interpretation of the relevant statutes and the manner in which regulators will exercise their supervisory and inspection powers under the law. When the JFSA proposes to amend any supervisory guidelines, it will usually also commence a public consultation process to obtain public feedback on the JFSA's proposals.

Self-regulatory rules

The JSDA and other self-regulatory organisations sometimes also initiate public consultations when proposing to amend their own rules.

CROSS-BORDER ISSUES

Cross-border regulation

21 | How do national financial services authorities approach cross-border issues?

Foreign securities firms are generally prohibited under the Financial Instruments and Exchange Act of Japan (FIEA) from engaging in any securities-related business with a person located in Japan. 'Foreign securities firm' is defined in the FIEA as an entity that:

- is based outside Japan;
- is not a financial instruments business operator (FIBO) or a financial institution regulated in Japan (that is to say, not licensed or registered in Japan under the FIEA or any other relevant Japanese financial regulatory regime); and
- engages in a securities-related business outside Japan in accordance with the relevant laws of such foreign jurisdiction.

The FIEA provides certain exemptions permitting foreign securities firms to conduct limited types of securities-related businesses from outside Japan with a person located in Japan, including situations where the counterparty located in Japan is a certain FIBO or financial institution. Additionally, a foreign securities firm is also permitted to engage in a securities-related transaction outside Japan with a person located in Japan if the transaction:

- involves no solicitation from the foreign securities firm; and
- the Japan resident places a transaction order with the foreign securities firm or the relevant transaction is conducted through the agency or intermediation of a Type I FIBO (ie, a local securities firm).

However, care should be taken when relying on this exemption. This is because the Financial Services Agency of Japan generally takes a broad interpretation of the concept of 'solicitation', such that solicitation would be deemed to have occurred if a foreign securities firm advertises its securities-related activities on its website.

In addition, a foreign entity acting outside Japan may be permitted, without registration as an IAA Business or DIM Business, to provide a Japanese FIBO engaging in the DIM Business with non-discretionary investment advisory service or discretionary investment management service.

Other than the foregoing, the FIEA provides no clear exemptions in most cross-border situations. Where no clear exemption applies, whether a person acting outside Japan is required to be registered as a FIBO under the FIEA when transacting with a Japan resident will be determined on a case-by-case basis.

International standards

22 | What role does international standard setting play in the rules and standards implemented in your jurisdiction?

International standards on financial services and products are sometimes reflected in Japanese laws and regulations. Given the informal and non-binding nature of international standards, however, implementation of such standards in Japan may be attenuated by the process discussed under the questions regarding rule making above.

UPDATE AND TRENDS**Key developments of the past year**

23 | Are there any other current developments or emerging trends that should be noted?

Pursuant to the amendment to the Financial Instruments and Exchange Act of Japan (FIEA) enacted and promulgated in 2019 (the FIEA 2019 Amendment), electronically recorded transferable rights were included within the definition of Type I Securities under the FIEA. Electronically recorded transferable rights are defined under the FIEA to mean certain illiquid securities (such as interests in a limited partnership) that are represented by proprietary value transferrable by means of an electronic data processing system (but limited only to proprietary values recorded in electronic devices or otherwise by electronic means). Further, over-the-counter (OTC) derivatives referencing crypto assets were included in the definition of OTC derivative transactions pursuant to the FIEA 2019 Amendment. The FIEA 2019 Amendment took effect on 1 May 2020.

24 | What emergency legislation, relief programmes and other initiatives specific to your practice area has your state implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

In Japan, various documents required for administrative procedures handled by the JFSA had to be in writing and sealed. Due to the outbreak of the covid-19 pandemic, the JFSA has now begun accepting documents without wet ink seals via email. In line with this practice initiated by the JFSA, the cabinet ordinances issued under the FIEA and Supervisory Guidelines were also amended to abolish the requirement for affixation of seal on various documents submitted to the regulator. This amendment was introduced as part of the initiatives of the Japanese government, to abolish certain regulatory obligations that require documents for administrative procedures to be in writing and sealed.

Additionally, the JFSA has announced, via a notification regarding the deadline for submission of annual securities reports and other reports, that an extension of the deadline for submission of such reports may be accepted by the regulator, if such a deadline cannot be met for unavoidable reasons triggered by the covid-19 pandemic.

Furthermore, to facilitate business continuation by overseas financial business operators (such as investment managers) in Japan for a certain period of time when continuation of its business overseas becomes difficult, the relevant cabinet ordinance issued under the FIEA was amended on 22 July 2020. Pursuant to such amendment, overseas financial business operators with businesses in Japan will be exempt from the need to undergo FIBO registration if they meet certain conditions, and if such exemption is approved by the Commissioner of the JFSA.

An entity facing difficulty in complying with any regulatory requirement under the FIEA due to the covid-19 pandemic, should check on the availability of practical measures to address such difficulty under the existing regulatory framework. Such entity should also seek the regulator's confirmation as to whether its adoption of such measures is acceptable.

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