Design of an Institutional Framework for Asset Formation by the Japanese People and the "Fiduciary Duty" of Financial Business Operators

MATSUMOTO Nobuko

Professor, Faculty of Law, Gakushuin University

Abstract

To promote asset formation through investment by the Japanese people, the Financial Services Agency (FSA) of Japan has been striving to strengthen confidence in the capital markets by using terms such as "fiduciary duty" and "customer-oriented business conduct" to encourage financial business operators to behave in ways that serve customers' interests.

The first purpose of this paper is to clarify what meaning the term "fiduciary duty," when written in Japanese katakana characters, is used to convey in the field of financial administration in Japan. Unlike its traditional meaning, the term "fiduciary duty," as used by Japan's FSA does not mean a duty that strictly regulates relationships of conflict of interests. Instead, it is an abstract concept in line with "respecting the interests of customers." It may be said that the term "fiduciary duty" is being used as a catchphrase for strengthening confidence in the capital market.

The second objective of this paper is to emphasize the following point by clarifying the traditional meaning of the term "fiduciary duty": that (1) the need to protect investors due to a fiduciary relationship between financial business operators and investors, and (2) the need to protect investors who are at a significant disadvantage compared with financial business operators in terms of access to information and capabilities are two different matters each of which must be accurately distinguished and understood. As institutional and legal changes continue to be made frequently in the field of financial regulations, it is essential to be clear which of these needs justifies imposing various regulations.

Finally, based on the understanding of the traditional meaning of the term "fiduciary duty," this paper asks the following question: Is it justifiable to impose restrictions on financial product providers' practice of making monetary or other forms of payment to sales companies in proportion to the amount of sales recorded by the sales companies? Companies providing non-financial products and services are not necessarily subject to such restrictions on payment of rebates to sales companies; therefore, if restrictions are to be imposed specifically in the case of financial products, it is necessary to make clear what justifies the imposition of the restrictions. For reference, we use Japan's "Principles for Customer- Oriented Business Conduct," "Regulation Best Interest" (also known as "Reg BI"), adopted by the U.S. Securities and Exchange Commission in June 2019, and rules applied to the healthcare industry, which has introduced strict restrictions.

Keywords: fiduciary duty, customer-oriented business conduct, conflict of interests, investor protection, rebate

I. Issues of this Paper

To promote asset formation through investment by the Japanese people, the Financial Services Agency (FSA) of Japan has been striving to strengthen confidence in the capital markets by using terms such as "fiduciary duty" and "customer-oriented business conduct" to encourage financial business operators to behave in ways that serve customers' interests.

The following is an excerpt from the "Financial Administration Policy for 2016-2017" published by the FSA.

> *"The concept of fiduciary duty has often been used to refer to the duty owed by trustees under trust contracts, etc., but recently there has been a movement to use the word as a general term showing the broad and various roles and responsibilities which persons who are trusted by others to complete a mission should uphold, and it is necessary to spread this movement in Japan as well. In other words, it is required that every financial business operator included in the investment chain, which includes sales of financial products, giving advice, financial products origination, custody, and investment management, shares and performs the principles of customer-oriented business conduct (i.e., business conduct that puts the interests of final investor and beneficiary first)."*

The English term "fiduciary duty" is often translated into Japanese as "*jyutakusha sekinin*" or "*shin-nin gimu*." However, in the area of financial administration, the word "fiduciary duty" has recently been written in Japanese katakana characters and keeping the English pronunciation (as "*fi-dyu-sha-rih-dyu-thih*"). In this paper, I will clarify the meaning that the term "fiduciary duty" as written in Japanese katakana characters conveys in the field of financial administration in Japan. As the "Financial Administration Policy for 2016-2017" shown above states, in Japan the term "fiduciary duty," unlike its traditional meaning, does not mean a duty which strictly regulates relationships of conflict of interests. In this paper, I emphasize how the meaning of Japanese katakana's "fiduciary duty" differs from the traditional, narrower meaning of the term (see Section II below).

Then, this paper will emphasize the following point by clarifying the traditional meaning of the term "fiduciary duty": that (1) the need to protect investors because of the fiduciary relationship between financial business operators and investors, and (2) the need to protect investors who are at a significant disadvantage compared with financial business operators in terms of access to information and capabilities are two different matters each of which must be accurately distinguished and understood. As institutional and legal changes continue to be made frequently in the field of financial regulations, it is essential to clarify which of these needs forms the basis for and justifies imposing regulations (see Section III below).

Finally, this paper asks the following question, based on the meaning of the term "fiduciary duty." Can we justify imposing restrictions on financial product providers' practice of making monetary or other payment to sales companies in proportion to the amount of sales recorded by the sales companies? Companies that provide products and services outside of

the financial industry are not necessarily subject to such restrictions. Therefore, if restrictions are to be imposed in the case of financial products, it is necessary to clarify what justifies imposing such restrictions (see Section IV below).

II. Japan's Financial Administration and "Fiduciary Duty"

II-1. The Narrow Sense of "Fiduciary" and "Fiduciary Duty"

The central issues of this paper are the concepts of "fiduciary" and "fiduciary duty," which a "fiduciary" owes.

According to Frankel (2011), all definitions of fiduciaries "share three main elements: (1) entrustment of property or power, (2) entrustors' trust of fiduciaries, and (3) risk to the entrustors emanating from the entrustment."[1] When someone is recognized as a "fiduciary," he/she owes a "fiduciary duty," which consists mainly of a "duty of care" and a "duty of loyalty." The "duty of loyalty" requires a fiduciary to act for the sole benefit of the entrustors and prohibits the fiduciary from acting in any way that conflicts with the interests of the entrustors.[2] Because the fiduciary owes the duty of loyalty, the fiduciary is prohibited from putting himself/herself in a position where the fiduciary's interest conflicts with a client's interests, and the fiduciary is prohibited from engaging in any transaction involving a conflict of interest, with the exception that the fiduciary is permitted to engage in such a transaction when the fiduciary receives approval from the entrustors to do so after disclosing the existence and nature of the conflict.

Why are fiduciaries such severely restricted? As Frankel's explanation shows, in order to make a fiduciary arrangement work for an entrustor, it is indispensable that the entrustor entrusts his/her assets and grant discretion over those assets to the fiduciary. Since there exists a risk that the fiduciary will abuse the assets or power over them that has been granted by the client, the fiduciary duty, especially the duty of loyalty, supports the goal of prohibiting fiduciaries from misappropriating or misusing entrusted property or power.[3]

Placing severe restrictions on fiduciaries is desirable in the sense that, given such regulations people can entrust assets and discretion over them to others without fear that their entrusted property will be abused.[4] People can benefit from this relationship in two ways. First, when people entrust their property or discretion to someone with specialized expertise, people can use professional knowledge and experiences to pursue their interests. Second, by asking others to act on his/her behalf, individuals can spend their limited time and effort more effectively. An example of the former is where people hire investment advisors to manage their assets. An example of the latter is where a lawyer who has the knowledge and expertise to deal with his/her own inheritance issues, hires another lawyer to handle a matter

1 Frankel (2011) at 4.
2 Frankel (2011) at 108.
3 Frankel (2011) at 25-26, 108.
4 See Frankel (2011) at 6-7.

so that the first lawyer can use his/her time for other projects.[5] The first example shows that the benefit of trusting a fiduciary typically arises where the fiduciary has expertise that the client does not have.[6] Still, there are also benefits in situations where an individual hires a fiduciary to handle an issue even when he/she has the expertise and ability to address it, as in the second example.

As there are clearly situations where it is desirable to entrust others, we need an infrastructure that allows people to entrust others without fear that their assets or the discretion granted over their assets will be abused, and one of the infrastructures is a strict fiduciary duty.[7]

II-2. Financial Business Operators in the U.S. and a "Fiduciary"

In the U.S., examples of "fiduciaries" include a trustee of a trust who is entrusted with settler's property, and a director of a company who is entrusted with the management of the company. As a result of owing a "fiduciary duty," trustees are strictly restricted to engage in self-dealing between the trust assets and the trustees' own assets, and directors are highly regulated when they engage in deals where the interests of the company and those of the director conflict.

Given this, is a financial business operator considered a "fiduciary"? To consider this question, this paper will discuss two types of financial business operators, (1) investment advisors, regulated by the U.S. Investment Advisers Act of 1940, and (2) broker-dealers, regulated by the U.S. Securities Act of 1933, the Securities Exchange Act of 1934, various regulations of the Securities Exchange Commission (SEC), and regulations of various Self Regulatory Organizations (SROs).[8]

Investment advisors in the U.S. play a similar role to that of Japanese investment advisors (*toushi komon gyousha*), and for compensation, engage in the business of advising others, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities.[9] Many investment advisers manage their clients' portfolios, and most of them charge their clients fees for investment advisory services based on a percentage of assets under management.[10]

On the other hand, U.S. broker-dealers, who play a role similar to Japanese securities companies (*shoken gaisha*), offer both brokerage services (in which they act as an agent) such as executing trades for customers, and dealer services (where they act as a principal), such as selling securities from their firm's inventory. Broker-dealers generally charge their clients transaction-based compensation, using commissions.[11]

---

[5] See Frankel (2011) at 10.
[6] See Frankel (2011) at 6-7.
[7] See Bank of Japan, Institute for Monetary and Economic Studies, Study Group (2010) at 184. See also id. at 187 ("If the legal regulation against the infringements of the interest in such a situation is not enough, it might shrink the trading, and bring the decrease of interests of the society as a whole. Therefore, in the perspective of efficiency in economics, it is considered to be necessary to provide legal regulations").
[8] See for example Staff of SEC (2011) at ii, 9-11, 21-22, 46, Hazen (2010) at 727-762, Cox, et. al. (2009) at 1025, 1035, 1064.
[9] Investment Advisors Act of 1940 §202(a)(11).
[10] Staff of SEC (2011) at 6-7.

Regarding the concept of "fiduciary," investment advisors are "fiduciaries" and owe a "fiduciary duty" to their clients, including the duties of loyalty and care.[12] Therefore, investment advisors must disclose to their clients information about any conflicts of interests that may exist between the investment advisor and the client.[13]

In contrast to investment advisers, it has been construed that "there is no blanket fiduciary relationship between a broker-dealer and a client as a matter of law, but…the surrounding circumstances can suffice to create a fiduciary duty."[14] Broker-dealers, especially when they act as dealers, stand as one party in a two-party-transaction, and it is not at all clear whether they should be obliged to act for the interests of the customer, or if they should be obliged to disclose all conflicts of interest in the transaction. Cox et. al. (2017) show the difficulties and complexities of this issue using an example of a retail shoe store, where penny loafers are overstocked. The shoe store might provide a special sales incentive to its sales staff to sell those penny loafers, and this practice is similar to that of a broker-dealer who provides a "special sales incentives to its staff in the form of additional shares of the sales commission charged the customer when sales are made from the house's inventory." It is not easy to answer the question of whether the store and the broker-dealer should be obliged to disclose this sort of incentive arrangement to their customers.[15]

Courts in the U.S. have shown that broker-dealers owe a fiduciary duty when they exercise discretion or control over their customers' assets, or when there exists a relationship of trust and confidence with their customers.[16] As mentioned in Section II-1, one reason to place severe restrictions on fiduciaries is to reduce the risk of abuse of the entrusted property or power. Therefore, an important criteria to be used for judging whether one is a "fiduciary" or not is whether discretion or control has been granted. Also, when a relationship of trust and confidence exists between a broker- dealer and its customer, the customer tends to depend on the broker-dealer's judgment. This situation is similar to the situation where the broker-dealer has discretion or control over a customer's assets.

II-3. Japan's Financial Administration and the "Fiduciary Duty"

II-3-1. The Terminology of "Fiduciary Duty" in Japan's Financial Administration

Thus far, this paper has referred to the concepts of "fiduciary" and "fiduciary duty" as they apply in the U.S. In contrast, in recent statements by the financial administration in Japan, the terms "fiduciary" or "fiduciary duty" as written in Japanese katakana characters are sometimes used in a different, broader context from the traditional narrow meaning described above. That is to say, the term "fiduciary duty" does not mean a duty that strictly regulates relationships of conflict of interests, but merely means an abstract concept like

[11] Staff of SEC (2011) at 9-11.
[12] Staff of SEC (2011) at iii, 21-22.
[13] Staff of SEC (2011) at iii, 22-23.
[14] Hazen (2010) at 742-743.
[15] Cox, et. al. (2017) at 1036.
[16] Staff of SEC (2011) at 54. See also Hazen (2010) at 743-744.

“respecting the interests of customers.”[17] A detailed explanation is provided below.

II-3-2. An Attention to the Concept of “Fiduciary Duty” and the Formation of Japan’s Financial Instruments and Exchange Act of 2006

(1) Professor Kanda’s article published in 2001

We begin with a description of how the concept “fiduciary duty” has been absorbed into Japanese financial regulations. In 2001, Professor Hideki Kanda wrote that “so called ‘fiduciary duty’ is an important pillar of the basic rules applied to financial business operators.”[18] He analyzed that “among (1) sales and solicitation, (2) dealing, (3) brokerage, (4) underwriting and selling, (5) asset management, (6) custody, (7) advice, and (8) arranging, <u>at least items (3) through (7)</u>, [the nature of the arrangements is] a so-called fiduciary” and pointed out that “legal regulations regarding above-mentioned fiduciary is one of the area where Japanese regulations are behind the most.”[19] He also mentioned that among items (1) to (8) above, “<u>at least for items (3) through (7)</u>, financial business operators who perform these activities owe a fiduciary duty” and noted that “we should interpret that regardless of the type of financial business operator that is engaged in these activities, every financial business operator owes a fiduciary duty when it engages in these activities” (emphasis is added by the author).[20] Professor Kanda’s article pointed out that many of the activities performed by financial business operators give rise to a fiduciary relationship with their customers, and it is necessary to make financial business operators owe a fiduciary duty in those cases. This view came to have a great impact on the Japanese financial regulations thereafter.

It should be noted that Professor Kanda wrote “at least for items (3) through (7),” financial business operators owe a fiduciary duty. In the case of items (1) (sales and solicitation) and (2) (dealing in financial products), financial business operators act as one party of a two-party transaction; therefore, a difficulty arises if they are also acting as a “fiduciary” (see II-2 above). As to item (8) (arranging of financial products), financial business operators who arrange financial products usually do not provide investors with products or services directly; therefore, it is difficult to claim a fiduciary relationship exists. Professor Kanda’s description appears to pay careful attention to this point.

(2) “Fiduciary Duty” in the Japan’s Financial Instruments and Exchange Act of 2006

Japan’s Financial Instruments and Exchange Act (*kin-yu shouhin torihiki hou*) of 2006 prescribes duties relating to a “fiduciary duty” as follows.

The Financial Instruments and Exchange Act (hereinafter “the Act”) provides for a “duty of good faith to customers” (section 36), as a basic duty for all financial business operators. Section 36 item 1 of the Act provides that financial business operators “shall execute their business in good faith and fairly to customers” (duty of good faith to customers).[21] Other

[17] For a detailed explanation, see also Matsumoto (2017) at 223-234.
[18] Kanda (2001) at 98.
[19] Kanda (2001) at 103.
[20] Kanda (2001) at 107-109.

regulations for financial business operators provided in the Act is explained as regulations that "embody" the "duty of good faith to customers."[22]

Is this "duty of good faith to customers" the same as a "fiduciary duty"? Concerning the activities of investment advice and investment management, the Act imposes the "duty of care" and the "duty of loyalty" on financial business operators engaged in those activities, in addition to the "duty of good faith to customers" (sections 41 and 42 of the Act). The fact that a duty of care and a duty of loyalty are prescribed separately from a "duty of good faith to customers" implies that the "duty of good faith to customers" differs from a "fiduciary duty." In contrast to investment advice and investment management, as to the activities of sales and solicitation, dealing, brokerage, underwriting, and selling, the Act does not impose a "duty of care" or a "duty of loyalty" on financial business operators. As a reason for this, it is pointed out that "(1) there is not necessarily an entrustment from the customer (as to the activities of sales and solicitation), and (2) even in the case where there is an entrustment from the customer, the financial business operator does not necessarily have sufficient discretion (as to the activities of brokerage), or the financial business operator stands as one party in a two-party-transaction (as to the activities of underwriting and selling), and the relationship between the financial business operator and the customers is not a relationship where the financial business operators acts for sole interests of the customer (as to the activities of brokerage, underwriting and selling)."[23] From these provisions of the Act and the explanation, we can see that the Act differentiates between a "duty of good faith to customers" and a "duty of care" or a "duty of loyalty," which is the main content of a fiduciary duty, and imposes a "duty of care" and a "duty of loyalty" only when a fiduciary relationship arises between financial business operators and their clients.[24]

II-3-3. The Terminology of "Fiduciary Duty" in Documents of the Japanese Financial Administration

(1) The First Appearance of the Term "Fiduciary Duty" in Documents of the Japanese Financial Administration

In 2014, the term "fiduciary duty" written in Japanese katakana characters ("*fi-dyu-sharih-dyu-thih*") appeared in documents of the Japanese financial administration.

It seems to be the "Financial Monitoring Policy for 2014-2015" where the term "fiduciary duty" written in Japanese katakana characters appeared documents of the Financial Service Agency (FSA) for the first time. This document states that "individual financial business operators are required to fulfill their roles and responsibilities (fiduciary duty) in carrying out the given function, such as financial products origination, financial product sales, investment management and custody," and explains the term "fiduciary duty" written

---

[21] An English translation of the Financial Instruments and Exchange Act is available at https://elaws.e-gov.go.jp/search/elawsSearch/elaws_search/lsg0500/detail?lawId=323AC0000000025.

[22] Sawaii et. al. (2008) at 54.

[23] Matsuo (2018) at 420.

[24] See Kawamura (2014) at 221.

in katakana characters as “a general term showing broad and various roles and responsibilities which persons who got others trust and should complete their mission owe.”[25]

In 2015 and in 2016, the katakana term “fiduciary duty” appeared in the FSA’s “Financial Administration Policy.” For example, the FSA’s “Financial Administration Policy for 2016-2017” includes the following statement, a part of which is shown at the beginning of this paper.[26]

> *“Establishing ‘Customer-Oriented Business Conduct’ (Fiduciary Duty) of Financial Business Operators*
>
> *In order to promote stable asset formation in households, it is important that financial business operators who, standing between investors and companies, commit to financial product sales, advice, product origination, custody and investment management, etc. engage in customer-oriented business conduct. In other word, it is required that financial business operators continually pursue best practices to provide financial products and services aligned with customers’ interests, by facing to customers, not to the FSA, with voluntary and various innovations, and for example, by providing various information in an understandable manner.*
>
> *The concept of fiduciary duty has often been used to show a duty owed by trustees under the trust contracts etc., but recently there has been a movement to use the term as a general term showing the broad and various roles and responsibilities which persons who have others trust and should complete their mission owe, and it is necessary to spread this movement in Japan as well. In other words, every financial business operator involved in the investment chain, which includes the sale of financial products, giving advice, financial products origination, custody, and investment management, shares and performs the principles of customer-oriented business conduct (business conduct which places the interests of the final investor and beneficiary first).*
>
> *[omitted] For example, the FSA will have a dialogue regarding the following arrangement.*
>
> *[omitted]*
>
> *Sales company: Customer-oriented choices and proposals of sales products, performance evaluations which are consistent with a customer-oriented management policy, voluntary disclosure of customer-oriented arrangements, improved explanations (materials) regarding the risk of the financial products, clarification of fee ratio (amount) which customers directly/indirectly pay and what is the fee for, and through these arrangements, eliminating conflicts of interest and information discrepancies between customers (improvement of information provision) etc.*

[25] https://www.fsa.go.jp/news/26/20140911-1/01.pdf. English translation is available at https://www.fsa.go.jp/en/news/2014/20141225-1/01.pdf.

[26] https://www.fsa.go.jp/news/28/20161021-3/02.pdf.

[omitted]"

The context in which the Financial Administration Policy announced the policy of "customer-oriented business conduct (fiduciary duty)" appears to reflect some anxiety on the part of the FSA regarding the business conduct of financial business operators, especially financial product sales companies. For example, the "Financial Administration Policy for 2015-2016" mentioned "as to sales companies, the problem has been pointed out that their conduct is not customer-oriented in that they engage in transactions for the purpose of generating fees, which includes frequent trading of mutual funds. There is also room for improvement in other areas; for example, in clarifying the fees that customers pay."[27]

The requirements for "customer-oriented choice and proposal of sales products," the "clarification of fee ratio (amount) which customers directly/indirectly pay and what is the fee for," and "eliminating conflicts of interest and information discrepancies between customers (improvement of information provision)" that appeared in the "Financial Administration Policy for 2016-2017" can be understood as measures that attempt to deal with these problems in sales companies.

(2) The Terminology of "Fiduciary Duty" in the "Financial Administration Policy for 2016-2017"

Next, we discuss the terminology of "fiduciary duty" in the "Financial Administration Policy for 2016-2017." As shown above, in this Policy statement the term "fiduciary duty" is used "as a general term showing the broad and various roles and responsibilities which persons who have others trust and should complete their mission owe." Also, it said "every financial business operator involved in the investment chain, which includes the sales of financial products, giving advice, financial products origination, custody, and investment management" are supposed to comply with this "fiduciary duty."

Among those activities, it is easier to apply the traditional concept of fiduciary duty to giving advice, custody and investment management. On the other hand, there does not appear to be a "fiduciary" relationship between financial business operators and investors regarding the sale of financial products and the origination of financial products in the narrow sense described in II-1 above.[28] Thus, the term "fiduciary duty" in the "Financial Administration Policy for 2016-2017" differs from the traditional concept of "fiduciary duty," in that

[27] https://www.fsa.go.jp/news/27/20150918-1/01.pdf.

[28] It is desirable that manufacturers of financial products, who originate financial products, identify the attributes of customers targeted for sales in consideration of the products' characteristics such as risks and complexity, and take measures to prevent the products from being sold to customers without the attribute (See "Principles concerning Customer-Oriented Business Conduct" at Principle 6 and its footnote). Similarly, in the EU, there has arisen a concept of "product governance," and guidance for business conduct of manufacturers are shown (See MiFID II Article 24 (2) and Commission Delegated Directive (EU) on April 7, 2016, Article 9).

Meanwhile, manufacturers, who originate financial products, do not stand as "fiduciaries" for investors. The grounds for these regulations to financial product manufacturers are sought in the need to protect investors who are at a significant disadvantage in terms of access to information and capabilities compared with financial business operator, not in the need to protect investors when there exists a fiduciary relationship. See III below.

it includes the relationship where no discretion or control is given, or that does not involve a relationship of trust and confidence.

Additionally, there remains some doubt about the accuracy of the statement that "*there has been a movement to use the term [fiduciary duty] as a general term showing the broad and various roles and responsibilities which persons who have others trust and should complete their mission owe.*" It is true that the U.S. Department of Labor changed and widened the scope of its definition of "fiduciary" in the Employee Retirement Income Security Act of 1974. This revision, however, only tried to widen the scope of the term "fiduciary" to include broker-dealers who provide a "recommendation" to their retail customers.[29] Also, in the process of the SEC's adoption of Regulation Best Interest (see IV below), there had been an argument that a "uniform fiduciary standard" should be imposed on broker-dealers, but this argument only tried to impose a uniform fiduciary duty on broker-dealers when they make a "recommendation" to retail customers.[30]

When financial business operators, in selling financial products, give their customers an individual "recommendation," a relationship of trust or dependence might arise with the customer, and consequently, a "fiduciary" relationship might arise. It appears that the movement to widen the scope of the concept of "fiduciary" in the U.S. focused on these specific situations. In other words, it was not an effort to widen the scope of the term "fiduciary" without limits, in a way that would include situations where no individual "recommendation" is given to customers.

(3) Why do I care?

As explained thus far, the term "fiduciary duty" in the "Financial Administration Policy for 2016-2017" differs from the traditional concept of "fiduciary duty" by including relationships where no discretion or control of property is given, or where there is no relationship of trust and confidence.

Why do I care about the terminology? To be clear, I do not object to the content of the "Financial Administration Policy" itself. The content seems appropriate in that it tries to strengthen confidence in the capital markets by improving business conduct of financial business operators. It may be a good idea to use the term "fiduciary duty" as a catchphrase for strengthening confidence in the capital markets. At the same time, I fear that by using the term "fiduciary duty" in a different way from its traditional and narrow sense, confusion may arise regarding the original concept of "fiduciary duty." Confusion could also arise regarding the reasons strict regulations should be imposed on fiduciaries, and when conflicts of interests should be strictly prohibited. My concern may be serious in Japan, whose legal system is generally based on Civil law, and where the concept of "fiduciary duty" is not necessarily well known or widespread.

One might object to these concerns by saying that the Japanese Financial Instruments

[29] Federal Register Vol. 81, No. 68, 20946. Available at https://www.govinfo.gov/content/pkg/FR-2016-04-08/pdf/2016-07924.pdf.
[30] Federal Register Vol. 84, No. 134, 33318 at 33334-33335. Available at https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12164.pdf.

and Exchange Act of 2006 carefully differentiates the term "duty of good faith to customers" from "duty of care" and "duty of loyalty" (see II-3-2 (2) above), thereby showing that no confusion exists. It might be true that the FSA's staff and legal academics are not confused and understand the concept accurately. However, that is not enough. In response to the FSA's recommendation to develop and publish a clear policy to achieve customer-oriented business conduct, many financial business operators have announced their policies, and have named them as an "announcement of fiduciary duty" or "policy to implement fiduciary duty."[31] It is important that not only the FSA's staff and academia, but also practitioners who correspond directly to customers, understand the original concept of "fiduciary" and "fiduciary duty" correctly.

III. (1) The Need to Protect Investors because of the Fiduciary Relationship versus (2) the Need to Protect Investors who are at a Significant Disadvantage compared with Financial Business Operators in terms of Access to Information and Capabilities

III-1. Issues

Thus far, I have focused on the concept of "fiduciary duty" and have pointed out that in Japan's financial administration, the term is used in a broader sense than its traditional meaning (see II above). Based on this understanding, in this section I emphasize that (1) the need to protect investors because of a fiduciary relationship between financial business operators and investors, and (2) the need to protect investors who are at a significant disadvantage compared with financial business operators in terms of access to information and capabilities are two different matters each of which must be accurately distinguished and understood.

In other words, there are at least two situations where investors should be protected as described below. First, the situation where a financial business operator is acting as a fiduciary for its customer, and should therefore prioritize the customer's interests over its own. The second situation is one in which an investor is in a weak position, and the weak should be protected regardless of whether the financial business operator is acting as a fiduciary or not.

As institutional and legal changes continue to be made frequently in the area of financial regulations, it is essential to be clear regarding which of these needs forms the basis for and justifies imposing regulations. The distinction made above may be helpful in the discussion of a specific regulation for consideration in IV below.

[31] FSA's "Principles concerning Customer-Oriented Business Conduct" (March 30, 2017. Available at https://www.fsa.go.jp/news/28/20170330-1/02.pdf) provide the principle that "financial business operators should develop and publish a clear policy for realizing customer-oriented business conduct and periodically disclose the implementation status of the policy."

III-2. The Distinction Between Two Needs

III-2-1. The Need to Protect Investors Due to a Fiduciary Relationship

When a financial business operator acts as a fiduciary in the traditional, narrow sense, strict regulations, such as restrictions against conflict-of-interest dealing should be imposed to protect its customers. This is needed so that people can entrust discretion or control of his/her property to others, without fear of abusive usage of them, as explained in II-1 above.

The need to protect investors because of the existence of a fiduciary relationship arises regardless of whether or not the customer has knowledge or expertise regarding the service being provided.[32] It is a breach of the duty of loyalty if a securities company is asked by its customer to buy a financial product for that customer, then buys the financial product at higher price from a counterparty that provides benefits to the securities company, even if the customer is a professional investor with expertise in the markets.

Among the regulations provided in Japan's Financial Instruments and Exchange Act of 2006, the duty of care and the duty of loyalty are imposed on the acts of giving investment advice and investment management (sections 41 and 42 of the Act). Along with the duty to establish a policy for best execution (section 40-2 of the Act) these constitute examples of regulations required because of the fiduciary relationship between financial business operators and their customers.

III-2-2. The Need to Protect Investors at a Significant Disadvantage relative to Financial Business Operators in terms of Access to Information and Capabilities

Regulations to protect investors are also required for the reason that there is a large disparity between financial business operators and their customers in terms of access to information and capabilities. These regulations are of the same nature as regulations provided in the Consumer Contract Act (*shouhi-sha keiyaku hou*) that tries to protect consumers who are in a weak position relative to businesses in terms of quality and quantity of information and ability they have.[33]

Among the regulations provided in Japan's Financial Instruments and Exchange Act of 2006, the regulation that requires delivery of the explanatory document prior to the conclusion of a contract (section 37-3 of the Act) and the regulation that allows consumers to cancel a contract under certain conditions (section 37-6 of the Act) constitute examples of regulations that attempt to protect investors who are in a weak position relative to financial

---

[32] The example in II-1 illustrates the situation. A lawyer, who himself/herself has the knowledge and expertise to deal with a dispute regarding his/her own inheritance, may ask another lawyer to deal with it. In this case, the entrusted lawyer is acting as a fiduciary and is strictly prohibited from receiving any benefits from the opponent in the dispute.

[33] English translation of the Consumer Contract Act is available at http://www.japaneselawtranslation.go.jp/law/detail/?id=3231&vm=04&re=01.

Regarding the nature of regulations of the Consumer Contract Act, see Bank of Japan, Institute for Monetary and Economic Studies, Study Group (2010) at 187.

business operators in terms of the quality and quantity of their information and expertise.[34] The purpose of the regulation concerning "Professional Investors" (*tokutei toushi-ka*) can be understood from this viewpoint. Section 45 of the Act provides that some regulations concerning sales and solicitations, which are intended to protect investors, shall not apply where the investors are "Professional Investors," as those regulations were established to protect investors who are in a weak position due to scarce information or inadequate abilities.[35]

III-2-3. The Relationship between these Two Needs

Are these two needs related, and if so, how? In many cases, both (1) the need to protect investors due to the presence of a fiduciary relationship and the need to protect investors who are at a significant disadvantage in terms of access to information and capabilities exist simultaneously. This is because when one party is in a significantly inferior position to the other party in terms of access to information and capabilities, the former tends to depend on the latter, or to grant discretion to the latter. For example, when a customer has little knowledge and expertise about financial products, a regulation designed to protect the weak is needed. At the same time, since this type of customer tends to entrust control and discretion on his/her property to a financial business operator who has superior information and ability, a fiduciary relationship may arise between them and this fiduciary relationship requires protection for the customer.

Related to this point, the purpose of "the suitability rule" can also be explained in terms of both of these needs. The suitability rule restricts solicitation of complicated and high-risk financial products to investors without the knowledge, experience, and assets to buy such products. On one hand, the nature of the suitability rule can be understood as a rule that protects customers when a fiduciary-like relationship arises as a result of active solicitation and advice given by the financial business operator. The fact that lawsuits against financial business operators are typically pursued in cases where an active solicitation occurred supports this view. On the other hand, if we emphasize that the suitability rule specifically restricts solicitations to investors who lack sufficient knowledge, experience or net worth, the rule can be understood as one that purports to protect the weak.[36]

Needless to say, the fact that both of those needs can exist simultaneously does not negate the necessity to distinguish between them and understand the two needs accurately.

---

[34] Note, however, that section 37-3 of the Act and related regulation requires financial business operators to show "fees," "compensation," and "expenses" on the explanatory document. When we focus on this point, this regulation can be understood as the one that purports to deal with the conflict of interests problem between financial business operators and investors (section 37-3, item 1(4) of the Act, section 81 of Cabinet Office Order on Financial Instruments Business, etc., whose English translation is available at http://www.japaneselawtranslation.go.jp/law/detail/?id=2902&vm=04&re=01).

[35] See Kuronuma (2016) at 569.

[36] Schwarcz (2007) states, in the context of the insurance industry, "insurance consumers typically have a limited understanding of the underlying insurance transaction" (at 314) and "the relationship between market intermediaries and their customers often induces trust and reliance that limit consumers' willingness to question the advice they receive" (at 318).

IV. On What Grounds Can Imposing Restrictions on Financial Business Operators be Justified?

IV-1. Question: Are Restrictions on Financial Product Providers' Practice of Paying Rebates to Sales Companies Justified?

As explained previously, this paper has thus far focused on the concept of "fiduciary duty" in a traditional and narrow sense (see II above), and pointed out that among the financial regulations designed to protect investors, there are (1) regulations whose purpose can be explained by the fiduciary-like relationship between financial business operators and their customers, and (2) regulations whose purpose can be explained by the need to protect investors who are at a disadvantage in terms of information and capabilities (see III above). Based on this, this paper now examines a particular question related to this distinction: is it justifiable to restrict financial product providers' practice of making monetary or other payments to sales companies in proportion to the amount of the providers' products sold by those companies?

The payments that product providers make to sales companies in proportion to the amount of the provider's product sold by those companies are often called "rebates," and the practice is not limited to financial products. When certain product providers promise to pay rebates in proportion to the sales of their products, sales companies have an incentive to sell those products preferentially, in order to receive higher rebates. This is precisely the reason product providers offer rebates to sales companies. In other words, sales companies might prioritize selling their customers products that generate rebates, rather than products that benefit their customers the most.[37] This gives rise to the claim that financial product sales companies should be restricted from receiving rebates from financial product providers.

However, rebates are not necessarily restricted in regulations governing non-financial products and services. Therefore, if restrictions are to be imposed specifically in the case of financial products, it is necessary to clarify the grounds that justify imposing such restrictions.[38]

For reference, we examine Japan's "Principles for Customer-Oriented Business Conduct" (see IV-2 below), "Regulation Best Interest" which was adopted by the U.S. Securities and Exchange Commission in June 2019 and provides specific rules on payments from financial product providers to financial product sales companies (see IV-3 below), and rules governing the healthcare industry, which entail strict restrictions on such payments (see IV-4 below).

[37] Jackson (2008) called this kind of situation as "Trilateral Dilemma."

[38] See Bank of Japan, Institute for Monetary and Economic Studies, Study Group (2010) at 187 and its foot note.

IV-2. Regulations on Rebates in Japan

In Japan, no law or regulation directly restricts financial product sales companies from receiving monetary or other payment from financial product providers.[39]

"Principles Concerning Customer-Oriented Business Conduct" announced by the FSA in 2017, whose nature is a non-binding "soft law," provides principles and explanations related to this issue.[40] For example, Principle No. 3 that requires financial business operators to manage conflicts of interests related to transactions with customers, has a footnote that mentions "in cases where a distributor receives sales commissions, etc. from the company providing the relevant financial products," financial business operators should consider the effects those circumstances may have on their transactions or business. Also, footnote 1 of Principle No. 5 recommends that financial business operators provide customers with "the details [of the possible conflict of interest concerning financial products or services that include sales and solicitations] (including fees and expenses to be received from any third party) and the effect this has on their transactions or business" as important information.

The "Principles Concerning Customer-Oriented Business Conduct" is a principles-based policy that does not provide specific rules; it relies on each financial business operator to determine how it will conform with the principles. In response, many financial business operators have announced their policies with titles such as "Announcement of Fiduciary Duty" or "Policy to Implement Fiduciary Duty" (see II-3-3(3) above, and foot note 31). Though every announcement mentions conflicts of interests, one cannot find specific descriptions of how the financial business operator deals with payments made from third parties (e.g. that they will disclose them, or that they will refrain from receiving them).

IV-3. The SEC's Regulation Best Interest of 2019

IV-3-1. Some Features of Regulation Best Interest

This section refers to "Regulation Best Interest" (also known as "Reg BI") adopted by the U.S. Securities Exchange Commission (SEC) in June 2019, to establish a standard of conduct for broker-dealers.[41] Reg BI adopts a specific rule regarding payments made to broker-dealers from financial product providers. Some characteristics and a summary of Reg BI

---

[39] "[W]here Rebates-giving to the trade partners on the condition for certain amount of purchase from the alleged entrepreneur etc. has effects in restraining the trade partners' dealings of the competitors' products," such conduct is referred to as "Exclusive Rebate-giving," and may falls under "Exclusionary Conduct" subject to a surcharge. However, conduct that falls under "Exclusive Conduct" will be assessed with the narrow standard of "whether or not such conduct would cause difficulty in the business activities of the competitors who are unable to easily find an alternative trade partner" (from The Guidelines for Exclusionary Private Monopolization under the Antimonopoly Act (*haijyo gata shiteki dokusen ni kakaru dokusen kinshi hou jyou no shishin*, October 28, 2009). English translation is available at http://www.japaneselawtranslation.go.jp/common/data/notice/032304_checked_2015-10-21-10-46-49.html).

[40] FSA "Principles concerning Customer-Oriented Business Conduct" (*kokyaku hon-i no gyoumu un-ei ni kakaru gensoku*, March 30, 2017. https://www.fsa.go.jp/news/28/20170330-1/02.pdf).

[41] Federal Register Vol. 84, No. 134, 33318. Available at https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12164.pdf.

are described briefly, followed by a discussion of the specific rule relating to rebates.[42]

As a result of Reg BI, part of the Securities Exchange Act of 1934 will be amended. In this sense, in contrast to the "Principles Concerning Customer-Oriented Business Conduct" from Japan's FSA, Reg BI is not a so-called soft law. An entity that breaches a provision of Reg BI is subject to disciplinary procedures by the SEC, and/or Self Regulatory Organizations (SROs).

Although Reg BI generally take a principle-based approach, some rules are quite specific. In addition, the SEC has provided an enormous number of comments that include specific interpretations and guidance regarding the Regulation.

I emphasize here that the standards of conduct provided in Reg BI apply only when broker-dealers make a "recommendation" to a retail customer. In the background of the Reg BI, the following issues have been pointed out. Investment advisers and broker-dealers in the U.S. are subject to two different regulatory schemes, and only investment advisers are subject to the Investment Advisers Act of 1940, which imposes a strict fiduciary duty (see II-2 above). As a result, although both broker-dealers and investment advisers make recommendations to retail customers, it is not clear that broker-dealers are sufficiently regulated compared to investment advisers.[43] To address this issue, Reg BI provides a standard of conduct for broker-dealers when making recommendations to their retail customers.

IV-3-2. Summary of Regulation Best Interest

As a result of Regulation Best Interest, section 240.15 *l*-1(a)-(b) is newly adopted into the Securities Exchange Act of 1934. Among them, paragraph (a) is titled "Best interest obligation" and imposes restrictions on broker-dealers. Paragraph (a)(1) provides that a broker and dealer "shall act in the best interest of the retail customer" when making a recommendation to such customers, and paragraph (a)(2) provides that in order to satisfy the "best interest obligation" in paragraph (a)(1), four specific obligations should be satisfied, namely the disclosure obligation, care obligation, conflict of interest obligation, and compliance obligation. This paragraph (a) is shown below (underlined by the author).

(a) Best interest obligation.

(1) A broker, dealer, or a natural person who is an associated person of a broker or dealer, <u>when making a recommendation of any securities transaction or investment strategy involving securities (including account recommendations) to a retail customer</u>, <u>shall act in the best interest of the retail customer</u> at the time the recommendation is made, without placing the financial or other interest of the broker, dealer, or natural person who is an associated person of a broker or dealer making the recommendation ahead of the interest of the retail customer.

(2) <u>The best interest obligation in paragraph (a)(1) of this section shall be satisfied if</u>:

[42] SEC's press release on Regulation Best Interest is available at https://www.sec.gov/news/press-release/2019-89.
[43] Staff of SEC (2011) at 102-106.

(i) Disclosure obligation.

The broker, dealer, or natural person who is an associated person of a broker or dealer, prior to or at the time of the recommendation, provides the retail customer, in writing, full and fair disclosure of:

(A) All material facts relating to the scope and terms of the relationship with the retail customer, including:

(1) That the broker, dealer, or such natural person is acting as a broker, dealer, or an associated person of a broker or dealer with respect to the recommendation;

(2) The material fees and costs that apply to the retail customer's transactions, holdings, and accounts; and

(3) The type and scope of services provided to the retail customer, including any material limitations on the securities or investment strategies involving securities that may be recommended to the retail customer; and

(B) All material facts relating to conflicts of interest that are associated with the recommendation.

(ii) Care obligation.

The broker, dealer, or natural person who is an associated person of a broker or dealer, in making the recommendation, exercises reasonable diligence, care, and skill to:

(A) Understand the potential risks, rewards, and costs associated with the recommendation, and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers;

(B) Have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation and does not place the financial or other interest of the broker, dealer, or such natural person ahead of the interest of the retail customer;

(C) Have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile and does not place the financial or other interest of the broker, dealer, or such natural person making the series of recommendations ahead of the interest of the retail customer.

(iii) Conflict of interest obligation.

The broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to:

(A) Identify and at a minimum disclose, in accordance with paragraph (a)(2)(i) of this section, or eliminate, all conflicts of interest associated with such recommendations;

(B) Identify and mitigate any conflicts of interest associated with such recom-

mendations that create an incentive for a natural person who is an associated person of a broker or dealer to place the interest of the broker, dealer, or such natural person ahead of the interest of the retail customer;

(C) *(1)* Identify and disclose any material limitations placed on the securities or investment strategies involving securities that may be recommended to a retail customer and any conflicts of interest associated with such limitations, in accordance with subparagraph (a)(2)(i), and

(2) Prevent such limitations and associated conflicts of interest from causing the broker, dealer, or a natural person who is an associated person of the broker or dealer to make recommendations that place the interest of the broker, dealer, or such natural person ahead of the interest of the retail customer; and

(D) Identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time.

(iv) Compliance obligation.

In addition to the policies and procedures required by paragraph (a)(2)(iii) of this section, the broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest.

IV-3-3. Provisions related to Payments from Financial Product Providers to Financial Product Sales Companies

(1) Disclosure Obligation under Reg BI paragraph (a)(2)(i)

Comments from the SEC accompanying Regulation Best Interests explain that "compensation associated with recommendations to retail customers and related conflicts of interest… is a conflict of interest about which material facts must be disclosed as part of the Disclosure Obligation."[44] This compensation and related conflicts of interest would be disclosed under (a)(2)(i)(B).

As an example of these compensation, the comments refer to "payments for inclusion on a broker-dealer's menu of products offered (sometimes referred to as shelf space)" from product providers (e.g., mutual funds). Also, the comments refer to the case where "a broker-dealer receives compensation derived from the sale of securities or other investment products held by retail customers of the firm, including asset-based sales charges or service fees on mutual funds" and point out that "that fact and the conflicts associated with the receipt of such compensation should be fully and fairly described."[45]

Regarding the contents of the disclosure, the comments concretely explain that "[f]or example, with regard to mutual fund transactions and holdings, a broker-dealer [at the be-

[44] Federal Register Vol. 84, No. 134 at 33363.
[45] Federal Register Vol. 84, No. 134 at 33362-33363.

ginning of a relationship] might disclose broadly that it is compensated by funds out of product fees or by the funds' sponsors, and that such compensation gives it an incentive to recommend certain products over other products for which the broker-dealer receives less compensation; later, when a broker-dealer recommends a particular fund, it could provide more specific detail about compensation arrangements, for example revenue sharing associated with the fund family." Concerning the amount of the compensation, the comments explain that "[t]he Disclosure Obligation … does not require specific written disclosure of the amounts of compensation received by the broker-dealer…," but "depending on facts and circumstances, full and fair disclosure may require disclosure of the general magnitude of the compensation."[46]

The explanation above is mainly related to the paragraph (a)(2)(i)(B). At the same time, in relation to paragraph (a)(2)(i)(A)(3), which require the disclosure of "material limitations on the securities or investment strategies involving securities that may be recommended to retail customers," if broker-dealers recommend only "products with third-party arrangements (e.g., revenue sharing, mutual fund service fees)," the broker-dealers might be required to disclose material facts relating to this practice.[47]

(2) Conflict of Interest Obligation under the paragraph (a)(2)(iii)

Conflict of Interest Obligation under paragraph (a)(2)(iii) is rather complicated. Paragraph (a)(2)(iii) of Reg BI requires broker-dealers to establish, maintain, and enforces written policies and procedures designed to meet the requirements specified in items (A), (B), (C) and (D).

Item (A) requires that all conflicts of interest be identified, and that once they have been identified, conflicts of interest must, at a minimum, be disclosed. There are certain cases where broker-dealers are required to "mitigate" or "eliminate" the conflicts of interest, rather than simply disclosing them. The SEC's comments explain that, "where a broker-dealer cannot fully and fairly disclose a conflict of interest in accordance with the Disclosure Obligation, the broker-dealer should eliminate the conflict or adequately mitigate (i.e., reduce) the conflict such that full and fair disclosure in accordance with the Disclosure Obligation is possible."[48]

Next, item (B) focuses on the conflicts of interests "that create an incentive for a natural person who is an associated person of a broker or dealer to place the interest of the broker, dealer, or such natural person ahead of the interest of the retail customer." Item (B) requires these conflicts of interest to be mitigated. Note that item (B) requires that broker-dealers not only "identify," but also "mitigate" these conflicts of interest. Comments related to this rule mention that "in certain cases, we [the SEC] do not believe that disclosure alone sufficiently reduces the potential effect that these conflicts of interest may have on recommendations made to retail customers."[49]

[46] Federal Register Vol. 84, No. 134 at 33363.
[47] Federal Register Vol. 84, No. 134 at 33357.
[48] Federal Register Vol. 84, No. 134 at 33388-33389.

While item (B) focuses on associated natural persons, item (C) focuses on “firm-level conflicts” and provide a rule regarding “the conflicts associated with the establishment of a product menu---which [the SEC] believe[s] are most likely to affect recommendations made to retail customers and have the greatest potential to result in recommendations that place the interest of the broker-dealer or associated person ahead of the interest of the retail customer.” Item (C) requires broker-dealers to “identify” and “disclose” “material limitations” and “conflicts of interests associated with such limitations,” and “prevent” them from causing broker-dealers to make recommendations that place their interests ahead of their customers. Examples of “material limitations” include “recommending only proprietary products (i.e., any product that is managed, issued, or sponsored by the financial institution or any of its affiliates).”[50]

Lastly, item (D) explicitly mentions “any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time,” and requires that broker-dealers “eliminate” them. As a reason why item (D) requires that these practices be eliminated, the SEC explains that with respect to these practices, “it would be difficult, if not possible, for a firm to establish reasonably designed policies and procedures to sufficiently mitigate the incentive created to put the broker-dealer’s interest ahead of the retail customer’s interest.”[51]

As we have seen, one feature of Reg BI is that broker-dealers are required to prepare policies and procedures that are designed not only to “disclose” conflicts of interest, but also to “mitigate” or “eliminate” certain of those conflicts of interests. The following explains how these “conflict of interest obligations” apply to the situation where monetary or other forms of payment are made from a financial product provider to a financial product sales company. Under item (A), the financial product sales company is required to identify and disclose the existence of this conflict of interest. In addition, if any incentive is given to a natural person who is an associated person of the sales company, items (B) and (D) might also apply, and if so, the conflict of interest must be “mitigated” or “eliminated.” Also, if the financial product sales company primarily recommends products from the financial product providers who offer them rebates or other payments and the product menu of the sales company is limited, it might constitute a “material limitation” under item (C). In this case, the sales company must make a disclosure under item (C)*(1)*, and according to item (C)*(2),* must prevent such limitations from causing recommendations that place the sales company’s interest ahead of the interests of its retail customers.

---

[49] Federal Register Vol. 84, No. 134 at 33390. As an example of policies and procedures to comply with the item (B), SEC’s comments mention “avoiding compensation thresholds that disproportionately increase compensation through incremental increases in sales” (Id. at 33392).

[50] Federal Register Vol. 84, No. 134 at 33393. As an example of policies and procedures to comply with the item (C), SEC’s comments refer to “establishing product review processes” (Id. at 33394).

[51] Federal Register Vol. 84, No. 134 at 33396.

IV-4. Healthcare Industry Regulations

IV-4-1. Strict restrictions in the Healthcare Industry

In most industries, the payment of rebates by goods/service providers to sales companies is not necessarily restricted by law and/or regulations. A notable exception is the healthcare industry. As shown below, in both Japan and the U.S. there are strict restrictions against payments made by medical product providers (e.g., pharmaceutical companies) to hospitals or doctors. Why do such strict restrictions exist?

IV-4-2. Japan's Act against Unjustifiable Premiums and Misleading Representations

(1) Regulations under the Act against Unjustifiable Premiums and Misleading Representations

In Japan, the Act against Unjustifiable Premiums and Misleading Representations (*futou keihin-rui oyobi futou hyouji boushi hou*. Hereinafter "the Unjustifiable Premium Act") limits and prohibits acts that are likely to interfere with the general consumers' voluntary and rational choice-making. The "Notice on Businesses involving Medical Drugs, etc." (*iryou-yo iyakuhin gyou tou kokuji*) was enacted based on section 4 of the Unjustifiable Premium Act, and provides that "a trader who runs a business of manufacturing or sales of medical drugs, a trader who runs a business of manufacturing or sales of medical devices, and a trader who runs a business of hygiene inspections shall not provide premiums to medical institutions etc. …as a means of unjustifiably inducing transactions of medical drugs, medical devices, or hygiene inspections."[52]

Section 31 of the Unjustifiable Premiums Act contains a provision that allows trade associations to establish agreements, with authorization from the Prime Minister and the Fair Trade Commission, that establish rules concerning Premiums or Representations. Based on this provision, 37 agreements have been established.[53] Among these, the agreement titled "Fair Competition Agreement regarding Restrictions on Providing Premiums for Business of Manufacturing and Sales of Medical Drugs" (*iryou-yo iyakuhin seizou hanbai gyou ni okeru keihin-rui no teikyou no seigen ni kansuru kousei kyousou kiyaku*) provides that "a trader who runs a business of manufacturing or sales of medical drugs shall not provide premiums to medical institutions, etc. as a means of unjustifiably inducing transactions of medical drugs."[54]

These provisions prohibit traders engaging in manufacturing and sales of medical drugs from making a payment to medical institutions or associated doctors as a means of inducing transactions of medical drugs.

---

[52] English translation of the Unjustifiable Premium Act is available at http://www.japaneselawtranslation.go.jp/law/detail/?id=2888&vm=04&re=01.
The notice is available at http://www.iyakuhin-koutorikyo.org/?action_download=true&kiji_type=1&file_type=2&file_id=1565.
[53] See https://www.jfftc.org/rule_kiyaku/kiyaku_keihin.html.
[54] http://www.iyakuhin-koutorikyo.org/?action_download=true&kiji_type=1&file_type=2&file_id=1566.

(2) Why are strict rules imposed in Healthcare industry?

Among the 37 agreements that are based on section 31 of the Unjustifiable Premiums Act, four that concern the Healthcare industry prohibit the provision of premiums as a means of unjustifiably inducing transactions (the four agreements concern businesses that are engaged in (1) manufacturing and sales of medical drugs, (2) wholesaling medical drugs, (3) hygiene inspections, and (4) medical devices.) On the other hand, under the other agreements concerning non-healthcare businesses, providing premiums is permissible under certain scope and conditions.[55] Why are strict rules imposed only on healthcare businesses?

One possible explanation is that, in the healthcare industry, where goods and services give an influence to customers' lives and health, it is more important to ensure that the goods and services provided are in the best interests of customers than in other industries. We can find support for this explanation in a document that describes the background of the fair competition agreement concerning medical devices businesses: "As medical devices are products that affect human life, medical institutions should choose such products based on quality, performance and price. If choices are made based on the amount of premiums provided, patients' interest would be significantly infringed."[56]

A second possible explanation is that patients are dependent on their doctors and believe that their doctors make recommendations that are in the interest of the patient, and therefore patients tend to follow doctors instructions without question.[57] In other word, a "fiduciary relationship" exists between doctors and patients.[58]

A third possible explanation concerns the patient's disadvantage compared with doctors in terms of information and capabilities. As advanced expertise is required to understand utilities of medication, there is a significant disparity between doctors and patients, and strict rules are required to protect patients who are in a weak position.[59]

A fourth possible explanation is the view that when it comes to medical products, it is difficult to stimulate demand through sales promotions. "The Code of Practice" provided by Japan Pharmaceutical Manufacturers Association explains, as one of the reasons why various regulations are necessary in pharmaceutical industry, that "who can be consumers are only patients who need the medication for treatment, and demand cannot be created through sales promotion measures."[60] This would not, however, constitute a persuasive reasoning for why we need strict regulations concerning medical products. In many cases, more than one medical product can be used to treat a certain condition or disease. For example, when a pharmaceutical company develops a new effective medical product that can replace an existing one, demand for the new product could well be stimulated through sales promotions.

---

[55] See https://www.jfftc.org/rule_kiyaku/kiyaku_keihin.html.

[56] The Japan Fair Trade Council of the Medical Devices Industry, *"Iryou kiki gyou kousei kyousou kiyaku" oyobi "iryou kikan nado ni okeru iryou kiki no tachiai ni kansuru kijyun" nado ni tsuite* (https://www.wam.go.jp/wamappl/bb13GS40.nsf/0/6af0037ce99f4fd04925755f00241920/$FILE/20090216_6shiryou4_1.pdf).

[57] See Morrison (2000) at 371.

[58] See II.1 above.

[59] Tower (1999) at 529 pointed out that "consumers of health care may be vulnerable and lack clear, complete information."

[60] Japan Pharmaceutical Manufacturers Association, Code of Practice (http://www.jpma.or.jp/about/basis/code/pdf/code2.pdf). I-1-9 of the Code prohibits its member companies from providing goods or monetary payments to medical institutions.

IV-4-3. Criminal Penalties for Acts involving Federal Health Care Programs in the U.S.

Title 42 § 1320a–7b of the U.S. Code is titled "Criminal penalties for acts involving Federal health care programs," and paragraph (b)(1) provides that "[w]hoever knowingly and willfully solicits or receives any remuneration (including any kickback, bribe, or rebate) directly or indirectly, overtly or covertly, in cash or in kind……in return for purchasing, leasing, ordering, or arranging for or recommending purchasing, leasing, or ordering any good, facility, service, or item for which payment may be made in whole or in part under a Federal health care program, shall be guilty of a felony and upon conviction thereof, shall be fined not more than $100,000 or imprisoned for not more than 10 years, or both." In short, this rule prohibits doctors and medical institutions from receiving rebates from pharmaceutical companies or other entities in return for prescribing or adopting a specific medication or service for which payment is made under the Medicare or Medicaid programs.[61] In United States v. Hancock, for example, the defendant chiropractors were charged with referring their Medicare and Medicaid patients' blood samples to a certain laboratory, which forwarded a payment back to the defendants.[62]

This provision originated in the 1972 amendments to the Social Security Act. At the time, the purpose of the statutes was explained as intending to prohibit "certain practices which have long been regarded by professional organizations as unethical... and which contribute appreciably to the cost of the [M]edicare and [M]edicaid programs."[63] The background behind the regulation was a "conflict of interest between financial gains for the physician and the best treatment options for the patient"[64] and the burden on the Medicare and Medicaid programs that are managed by the Federal government.

The regulation had been revised several times and in 1987, the Medicare and Medicaid Patient and Program Protection Act of 1987 was introduced. The purposes of this Act were "(1) preventing overutilization of services; (2) containing program costs; (3) preserving patient freedom of choice; and (4) protecting competition."[65]

IV-4-4. Analysis

As we have seen, while providing payments or premiums to sales companies involved in non-healthcare goods or services are not generally restricted, payments or premiums made as a means of inducing transactions in healthcare goods or services is prohibited. The regulations concerning healthcare goods and services are much restrictive than for other industries.

---

[61] It should be noted that this rule applies only to the remuneration concerning products "for which payment may be made… under a Federal health care program" such as Medicare and Medicaid. Why is the remuneration concerning those products specifically regulated? When payment is made not by patients themselves but by healthcare programs, patients might not pay enough attention to the amounts or volume of the product, and do not have the incentive to monitor the inappropriate use of expensive or excessive medication. Therefore, a strict rule might well be needed concerning such products.

[62] United States v. Hancock, 604 F.2d 999 (7th Cir. 1979). See also Morrison (2000) at 363.

[63] See Kucera (1996-1997) at 417-418 and Morrison (2000) at 354 (quating H.R. Rep. Np. 231, 92d Cong., 1st Sess. 108 (1972)).

[64] Morrison (2000) at 352.

[65] Kusserow (1992) at 50-52. See also Kucera (1996-1997) at 419, Morrison (2000) at 355.

Given this, what kind of regulation is appropriate for the sale of financial products? In Section IV-4-2 (2), I mentioned the following three possible reasons that strict rules are imposed only on healthcare businesses: (1) goods and services give an influence to customers' lives and health, and it is therefore extremely important to make sure that goods or services selected are in the best interests of the patients to whom they are provided; (2) patients are dependent on their doctors; therefore, a "fiduciary relationship" exists between patients and doctors that requires doctors to act in the patients' interest; (3) there is a significant disparity between doctors and patients in terms of access to information and capabilities; therefore, strict rules are required to protect patients who are in a weak position with respect to that information and expertise.

Let us now apply these viewpoints to financial products. (1) With respect to the first rationale, financial regulations are trying to protect investors' financial interests. Investors' financial interests are, of course, important, but it is not sure if they are as important as human life and health. (2) Regarding the second, do fiduciary relationships exist between financial product sales companies and their customers? As we have seen, a financial product sales company that stands as one party of a two-party-transaction is not necessarily required or expected to act as a fiduciary for its customers, which would require that it prioritize its customers interests over its own. However, when a financial product sales company gives a customer an individual "recommendation," a fiduciary-like relationship might arise between the company and the customer. (3) Regarding the disparity of access to information and capabilities, given the complexity of some financial products the disparities between financial product sales companies and their customers might be as significant as those that exist between doctors and their patients.

Based on those comparisons, regarding the question of whether imposing regulations against rebates is justified, the sale of financial products can be positioned somewhere between non-healthcare products (other than financial products) and healthcare products. Imposing more restrictive regulations on financial product sales companies than on other general product sales companies can therefore be justified. At the same time, imposing regulations that are as restrictive as those imposed on healthcare product sales companies cannot be justified. For example, compulsory disclosure of information regarding payments of rebates could be seen as appropriate, while a complete ban against paying rebates, as is done with healthcare products, would be over-regulation.

V. Summary and Issues to be Considered

This paper clarified the traditional meaning of the term "fiduciary duty" and pointed out that (1) the need to regulate the acts of entities and individuals who are in a position of "fiduciary" and (2) the need to protect investors who are at a significant disadvantage in terms of access to information and capabilities are two different matters that should be accurately distinguished. Based on this understanding, this paper also discussed the specific issue of whether imposing restrictions on the payment of rebates to financial product sales compa-

nies can be justified.

There are many other issues concerning financial business operators' business conduct that should be considered in terms of whether or not new restrictions should be imposed, and if so, what kind of restrictions would be appropriate.[66] I hope that the discussions in this paper, especially the distinction between (1) the need to protect investors because of the fiduciary relationship between financial business operators and investors, and (2) the need to protect investors due to their being at a significant disadvantage compared with financial business operators in terms of access to information and capabilities, would offer an appropriate perspective for future studies.

References

Bank of Japan, Institute for Monetary and Economic Studies, Study Group, "*Kin-yu torihiki ni okeru fiduciary" ni kansuru houritsu mondai kenkyukai* (2010), *Kin-yu torihiki no tenkai to shin-nin no shosou* [The Development of Financial Trading and Fiduciary], Kin-yu Kenkyu No. 2010.10, pp 179-263 (https://www.imes.boj.or.jp/research/papers/japanese/kk29-4-9.pdf#search='%E9%87%91%E8%9E%8D%E5%8F%96%E5%BC%95%E3%81%AE%E5%B1%95%E9%96%8B%E3%81%A8%E4%BF%A1%E8%AA%8D%E3%81%AE%E8%AB%B8%E7%9B%B8')

James D. Cox, et. al., (2017) Securities Regulation Cases and Materials (8th ed., Aspen Publishers)

Financial Services Agency, *Heisei 26 jimu nendo kin-yu monitoring kihon hoshin* (Financial Monitoring Policy for 2014-2015) (September 2014, https://www.fsa.go.jp/news/26/20140911-1/01.pdf. English translation is available at https://www.fsa.go.jp/en/news/2014/20141225-1/01.pdf)

Financial Services Agency, *Heisei 27 jimu nendo kin-yu gyousei houshin* (Financial Administration Policy for 2015-2016) (September 2015, https://www.fsa.go.jp/news/27/20150918-1/01.pdf)

Financial Services Agency, *Heisei 28 jimu nendo kin-yu gyosei hoshin* (Financial Administration Policy for 2016-2017) (October 2016, https://www.fsa.go.jp/news/28/20161021-3/02.pdf)

Financial Services Agency, *Kokyaku hon-i no gyoumu un-ei ni kansuru gensoku* (The Principles Concerning Customer-Oriented Business Conduct) (March 30, 2017, https://www.fsa.go.jp/news/28/20170330-1/02.pdf)

Tamar Frankel (2011), Fiduciary Law (Oxford University Press)

Thomas Lee Hazen (2010), Are Existing Stock Broker Standards Sufficient? Principles, Rules, and Fiduciary Duties, 2010 Colum. Bus. L. Rev. 710

Howell E. Jackson (2008), The Trilateral Dilemma in Financial Regulation, in Annamaria

[66] For example, it has been pointed out that some financial products sales companies sell mainly products provided by their affiliates.

Lusardi ed., Overcoming the Saving Slump (University of Chicago Press)
Japan Fair Trade Council of the Medical Devices Industry, "*Iryou kiki gyou kousei kyousou kiyaku" oyobi "iryou kikan tou ni okeru iryou kiki no tachiai ni kansuru kijyun" tou ni tsuite* (https://www.wam.go.jp/wamappl/bb13GS40.nsf/0/6af0037ce99f4fd04925755f00241920/$FILE/20090216_6shiryou4_1.pdf)
Japan Pharmaceutical Manufacturers Association, *Seiyakukyo* Code of Practice (http://www.jpma.or.jp/about/basis/code/pdf/code2.pdf)
Hideki Kanda (2001), *Iwayuru jyutakusha sekinin ni tsuite; Kin-yu sahbisu hou heno kousou* [Regarding so-called Fiduciary Duty; A Plan for a Financial Service Act], Financial Review (Policy Research Institute, Ministry of Finance, Japan) No. 56, pp 98-110 (https://dl.ndl.go.jp/view/download/digidepo_11172731_po_r_56_098_110.pdf?contentNo=1&alternativeNo=)
Kenji Kawamura (2014), in Hideki Kanda et. al. eds, *Kin-yu shouhin torihiki hou* commentary [Commentary on the Financial Instruments and Exchange Act] Vol. 2, Shoji Homu
William R. Jr. Kucera (1996-1997), Hansletter Network v. Shalala: A Model Approach to the Medicare and Medicaid Kickback Problem, 91 Nw. U.L. Rev. 413
Etsuro Kuronuma (2016), *Kin-yu shouhin torihiki hou* [The Financial Instruments and Exchange Act], Yuhikaku
Richard P. Kusserow (1992), The Medicare & Medicaid Anti-Kickback Statute and the Safe Harbor Regulations—What's Next, 2 Health Matrix 49
Nobuko Matsumoto (2017), *Kin-yu bunya ni okeru fiduciary no yougo-hou ni tsuite no ichikousatsu* [Regarding the Use of the Term "Fiduciary" in the field of Financial Law], Yoshihisa Nomi et. al. eds, *Shintaku-housei no shin jidai*, Kohbundo
Nobuko Matsumoto (2019), *2019 nen 6 gatsu ni SEC ga saitaku shita Regulation Best Interest ni tsuite* [Regarding Regulation Best Interest Adopted by SEC in June 2019], Hideki Kanda eds, *Kigyo housei no shourai tembo* 2020, Shihon Shijo Kenkyukai
Naohiko Matsuo (2018), *Kin-yu shouhin torihiki hou* [The Financial Instruments and Exchange Act], 5th ed, Shoji Homu
Anne W. Morrison (2000), An Analysis of Anti-Kickback and Self-Referral Law in Modern Health Care, 21 J. Legal Med. 351
Atsushi Sawaii et. al. (2008), *Koui kisei* [Regulations on Acts], Naohiko Matsuo eds, *Kin-yu shouhin torihiki hou kanren seishourei no kaisetsu*, Bessatsu Shoji Homu No. 318
Daniel Schwarcz (2007), Beyond Disclosure: The Case for Banning Contingent Commissions, 25 Yale L. & Pol'y Rev. 289
Staff of SEC (2011), Study on Investment Advisors and Broker-Dealers (January 2011, https://www.sec.gov/news/studies/2011/913studyfinal.pdf)
Eric S. Tower (1999), Health Care Marketing under the Anti-Kickback Statute, 7 Miami Bus. L. Rev. 513