



Banking in the crosshairs: Investigations by financial regulators and competition authorities in the banking industry – Libor, Forex, what next?

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Certain episodes of benchmark manipulation (Libor, Forex, etc.) have generated global doubt and concern with regards to the integrity of many benchmarks, undermining the integrity of the system and legal and commercial certainty, and resulting in major losses for investors.

- 1. Have the authorities from your jurisdiction proposed or adopted any measures to ensure the necessary integrity of the market and of its benchmarks, guaranteeing that they are not distorted by any conflict of interest, that they reflect economic reality and that they are used correctly? (i.e.: measures to better protect investors, reinforce confidence, address unregulated areas, and/or ensure that supervisors are granted adequate powers to fulfil their tasks)**

Yes. The Diet has passed the amendment to the Financial Instrument Exchange Law (the “FIEL”) in 2014 to be effective in May 2015. The FIEL did not have explicit rules which regulate manipulation of financial benchmarks/indexes, but in response to LIBOR/TIBOR scandal which involved foreign financial institutions doing business in Japan, the FSA proposed the amendment to ensure reliability of specific financial benchmarks/indexes which are widely used as the basis of financial transactions.

Under the amended FIEL, the FSA may specify “Specified Financial Benchmarks/Indexes Calculator” (Article 156-85 of the amended FIEL), corresponding to the Administrator under “Principles for Financial Benchmarks” (“IOSCO Principles”) issued by International Organization of Securities Commissions (“IOSCO”), and the Specified Financial Benchmarks/Indexes Calculator (“SFB Calculator”) is obliged to establish “Operation Rule” the items of which is in line with the IOSCO Principles and to be approved by the FSA (Article 156-87 of the amended FIEL). Also, “Code of Conduct”, which the SFB Calculator is obliged to execute with the “Information Provider” (which corresponds to “Submitters” under the IOSCO Principles such as reference banks, etc.), needs to be listed in the “Operation Rule” and approved by the FSA. For now, only TIBOR is covered for “Specified Financial Benchmarks/Indexes”. The FSA may request report to or conduct investigation of the SFB Calculator, and may order to take improvement measures (Article 156-79 and 156-90 of the amended FIEL). If the SFB Calculator breaches the law, the FSA may order cessation of business up to 6 months (Article 66-20 of the FIEL).

Under the amended FIEL, the Information Provider (Submitter) is indirectly regulated through “Code of Conduct” to be executed with the SFB Calculator (Administrator). In addition to this, the Information Provider which applies to the regulated financial institutions under the FIEL is directly regulated and prohibited to provide information to be used as a basis for calculating reference rate of financial

benchmarks/indexes (“Calculation Basis Information”) without reasonable ground and for the benefit of itself or third parties (Article 38, Item 7 of the amended FIEL), and not only the regulated financial institutions but also their officers and employees are regulated and subject to the same prohibition. Breach of this obligation may be subject to criminal sanction (i.e. imprisonment of 3 years or less and/or fine of JPY 3 million or less) (Article 198, Item 2-3, of the amended FIEL). The FSA may request report to or conduct investigation of the Information Provider (which is not limited to the regulated financial institution under the FIEL) as far as it is necessary to confirm the accuracy of the Calculation Basis Information (Article 156-79, Paragraph 2 of the amended FIEL).

2. Which authority monitors financial bodies in your jurisdiction?

The Financial Services Agency (the “FSA”) does.

3. [For EU and EFTA member states] has your country completed the transposition of Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments (also known as «MiFID II»)? If not, when will transposition be completed?

N/A

4. Have the authorities in your jurisdiction conducted any inquiry on leading banks or institutions in relation anti-trust practices with regards to essential financial information and/or the clearing system?

The Japanese anti-trust authority (i.e. Japan Fair Trade Commission (“JFTC”)) did not take action on LIBOR/TIBOR scandals. However, the FSA took certain measures against financial institutions based in Tokyo as explained below.

The FIEL did not have explicit rules regarding manipulation of financial benchmarks/indexes when the scandal occurred, but the FSA used its authority to inquire regulated financial institutions and applied general provision to Tokyo-based branch/subsidiary of financial institutions (including UBS and Citi to which the trader who actually manipulated TIBOR belonged).

Under the general provision, the FSA may impose cancellation or suspension of licence if the regulated financial institution has conducted unjustified or significantly inappropriate activities, and the said circumstances are considered serious (Article 52, Paragraph 1, Item 9 of the FIEL). The FSA also has power to request change/improvement of practice if it thinks necessary for public interest and

protection of investors (Article 51 of the FIEL. Article 26, Paragraph 1 of the Banking Act provides similar authority to the FSA).

The actual sanctions imposed on financial institutions by the FSA were as follows:

| Name of institution | Statute applied | Date of order | Sanction |
|---|---|------------------|---|
| UBS Securities Japan Ltd., Tokyo branch | Articles 51 and 52, Paragraph 1, Item 9 of the FIEL | 16 December 2011 | Suspension of TIBOR/LIBOR related derivative transaction for 7 days. Improvement order including the establishment of measures to prevent recurrence. |
| UBS AG | Article 26, Paragraph 1 of the Banking Act | 16 December 2011 | Improvement order including the establishment of measures to prevent recurrence. |
| Citi Group Global Markets Japan, Inc. | Articles 51 and 52, Paragraph 1, Item 9 of the FIEL | 16 December 2011 | Suspension of TIBOR/LIBOR related derivative transaction for 14 days. Improvement order including the establishment of measures to prevent recurrence. |
| Citibank Japan Ltd. | Article 26, Paragraph 1 of the Banking Act | 16 December 2011 | Improvement order including the establishment of measures to prevent recurrence. |
| RBS Securities Japan Ltd. | Articles 51 of the FIEL | 12 April 2013 | Improvement order including the establishment of measures to |

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| | | | prevent recurrence. |
| Rabobank Nederland, Tokyo branch | Article 26, Paragraph 1 of the Banking Act | 29 October 2013 | Improvement order including the establishment of measures to prevent recurrence. |

5. Which new requirements have been established in order to reinforce governance and oversight and introducing measures sanctioning those responsible for LIBOR and other index manipulation?

Please see answer to 1 above. The FIEL was amended to enable the FSA to monitor TIBOR transactions. The SFB Calculators (Administrators) are now required to establish “Operation Rule” that is in line with the IOSCO Principles, and the Information Providers (Submitters) are now indirectly regulated through “Code of Conduct” with the SFB Calculators and directly regulated by certain prohibitions and criminal sanctions under the FIEL.

6. Has any similar scandal-malpractice affected your jurisdiction? Have penalties been imposed? and/or administrative or criminal sanctions? If not, which sanctions are foreseen in your jurisdiction for this type of misconducts?

Traders who were based in Japan were involved in LIBOR/TIBOR scandal and the FSA administratively sanctioned the financial institutions as explained above. However, no sanction was imposed on the individuals.

We have not experienced similar scandal regarding financial benchmarks/indexes. However, attempt to manipulate stock market sometimes happen, for example, by putting extraordinary size of order and withdrawing it soon. This may be subject to imprisonment of 10 years or less and fine of JPY 10 million or less (Article 197, Paragraph 1, Item 5 and Article 197, Paragraph 2 of the FIEL).

7. How are the potential conflicts of interest affecting banks or other financial institutions addressed in your jurisdiction? Which requirements are adopted to ensure that benchmarks reflect economic reality and that they are used correctly?

The FIEL stipulates the “honesty and fairness” rules of the regulated financial institutions, their officers and employees (Article 36, Paragraphs 1 of the FIEL). This was originally taken from IOSCO’s “honesty and fairness” principle. Also, based on the concept of “honesty and fairness”, certain regulated financial institutions (financial institutions which operate the Securities Related Business under the FIEL) are required to establish rules to avoid conflict of interests such as to set Chinese wall and/or to obtain informed consent from the clients (Article 36, Paragraphs 2 of the FIEL. Article 13-2 of the Banking Act stipulates similar provision to avoid conflict of interests).

Those rules were not directly applied to LIBOR/TIBOR scandals in Japan, but maintenance of fairness in the market was one of the factors that the FSA considered when imposing administrative sanctions to the financial institutions.

Japan Bankers Association (“JBA”) which was the issuer of TIBOR benchmark at the time scandal occurred established an independent organization named “JBATA” (Japan Banking Association TIBOR Administrator) on 1 April 2014 for the purpose to strengthen the governance and secure the fairness and transparency as an administrator. It is planned that JBATA will be the SFB Calculators under the amended FIEL. JBATA also adopted a code of conduct (“JBATA Code of Conduct”) which is planned to be “Code of Conduct” under the FIEL and to be executed with the Information Provider (reference bank). Under “JBATA Code of Conduct”, in order to strengthen the governance of the Information Provider, various arrangements to avoid the conflict of interest when the reference rate of financial benchmarks/indexes are provided are required such that (i) establishment of rules to avoid conflict of interests, (ii) prohibition of information exchange and adjustment of the reference rate, etc.

8. Are any measures foreseen in your jurisdiction for the protection of “whistleblowers”?

The Whistleblower Protection Act protects employees for their “whistleblowing” if such whistleblowing is not done for unjustifiable purpose and in relation to breach or likelihood of breach of listed statutes. The FIEL and Anti-Monopoly Act are one of the listed statutes with respect to which whistleblowers are protected.

9. Is there any measure in place in your jurisdiction to guarantee suitable and appropriate evaluation of benchmarks?

As explained in 1 above, manipulation of TIBOR is now a direct breach of the FIEL and may be subject to criminal sanctions. In addition, as explained in 7 above, JBA has established a self-regulated organisation (JBATA) which plans to issue TIBOR benchmark as the SFB Calculators under the amended FIEL in order to strengthen the governance and to improve the fairness and transparency.

10. Which requirements and/or transparency rules –if any- are undertaken in your jurisdiction in order to prevent distortions of competition resulting from divergences between other national laws and/or to provide more legal certainty for market participants? (i.e. to prevent or limit regulatory complexity and potential regulatory arbitrage)

As explained in 5 and 7 above, Japanese regulators are basically following/respecting the principles adopted by IOSCO to ensure harmonisation with international standards or laws in other jurisdictions. They are sometimes incorporated into the regulations directly or used indirectly as guidelines.