Financial Consumer Protection in Japan

2012.12.14

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*Any views expressed in this presentation are those of the speaker, and are not necessarily the official views of the FSA.*
Authorities over Consumer Protection

◆ **Consumer Affairs Agency**: 消費者庁
--- Control tower of consumer protection issues
  - With overall responsibility for consumer protection: working on any consumer problems other agencies are not responsible for
  - Collecting and analyzing relevant information for consumer protection
  - Disseminating risk information and warning timely

◆ **Financial Services Agency (FSA)**：金融庁
--- Responsible for Financial Consumer Protection (FCP)
  - As the regulator, supervisor and inspector across the sectors (banking, securities and insurance), FSA
    - Issues regulations for financial consumer protection
    - Supervises and inspects financial institutions and non-banks
    - Takes legal actions (e.g. administrative actions) as necessary
Legal Structure for FCP in Japan

- There is no uniform FCP law in Japan, but FCP has legal bases.
- Conduct regulations for FCP (e.g. Point of Sales Disclosure and ADR) are stipulated in each sector law.
  - Financial Instruments and Exchange Act (Securities)
  - Banking Act (Banking)
  - Insurance Business Act (Insurance)
- In addition, there is a special statute to shift burden of proof for FCP.

⇒ Financial Instruments Sales Law provides that a financial institution (FI) shall be held liable for a consumer’s loss if the consumer proves the FI did not meet the disclosure requirement. (strict liability)
Measures for FCP in Japan -- ex-ante

Financial Education (to reach out to the people)

- Financial education is the best way to prevent financial frauds: i.e. enhancing financial literacy through collaboration with financial institutions and relevant government agencies.
- The Japanese Government has adopted the National Strategy for financial education, and FSA’s study group is discussing how to strengthen and improve financial literacy.

Conduct regulations (regulating financial institutions)

As mentioned above, financial institutions are required by law to:

- Disclose Key information in a written document before making a contract of investment products (Point of Sales Disclosure) ; and
- Ensure that the degree of disclosure to their consumers is commensurate with the nature of the offered transactions, consumers’ knowledge and experience.
Measures for FCP in Japan -- ex-post

**Alternative Dispute Resolution (ADR) (effective 2010)**

- Resolving FCP disputes flexibly and expeditiously.
  - ADR is available for all sorts of financial products and services.
  - ADR procedure is started when a case is brought by either party.
  - A draft ADR settlement shall be respected by both parties, but either party is free to take the case to judicial proceedings.
  - ADR scheme (including its operational rules) is supervised by FSA.
  - In 2011, 1,981 cases were brought to ADR, 1,506 cases concluded.

**Counseling Office for Financial Services Users in FSA**

- Complaints and suggestions on financial services are reported to this office. (around 10,000 cases annually)
  - e.g. unreasonable refusal to lend, forceful solicitation activity
- Reporting financial consumers get advice from this office, which gives feedback to relevant FSA staff (policy makers).
- Features of reported transactions are disclosed.
In Feb. 2008, “Multiple debtors” (hereinafter defined as debtors who have had 5 borrowings or more) were 1.8 million in number.

Multiple debtors had 2.4 million outstanding loans per debtor.

This problem was attributable to:
- high interest rates;
- risk-taking business model resulting in excessive lending;
- and debtors’ lack of knowledge about risk of accumulated debt.

⇒ Amendment of the Money Lending Business Act in 2006
Legal reforms to regulate 1) compliance of non-bank lenders, 2) lending transactions and 3) black-market lending activities
The challenges FSA has addressed (1)

--- Consumer Credits:

[Amendment of Money Lending Business Act in 2006 (2)]

1. Stipulating tougher prudential and compliance rules
   -- Raising minimum net assets from $5 million to $50 million
   -- Requiring appointment of “Chiefs of Money Lending Operations” who are officially qualified

2. Enhancing lenders’ disciplines to ban inappropriate activities (e.g. obstinate debt collection).

3. Authorizing FSA to act proactively by issuing business improvement order to lenders

--- Regulation of lending

1. Introducing a cap system for the total lending by non-bank lenders (e.g. one-third of the debtor’s annual income)

2. Requiring lenders to report borrower’s debt information to the designated credit information agencies to enforce 1. above effectively.

3. Lowering the cap of lending rate from 29.2% to 20%

--- Regulating black-market lending

Strengthen penalties against black-market lending (e.g. maximum imprisonment: 5 years → 10 years)
The challenges FSA has addressed (1)  
--- Consumer Credits:  
[Amendment of Money Lending Business Act in 2006 (3)]

- Significant improvement has been achieved since the Act was revised.

[Data on unsecured and unguaranteed loans from non-bank lenders]

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<td>Outstanding loan per debtor</td>
<td>1169</td>
<td>1066</td>
<td>957</td>
<td>797</td>
<td>671</td>
<td>590</td>
<td>557</td>
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<td>(thousand yen)</td>
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<td>Number of debtors who have had 5 borrowings or more (10 thousand)</td>
<td>171</td>
<td>118</td>
<td>73</td>
<td>84</td>
<td>70</td>
<td>44</td>
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Fraudulent investment reports published by AIJ Investment Advisors attracted investors (e.g. pension funds), who ended up with huge losses. (AIJ lost $109.2 billion in total from derivative transactions.)

Small pension funds (e.g. for taxi drivers) without sufficient investment expertise also suffered.

FSA has made proposals including effective oversight mechanism by a third party (e.g. by a trust bank that entrusted its funds to an investment fund), and severer non-compliance penalties.

Examples of severer penalties against offenders:

(i) Making false statements in Investment reports delivered to customers: (Imprisonment or fine: not more than 6 months → not more than 3 years)

(ii) Making false statements in the course of solicitation: (Imprisonment or fine: not more than 1 year → not more than 3 years)

(iii) Concluding contracts for discretionary accounts by fraudulent means. (Imprisonment or fine: not more than 3 years → not more than 5 years)
Since 2006, it was brought to attention that life insurance claims had not been fully paid.

FSA ordered life insurance companies to improve internal control systems to expedite full payments.

The Challenges FSA has addressed (3)

--- Insurance: Insufficient insurance payments

- Since 2006, it was brought to attention that life insurance claims had not been fully paid.
- FSA ordered life insurance companies to improve internal control systems to expedite full payments.
Thank you for your attention.