Investment Services Regulation in Germany and Japan

by

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This article studies the protection of retail and professional investors when financial products are sold or when investment advice is given. To this end, it clarifies the similarities and differences in the legal setting governing investment services firms in Germany and Japan, with a particular focus on a) the persons to be protected, b) information to be provided and c) private enforcement. Although regulatory structures are largely divergent in these two jurisdictions, the legal situation converges in several important points in relation to lawmaking in the European Union and the United States. Those convergences appear informative for the development of laws in jurisdictions other than Germany and Japan.

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Note: Some sections of this article are based on Harald Baum, Information Duties under German Capital Markets Law, in: Marc Dernauer/Harald Baum/Moritz Bälz (ed.), Information Duties: Japanese and German Private Law, 2018, p. 217–236, and Toshiaki Yamanaka/Gen Goto, Information Duties under Japanese Capital Markets Law, *ibid.*, p. 209–216.

European regulatory materials and the (semi-)official translations of Japanese legal texts sometimes differ in their terminology. We use pertinent terms such as "client(s)" (European regulatory sources) and "customer(s)" (Japanese legal sources), where possible, synonymously.

1. Research Agenda and Background

1-1. Research Agenda

This article considers the protection of retail and professional investors when financial products are sold to them or when investment advice is given to them. To this end, it focuses on Germany and Japan, and highlights the similarities and differences in the legal setting governing investment services firms in these jurisdictions. It also discusses what is called the "information model" and its limits or shortcomings. The model has long been and still is the underlying concept for modern information-based investor protection.

Regarding information duties, Germany has a fairly detailed set of regulations regarding the information that has to be provided in the presence of investment services by different players, especially investment services firms.[1] Its regulatory setting is characterized by a mix of supranational, *i.e.* European Union (EU), and national statutory provisions. Furthermore, German courts were overwhelmed with investor suits in the aftermath of the global financial crisis, and there are countless decisions including many by the Federal Supreme Court dealing with a broad spectrum of information-related issues.[2] In contrast, the Japanese capital market legislation provides less complicated provisions on the information to be provided in the same context, which is of purely national character.[3] Japanese courts have delivered several important judgments on the liability of securities companies for breach of information duties

1 See *infra* at 4–1.
2 See *infra* at 4–1-2.
3 See *infra* at 4–2-1 and 4-2-2.

to their customers.[4] In this context, Japan's Supreme Court did not establish a detailed general ruling to judge whether there is a breach of information duties, and the lower courts consider individual facts in individual cases.[5] The legal situation in Germany and Japan, including those judgments, are examined in this article.

This article is organized as follows. The rest of this section introduces the information model as the conceptual basis of modern capital market law, and it highlights the influences from EU law and U.S. securities regulations on German and Japanese law, respectively. Section 2 sheds some light on the regulatory frameworks and their underlying principles in Germany and Japan. Section 3 discusses the persons to be protected. Section 4 analyzes the question of what information has to be provided, and Section 5 deals with enforcement issues. The final Section 6 draws conclusions.

1-2. Modern Capital Market Law

General investors purchasing financial products do not have financial expertise or a continuous business relationship with an issuer company. Capital markets law (as it is called in Europe), or securities regulations (as in the U.S.),[6] has become increasingly important for investor protection and market functioning. It was either extended, as in Japan, or had to be created as a field of law in its own right approximately 20 years ago, as in Germany.[7]

In this article, we distinguish between shareholder and investor protection and focus on the latter. Shareholder protection is traditionally provided by company law and by some additional rules governing trading on a stock exchange, whereas investor protection is a fairly new concept which is based on capital markets law and encompasses all kinds of investments in publicly traded financial instruments.[8]

4 See *infra* at 4–2-3.

5 See *infra* at 4–2-3-5.

6 In Japan, terminologies appear to be not firmly established, compared to Europe and the U.S. Some common expressions seem to include; "*shōken torihiki kisei*" (securities transactions regulation) or "*kin'yū shōhin torihiki kisei*" (financial instruments transactions regulation).

7 See *infra* at 2–2 and 2-1, respectively.

8 See *Klaus J. Hopt*, Investor Protection, in: Jürgen Basedow/Klaus J. Hopt/Reinhard Zimmermann/Andreas Stier (ed.), The Max Planck Encyclopedia of European Private Law, 2012, Vol. II, p. 996–997.

1-3. Concept and Aims of Capital Market Regulation

In a focused narrow understanding, the term capital markets law means the "rules which deal with the constitution of the capital markets".[9] These include the rules governing transactions in the primary market (tripartite transactions among issuers, financial institutions and investors) and those in the secondary market (transactions between investors and financial intermediaries of various kinds).[10] This article focuses on the regulation of transactions in the secondary market. Specifically, we focus on the relationship between investment services firms and investors, and thus not on the disclosure duties of an issuer company or on the prohibition of insider trading or market abuse. The pertinent rules can be partly of public law nature and partly belong to the sphere of private law.[11] Additionally, criminal law can come into play, but it is not discussed here in detail.

The regulatory aim in Germany is the promotion of allocational, operational and institutional efficiency of capital markets.[12] This aim overlaps with that in Japan.[13] The regulation rests on some fundamental assumptions.[14] First, existing capital markets are at least moderately efficient.[15] Second, the market's functioning depends on the indispensable trust of the market participants. Third, the participants' trust depends in turn on sufficient investor protection.[16] Fourth, for securing sufficient protection, it is crucial to solve the problems arising from information asymmetries and conflicts of interests. Fifth, to achieve this aim, all relevant information should be made available in a timely fashion and without distortion. Sixth, to this end mandatory information (and disclosure) duties have been regarded, until very recently, as the most suitable

9 *Klaus J. Hopt*, Capital Markets Law, in: Jürgen Basedow/Klaus J. Hopt/Reinhard Zimmermann/Andreas Stier (ed.), The Max Planck Encyclopedia of European Private Law, 2012, Vol. I, p. 141.

10 *Ibid.*

11 See *infra* at 4–1-2-1.

12 See *Hopt* (fn. 9), p. 142; *Christopher P. Buttigieg/John A. Consiglio/Gerd Sapiano*, "A Critical Analysis of the Rationale for Financial Regulation Part II: Objectives of Financial Regulation", European Company and Financial Law Review (ECFR) 2020, 437–477; *Rüdiger Veil* in: id. (ed.), European Capital Markets Law, 2nd ed., 2017, p. 23 et seq.

13 See Art. 1 of the Financial Instruments and Exchange Act. See *infra* at 1–4-2 and 2-2-1.

14 For a discussion see *Katja Langenbucher*, "Anlegerschutz: Ein Bericht zu theoretischen Prämissen und legislativen Instrumenten", Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht (ZHR) 177 (2013), 679–701; *Christopher P. Buttigieg/John A. Consiglio/Gerd Sapiano*, "A Critical Analysis of the Rationale for Financial Regulation Part I: Theories of Regulation", European Company and Financial Law Review (ECFR) 2020, 419–436; *Veil* (fn. 12), p. 87 et seq.

15 *Langenbucher* (fn. 14), 680 et seq.

16 See *Klaus J. Hopt*, Die Haftung für Kapitalmarktinformationen, in: Susanne Kalss/Ulrich Torggler (ed.), Kapitalmarkthaftung und Gesellschaftsrecht, 2013, p. 55, 58.

means.[17] Therefore, modern investor protection has so far been based on what is called the "information model": if investors have received all relevant information in an appropriate form – and thus information asymmetries are deemed to be resolved – they are bound to the investment contract and have to bear the economic consequences of their own investment decision.[18] Sensibly, the relevant scope of information can be different, according to the types of financial services and customers.[19]

Recently, however, doubts have grown as to the validity of the fundamental assumption that a properly informed investor will make a reasonable investment decision in all circumstances. Researches in behavioral finance have shown that the ordinary investor does not always behave rationally, as aptly expressed by concepts such as bounded rationality, financial illiteracy and information overload.[20] It has been gradually recognized that too much and/or overly complex information may lead to a non-reception of information due to cognitive limits ("information overload").[21] The fallout from the global financial crises has amplified these doubts.[22] Empirical studies show that private investors without knowledge about financial markets or investment advice are systematic losers in the markets.[23] The simplification of mandatory information

17 For an interdisciplinary state-of-the-art discussion see *Klaus Ulrich Schmolke*, Information and Disclosure Duties from a Law-and-Economics Perspective – A Primer, in: Marc Dernauer/Harald Baum/Moritz Bälz (ed.), Information Duties: Japanese and German Private Law, 2018, p. 3–24.

18 See *Florian Möslein*, Disclosure, in: Basedow/Hopt/Zimmermann/Stier (ed.) (fn. 9), p. 470.

19 See *infra* at 3.

20 See *Schmolke* (fn. 17), p. 12 et seqq.; *Veil* (fn. 12), p. 94 et seqq.; *Martin Brenncke*, "The Legal Framework for Financial Advertising: Curbing Behavioural Exploitation", European Business Organization Law Review (EBOR) 19 (2018), 853–882; *Lars Klöhn*, Der Beitrag der Verhaltensökonomik zum Kapitalmarktrecht, in: Holger Fleischer/Daniel Zimmer (ed.), Beitrag der Verhaltensökonomie (Behavioral Economics) zum Handels- und Wirtschaftsrecht, 2011, p. 83–99; for a comprehensive discussion see *Joshua C. Teitelbaum/Kathryn Zeiler* (ed.), Research Handbook on Behavioral Law and Economics, 2018.

21 For details, see, *e.g., Carolin Stahl,* Information Overload am Kapitalmarkt, 2013; *Philipp Hacker*, Verhaltensökonomik und Normativität, 2017, p. 429 et seqq.

22 For a normative discussion, see *Susanne Kalss*, Das Scheitern des Informationsmodells gegenüber privaten Anlegern, in: Gutachten für den 19. Österreichischen Juristentag, Bd. II/1, 2015, p. 7 et seqq.; *Hans Christoph Grigoleit,* Grenzen des Informationsmodells, in: Mathias Habersack/Peter O. Mülbert/Gerd Nobbe/Arne Wittig (ed.), Anlegerschutz im Wertpapiergeschäft. Bankrechtstag 2012, 2013, p. 25–64.

23 *Brad M. Barber/Yi-Tsung Lee/Yu-Jane Liu/Terrance Odean*, "Just How Much Do Individual Investors Lose by Trading?", Review of Financial Studies 22 (2009), 609–632. For further references, see *Paolo Giudici*, Independent Financial Advice, in: Danny

is one attempt to mitigate the problem.[24] Furthermore, in an era of a conceptual paradigmatic change, product intervention by the relevant supervisory authorities is considered as an alternative or a supplement to the information model.[25]

The most important, however, is the new regulatory emphasis on the role played by financial intermediaries. The intermediation by financial advisors is regarded as the most appropriate solution to the problem of insufficient gathering and evaluation of information.[26] The regulator's expectation is that the intermediation by an investment firm transforms the broad and constantly changing *public* information generated by mandatory disclosure rules in the primary and secondary markets into a kind of *customized* information which a retail investor can use individually for his or her investment decision. The customized information has to be tailored exclusively for the individual investor and must not be distorted in any way by the investment firm or any other parties having potentially conflicting interests. Consequently, conflicts of interests are the subject of increasing regulatory attention.[27]

1-4. Influences from the U.S. and the EU

The regulation of stock exchanges has a long history in Europe, reaching back centuries, with the first modern (statutory) exchange laws dating from the 19th century.[28] Germany enacted its Stock Exchange Act in 1896.[29] It is noted that Japan started its first organized exchange for trading futures in rice in the form of standardized contracts in 1730 in Osaka.[30] After that, the country's stock exchange law was enacted in 1893.[31]

Busch/Guido Ferrarini (ed.), Regulation of the EU Financial Markets: MiFID II and MiFIR, 2017, at 6.06.

24 See *infra* at 4–1-1-3.

25 See *infra* at 2-1-5.

26 See *Stefan Grundmann*, in: Claus-Wilhelm Canaris/Mathias Habersack/Carsten Schäfer (ed.), Großkommentar HGB, 8. Teil, 2018, mn. 37.

27 See *infra* at 2–1-3 and 2-2-5, respectively.

28 A comparative historical overview can be found in *Hanno Merkt*, Zur Entwicklung des deutschen Börsenrechts von den Anfängen bis zum Zweiten Finanzmarktförderungsgesetz, in: Klaus J. Hopt/Bernd Rudolph/Harald Baum (ed.), Börsenreform, 1997, p. 17–142; *Andreas Fleckner*, Exchanges, in: Basedow/Hopt/Zimmermann/Stier (ed.) (fn. 9), p. 658.

29 The original version of the Act is reprinted in *Hans Pohl*, Deutsche Börsengeschichte, 1992, p. 377 et seqq.

30 *Ulrike Schaede*, Der neue japanische Kapitalmarkt. Finanzfutures in Japan, 1990, p. 37 et seqq.

31 *Torihikijo-hō*, Act No. 5/1893 (available in Japanese at the National Diet Library website: http://dl.ndl.go.jp/info:ndljp/pid/787990/13 [accessed 30 April 2021]).

However, modern capital market law was more recently established in both Germany and Japan. It developed in the 20th century starting with the Securities Act of 1933 and the Securities Exchange Act of 1934 in the U.S., which are administered by the Securities and Exchange Commission as a central independent agency.[32] This regulatory model spread indirectly to Germany via European Community law, but directly to Japan.

Japan reshaped its pertinent regulations as early as the late 1940s according to the framework in the U.S.[33] Ever since, developments in the U.S. securities regulation are given special attention in Japan. In Germany, by contrast, modern capital market regulation developed much later and under the influence of EU law. Developments in U.S. securities regulation may sometimes be reflected in EU regulations, but they are much less important to national legislators in the Member States than to those in Japan.

1-4-1. The European Concept and Its Shaping of German Capital Market Law

In Germany, the first major step in creating a modern capital market regulation was the enactment of the *Securities Trading Act*, the *Wertpapierhandelsgesetz* (WpHG), in 1994.[34] The WpHG implemented the EU's *Investment Services Directive* of 1993,[35] the core regulatory instrument at that time within the EU, into Germany's domestic law. Since then, the German Act has been amended numerous times to adopt a multitude of increasingly comprehensive reforms of the pertinent EU regulation, namely the *Markets in Financial Instruments Directive* (MiFID I) of 2004,[36] which replaced the Directive of 1993, and the revised *Directive on Markets in Financial Instruments* of 2014

32 A classical analysis of the U.S. regulatory setting can be found in *Louis Loss*, Fundamentals of Securities Regulation, 1983, p. 38 et seqq.

33 See *infra* at 1–4-2. For a brief historical overview in German, see *Harald Baum*, Börsen- und Kapitalmarktrecht in Japan, in: Hopt/Rudolph/Baum (ed.) (fn. 28), p. 1265, 1274 et seqq.

34 Gesetz über den Wertpapierhandel (Wertpapierhandelsgesetz – WpHG), vom 26. Juli 1994 (BGBl. [Federal Law Gazette] I p. 1749), in der Fassung der Bekanntmachung vom 9. September 1998 (BGBl. I p. 2708), as amended by the Act of 17. August 2017 (BGBl. I p. 3202).

35 Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field, Official Journal L 141, 11.6.1993, p. 27.

36 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, Official Journal L 145, 30.4.2004, p. 1.

(MiFID II),[37] which for its part replaced MiFID I and whose rules have been applied since 3 January 2018.[38] Thus, from the beginning, EU law – and not national legislation as in Japan – has been the decisive factor in shaping modern capital market regulation in Germany.[39] This regulatory pattern will be reinforced with the creation of the future EU Capital Market Union.[40]

The three just-mentioned Directives – together with the accompanying regulatory instruments – have been regarded as the "basic law" of EU financial markets and the central building block for the EU regulatory architecture that governs the provision of investment services throughout the EU. It primarily promotes market integration by granting market access and integrity by regulating market supervision. As part of this, it also emphasizes investor protection as a regulatory goal. Accordingly, the Directives pursue the two-fold aim of ensuring the smooth operation of securities markets and protecting investors.[41]

EU Regulations come in two forms: either as a directive requiring implementation by domestic laws in the Member States or, increasingly, as a regulation directly applicable in the Member States without any implementation. Prominent examples for the latter are the *Market Abuse Regulation* of 2014[42] and the *Markets in Financial Instruments Regulation* (MiFIR) of 2014.[43] MiFIR sup-

37 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, Official Journal L 173, 12.6.2014, p. 349.

38 An informative overview can be found in Busch/Ferrarini (ed.) (fn. 23).

39 The present degree of harmonization of German investor protection in conformity with EU law is analyzed in *Sebastian Kasper*, "Harmonisierungsgrad der Anlegerschutzbestimmungen nach der MiFID II", Wertpapier-Mitteilungen (WM) 2021, 60–67 (Part I), 101–106 (Part II).

40 Cf. *Katja Langenbucher*, "Building a Capital Market – the Final Report of the High Level Forum on the EU Capital Market Union", European Company and Financial Law Review (ECFR) 2020, 601–618; *Miriam Parmentier*, "Capital Markets Union – One Year On From the Action Plan", European Company and Financial Law Review (ECFR) 2017, 242–251.

41 Cf. Recital 44 of MiFID I, Recitals 3, 7 (et passim) of MiFID II; for a critical review of the specific aims and means of investor protection, see *Peter O. Mülbert*, "Anlegerschutz und Finanzmarktregulierung – Grundlagen", Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht (ZHR) 177 (2013), 160–211.

42 Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC, Official Journal L 173, 12.6.2014, p. 1.

43 Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012, Official Journal L 173, 12.6.2014, p. 84.

plements MiFID II and should therefore be understood together with that Directive.[44] As far as they apply, regulations directly replace the pertinent domestic laws of the Member States. All directives are accompanied by delegated regulatory instruments.[45]

1-4-2. U.S. Securities Laws and Their Impact on the Legal Situation in Japan

It has been pointed out that in the course of economic reforms following the end of the Second World War, Japanese financial market law found itself extensively revised according to the U.S. model.[46] In Japan, the Securities and Exchange Act (*Shōken torihiki-hō*) was enacted in 1947[47] and totally amended in 1948.[48]

A representative government official at the Ministry of Finance who played an important role in the amendment documented the following reasons for the amendment.[49] Firstly, it became necessary to have in an Act certain provisions which were initially planned to be included in an Ordinance related to the 1947 Act.[50] Secondly, there was a policy change to increase the power of the Securities and Exchange Commission (*shōken torihiki i'in-kai*) and to make it an administrative bureau which independently conducts securities administration.[51] Thirdly, with regard to a framework for licensing allowing the initiation of securities businesses (*shōken-gyō*) and establishing a securities exchange (*shōken torihiki-jo*), it became necessary to amend the 1947 Act in harmony with the idea adopted by the Act on Prohibition of Private Monopolization

44 Cf. Recital 7 of MiFID II.

45 For an overview of the EU's regulatory architecture, see *Veil* (fn. 12); *Niamh Moloney*, EU Securities and Financial Markets Regulation, 3rd ed., 2014; for a discussion of recent developments see *Elke Gurlit*, "Die Entwicklung des Banken- und Kapitalmarktaufsichtsrechts seit 2017", Wertpapier-Mitteilungen (WM) 2020, 57–75 (Part I), 105–115 (Part II).

46 *Harald Baum/Hideki Kanda*, "Financial Markets Regulation in Japan", Journal of Japanese Law 44 (2017), 65, 67. See *Hiroyuki Kansaku*, Der Einfluss des deutschen und amerikanischen Rechts auf das japanische Gesellschafts- und Kapitalmarktrecht, in: Harald Baum/Moritz Bälz/Karl Riesenhuber (ed.), Rechtstransfer in Japan und Deutschland, 2013, p. 143, 151–152.

47 Act No. 22/1947 (available in Japanese at the National Diet Library website: http://dl.ndl.go.jp/info:ndljp/pid/2962573/2 [accessed 30 April 2021]).

48 Act No. 25/1948 (available in Japanese at the National Diet Library website: http://dl.ndl.go.jp/info:ndljp/pid/2962904/6 [accessed 30 April 2021]).

49 *Shun Okamura*, Kaisei shōken torihiki-hō kaisetsu [Commentary on the Amended Securities and Exchange Act], 1948, p. 4 et seq.

50 *Ibid.*, p. 4.

51 *Ibid.*

and Maintenance of Fair Trade (*Shiteki dokusen no kinshi oyobi kōsei torihiki no kakuho ni kansuru hōritsu*).[52] Fourthly, it became necessary to adopt in an Act provisions found in the U.S. Securities Act of 1933 and in the U.S. Securities Exchange Act of 1934, additions which were seen as appropriately adopted in Japan's institutional framework.[53]

Against this backdrop, the entire amendment of the 1947 Act in 1948 was modeled on the Securities Act of 1933 and the Securities Exchange Act of 1934 in the U.S. In 2006, the amended Act was redrafted and consolidated in the Financial Instruments and Exchange Act (*Kin'yū shōhin torihiki-hō*, hereinafter, "FIEA") (effective from September 2007).[54] Before the consolidation, several statutes had been enacted for different individual investment objects and services, for example, the Securitized Mortgage Act (*Teitō shōken-gyō-hō*)[55] and the Financial Futures Act (*Kin'yū sakimono torihiki-hō*).[56] The legal situation at that time was considered insufficient in that financial instruments and services were not comprehensively or systematically regulated.[57] This constituted the motivation for the consolidation in 2006.

Further, the Act on Sales, etc. of Financial Instruments (*Kin'yū shōhin no hanbai-tō ni kansuru hōritsu*, hereinafter, "ASFI") was enacted in 2000 (effective from April 2001), which consisted of only nine articles at that time.[58] The ASFI was not consolidated in the FIEA even though the ASFI was also amended in 2006.[59] In 2020, the ASFI was amended and renamed the Act on Provision of Financial Services (*Kin'yū sābisu no teikyō ni kansuru hōritsu*, hereinafter, "APFS").[60]

52 Act No. 54/1947. *Okamura* (fn. 49), p. 4.

53 *Okamura* (fn. 49), p. 4.

54 Act No. 65/2006. For an informal English translation of Japanese acts and related legal rules, see, the website of Japan's Ministry of Justice (http://www.japaneselawtranslation.go.jp/ [accessed 30 April 2021]). For a systematic introduction to the FIEA, see *Hiroyuki Kansaku/Yoko Manzawa/Naohiko Matsuo/Sadakazu Ōsaki/Masakazu Shirai/Masao Yanaga,* Japanese Financial Instruments and Exchange Act, 2018.

55 Act No. 114/1987.

56 Act No. 77/1988.

57 See *Hidenori Mitsui/Yūichi Ikeda* (supervising editors), *Naohiko Matsuo* (the author and editor), Ichimon ittō kin'yū shōhin torihiki-hō [Questions and Answers on the Financial Instruments and Exchange Act], revised ed., 2008, p. 7.

58 Act No. 101/2000.

59 Art. 182 of Act No. 66/2006.

60 Act No. 50/2020. This amendment introduced new provisions on financial services intermediary businesses (*kin'yū sābisu chūkai-gyō*) and made it possible to provide intermediary services in all fields of banking, securities and insurance by means of a single registration as a financial services intermediary business operator (*kin'yū sābisu chūkai-gyōsha*). The APFS has 105 articles. The APFS is currently not in force (as of April 2021)

2. Regulatory Framework and Regulatory Principles

2-1. Germany

2-1-1. The Securities Trading Act (WpHG) as the Basic Law

The Lehman shock of 2008 and the ensuing global financial crises led to a regulatory surge in the EU and its Member States, including Germany, that still reverberates. The capital market law regime in Germany has since that time been in constant flux: as many as approximately 40 legislative measures have been enacted since 2008.[61] The German regulatory landscape is clearly more diverse than its Japanese counterpart. The Japanese FIEA of 2006 is a comprehensive piece of legislation that covers most activities in capital markets from public offerings to securities trading, stock exchanges and tender offers.[62] The scope of the much shorter WpHG is significantly more restricted by comparison. But nevertheless, the WpHG constitutes the legislative foundation of German capital market regulation. Its regulatory characteristic is a market-based approach.[63] Partly for historical reasons and partly because of the regulatory dynamics within the EU, other various and specific laws dealing with different activities in the capital markets complement the WpHG. All of these stipulate varying information duties as a means of investor protection: the Securities Prospectus Act (*Wertpapierprospektgesetz*),[64] the Capital Investment Act (*Kapitalanlagegesetzbuch*),[65] the Stock Exchange Act (*Börsengesetz*),[66] and the Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*)[67] to name but some. Further, since 2016, the *Market Abuse Regulation*[68] has replaced those previous sections of the WpHG that

and will be in effect by December 2021. Accordingly, in our article, pertinent provisions are cited from both the ASFI and APFS.

61 See *Petra Buck-Heeb*, "Entwicklung und Perspektiven des Anlegerschutzes", Juristen-Zeitung (JZ) 2017, 279.

62 See *infra* at 2–2-1.

63 See *Andreas Fuchs*, id. (ed.), WpHG, 2nd ed., 2016, Einl., mn. 4f.

64 Wertpapierprospektgesetz vom 22. Juni 2005 (BGBl. I S. 1698). This Act is, however, of secondary importance subsequent to the 21 July 2019 entry into force of the directly applicable Regulation (EU) 2017/1129 of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC, Official Journal L 168, 30.6.2017, p. 12; see *Jonathan Bauerschmidt*, "Die Prospektverordnung in der europäischen Kapitalmarktunion", Zeitschrift für Bank- und Kapitalmarktrecht (BKR) 2019, 324–332.

65 Kapitalanlagegesetzbuch vom 4. Juli 2013 (BGBl. I S. 1981).

66 Börsengesetz vom 16. Juli 2007 (BGBl. I S. 1330, 1351).

67 Wertpapiererwerbs- und Übernahmegesetz vom 20. Dezember 2001 (BGBl. I S. 3822).

68 *Supra* note 42.

dealt with insider trading and market abuse. Since 3 January 2018, the MiFIR and its additional delegated regulations are directly applicable, partly replacing sections of the WpHG, partly supplementing the Act.[69] The WpHG was substantially revised in 2017 in order to implement MiFID II into German law. The major parts of the revised WpHG entered into force on 3 January 2018. In short, German capital market law is a kaleidoscope of regulations, in the sense that it has always been changing and features many details.

Rules on various kinds of information duties can be found in all of the capital-markets-related laws mentioned above. Of comparative interest here are those rules dealing with the professional handling of financial products. These are concentrated in the WpHG. The Act regulates, among other items, the providing of investment services.[70] Investment services within the meaning of the Act include, among others and broadly speaking, the promotion, recommendation, offering, purchase or sale of financial instruments.[71] Financial instruments within the meaning of the Act are namely shares in companies, debt securities and derivatives.[72]

The relationship between "investment services firms" (*Wertpapierdienstleistungsunternehmen)*, mostly banks in Germany,[73] and their clients is regulated in Part 11 of the WpHG[74] under the heading "Conduct of business obligations, organizational requirements, transparency obligations". These issues constitute the regulatory heart of the WpHG after the rules on disclosure in the secondary market and the prohibition of insider trading and market abuse were transferred into the *Market Abuse Regulation*.[75] The rules of conduct are shaped by the following core principles.

69 Of special interest in this context is the Commission Delegated Regulation (EU) 2017/565 of 25 April 2016, supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, Official Journal L 87, 31.3.2017, p.1; applicable in the EU Member States since 3 January 2018.

70 Sec. 1 (1) WpHG.

71 Sec. 2 (8) WpHG.

72 Sec. 2 (4) WpHG.

73 Sec. 2 (10) WpHG.

74 Secs. 63 to 96 WpHG.

75 Cf. *supra* note 42.

2-1-2. Acting in the Interest of the Client

The central Sec. 63 WpHG stipulates general rules of conduct for investment services firms.[76] The basic rule is found in Sec. 63 (1) (i) WpHG: Investment services firms are required to provide all investment services in the sole and best interests of their clients and with the appropriate degree of expertise, care and diligence. The overarching duty is to act without exception in the best interest of the client – a most honorable principle but difficult to ensure. These general principles are put in concrete form and enforced by a plethora of information, inquiry and other conduct duties.

2-1-3. Prevention of Conflicts of Interest

A central regulatory aim of the reform initiated by MIFID II was the prevention of conflicts of interests.[77] European legislators regarded conflicts of interests as a major source for distortion of the customized information provided by investment services firms to investors and thus as a danger for a successful information intermediation by the former.[78] Three regulatory strategies are cumulatively applied to prevent or at least to manage conflicts of interests: a) various far-reaching organizational duties imposed on investment services firms, b) additional transparency obligations and c) a principal duty to abstain from accepting inducements from third parties (there are practically important exceptions if certain safeguards are guaranteed).[79]

2-1-3-1. Organizational Duties

Wherever possible, investment services firms have to avoid conflicts of interest and put in place appropriate organizational measures for that purpose.[80] They

76 Supplemented by specific rules of conduct in the context of investment advice and portfolio management in Sec. 64 WpHG. Both implement Arts. 16 (3) and 23 MiFID II.

77 See *Stefan Grundmann*, "Das grundlegend reformierte Wertpapierhandelsgesetz – Umsetzung von MiFID II (Conduct of Business im Kundenverhältnis)", Zeitschrift für Bankrecht und Bankwirtschaft (ZBB) 2018, 1, 12 et seq.; for a general discussion see *Harald Baum*, "Die Regelung von Interessenkonflikten: MiFID II, WAG 2018 und WpHG 2018", Österreichisches BankArchiv (ÖBA) 2019, 266–279; *Stefan Grundmann/Philipp Hacker*, Conflicts of Interest, in: Busch/Ferrarini (ed.) (fn. 23), at 7.01; *Christoph Kumpan/Patrick C. Leyens*, "Conflicts of Interest of Financial Intermediaries: Towards a Global Common Core in Conflicts of Interest Regulation", European Company and Financial Law Review (ECFR) 2008, 72 et seq.

78 Cf. *supra* at 1-3.

79 Cf. *supra* at 1-3.

80 Sec. 80 (1) WpHG in connection with Art. 34 of the Delegated Regulation (EU) 2017/565.

have to establish, implement and maintain an effective conflicts of interest policy set out in writing; the policy needs to be appropriate to the size and organization of the firm and its nature as well as to the scale and the complexity of its business.[81] They have to specify procedures to be followed and measures to be adopted in order to prevent or manage such conflicts.[82] These include, among others, extensive compliance and documentation obligations. In addition, the firms' remuneration policies and practices have to be designed in such a way as not to create conflicts of interests or incentives that may lead their employees to place their own or the firms' interests over those of the clients to the latter's potential detriment.[83]

Furthermore, MiFID II introduced a system of so-called "product governance" as a means to prevent conflicts of interests and to improve the quality of financial products.[84] Investment services firms, which manufacture financial instruments for sale to clients, are now obliged to make sure that these instruments are from the outset designed to meet the needs of an identified target market of end clients.[85] Also, the strategy for the distribution of the financial instruments must be compatible with this identified target market, and the firm has to take reasonable organizational steps to ensure that the financial instruments are (only) distributed to that market.[86] The product governance regime introduced by MiFID II is of great practical relevance for the business of the investment services firms.

2-1-3-2. Additional Transparency Duties

If the organizational measures taken prove insufficient to prevent, with reasonable certainty, clients' interests from being prejudiced, the investment services firm has to clearly inform those clients of the general nature and the source of

81 *Ibid*.

82 Art. 27 of the Delegated Regulation (EU) 2017/565.

83 *Ibid*.

84 See *Grundmann* (fn. 26), mn. 160; for an overview of the new regime, see *Danny Busch*, "Product Governance and Product Intervention under MiFID II/MiFIR", in: Busch/Ferrarini (ed.) (fn. 23), at 5.02. The EU reform was preceded by the Final Report of the International Organization of Securities Commissions "Regulation of Retail Structured Products" (2013), which discusses some similar measures; available at https://rdmf.files.wordpress.com/2014/01/informe-iosco.pdf [accessed 30 April 2021].

85 Sec. 80 (9) WpHG in connection with Sec. 11 of the Wertpapierdienstleistungs-Verhaltens- und -Organisationsverordnung (WpDVerOV), Ordinance of 17 October 2017 (BGBl. I S. 3566).

86 Sec. 63 (4) WpHG in connection with Sec. 12 WpDVerOV; for an overview from the German perspective see *Petra Buck-Heeb*, "Der Product-Governance-Prozess", Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht (ZHR) 179 (2015), 782, 797.

the conflicts of interest as well as of the measures taken for limiting the associated risks *prior* to the execution of transactions for clients.[87] The obligation further includes informing clients about the potential consequences of the conflict of interest for the investment advice given. The information duty is not a substitute for organizational measures; rather, it is designed only as an *ultima ratio* measure.[88]

2-1-3-3. Remuneration as a Cause for Conflicts of Interests

Conflicts of interests in connection with the remuneration of investment services firms have the severest potential for damaging the clients' interests. This is especially true in "three-party-constellations" where a third party pays for the advisory or other services provided by the firm to its clients. This is the usual practice in the context of the traditional commission-based advisory business where the client gets the advice "for free", its being paid for by so-called "inducements" provided by a third party, usually the issuer of the financial instrument under consideration for an investment. The question whether such inducements should be still allowed in the future was one of the most intensely discussed issues during the reform of MiFID. Finally, the European legislature adopted a compromise by allowing two alternative remuneration models: the traditional commission-based advisory business with its intrinsic conflicts of interest (though more strictly regulated) and a new model of independent fee-based investment advice. Both remuneration models have been competing in the German market since 2014, whereas the UK prohibited commission-based advisory business in relation to retail clients (consumers) already in 2012.[89] The Netherlands followed the UK in 2013.[90]

2-1-3-4. Commission-Based Investment Advice

Even within the context of the traditional commission-based investment advice, at least as a rule, German investment services firms today may not, in relation to the provision of an investment service, accept any inducements from third parties or provide any inducements to third parties that are not clients of this service.[91] However, the most important exception exists when the following three conditions are fulfilled: the inducement a) does not conflict

87 Art. 23 (2) MiFID II; Art. 34 (4) of the Delegated Regulation (EU) 2017/565; Sec. 63 (2) WpHG.
88 Art. 34 (4) of the Delegated Regulation (EU) 2017/565.
89 See *Larissa Silverentand/Jasha Sprecher/Lisette Simons*, Inducements, in: Busch/Ferrarini (ed.) (fn. 23), at 8.30 et seqq.
90 See *ibid.*, at 8.18 et seqq.
91 Sec. 70 WpHG.

with the firm's duty to act in the best interest of its client, b) is designed to improve the quality of the service to the client and c) is made fully transparent to the client.[92] Under these circumstances, inducements may be accepted. Because of the fact that keeping a network of bank branches where investment services are provided meets the first and second conditions, commission-based services are still the dominant form of services in Germany. The German financial industry still refuses to offer independent fee-based advisory business on a large scale.[93]

2-1-3-5. Independent Fee-Based Investment Advice

The German legislature introduced independent fee-based investment advice in 2014 as an alternative to the traditional commission-based advisory business (along the lines of MiFID II).[94] An investment services firm that intends to provide investment advice has to inform its clients beforehand whether or not it offers independent fee-based advice.[95] The legislature aimed at raising the awareness of investors as to the difference between commission- and independent fee-based investment advice, with the intention to promote the later.[96] The existing duty to inform a client about the general nature and the source of unavoidable conflicts of interest prior to the execution of the transaction was regarded as insufficient. An investment services firm that provides independent fee-based investment advice may not accept any inducements whatsoever from third parties.[97]

2-1-4. Best Execution

The WpHG provides for various additional duties for investment services firms that cannot be discussed here in detail. Of special practical relevance is the duty that investment services firms have to take all reasonable steps to ob-

92 Sec. 70 (1) WpHG in connection with Sec. 6 WpDVerOV; for details see *Ingo Koller*, in: Heinz-Dieter Assmann/Uwe H. Schneider/Peter O. Mülbert (ed.), Wertpapierhandelsrecht, 7th ed., 2019, § 70 mn. 3 et seqq.

93 Less than 20 firms are registered in the BaFin's official register as offering independent fee-based investment advice; information available at https://portal.mvp.bafin.de/database/HABInfo/ [accessed 30 April 2021].

94 For an overview, see *Peter Balzer*, Rechtliche Rahmenbedingungen der Honorarberatung, in: Mathias Habersack/Peter O. Mülbert/Gerd Nobbe/Arne Wittig (ed.), Bankenregulierung, Insolvenzrecht, Kapitalanlagegesetzbuch, Honorarberatung. Bankrechtstag 2013, 2014, p. 157–184.

95 Sec. 64 (1) WpHG.

96 *Fuchs* (fn. 63), § 31 mn. 202 et seq.

97 Sec. 64 (5) WpHG. For the details, see *Koller* (fn. 92), § 64 mn. 63 et seqq.

tain the best possible result for its clients when executing client orders for the purchase or sale of financial instruments ("best execution of client orders").[98]

2-1-5. Product Intervention

As a reaction to the global financial crisis and perceived shortcomings of the information model, the *Markets in Financial Instruments Regulation* (MiFIR) of 2014[99] introduced a "product intervention" mechanism which supplements the product governance rules described earlier.[100]

The statutory authorization for product intervention indicates a paradigmatic regulatory change and at least a partial departure from the information model.[101] While the information model is based on an *ex post* control of financial instruments and services by the courts, product intervention relies on a paternalistic *ex ante* market control by bureaucratic means. It is regarded as a general shift towards a collective consumer protection that is far more encompassing in its design than the traditional investor protection.[102] One obvious drawback is that even experienced retail investors with no need for protection are protected "by force".[103] Whether and, if so, how this new concept fits into the regulatory framework of the information model that is still upheld in general is an entirely open question, to say the least. Japan traditionally had a long history of *ex ante* regulation of the country's financial markets, which was challenged in the country's financial crisis during 1990s.[104]

98 Sec. 82 WpHG; for a discussion of the EU concept see *Peter Krüger Andersen*, "Time to Reduce Complexity in a Data-Driven Regulatory Agenda – Perspectives on the MiFID II Best Execution Regime", European Company and Financial Law Review (ECFR) 2020, 692–725.

99 *Supra* note 43.

100 See *supra* at 2-1-3-1.

101 Critical, *e.g.*, *Buck-Heeb* (fn. 61), 286 et seq.

102 *Veerle Colaert*, "The MiFIR and PRIIPs Product Intervention Regime: In Need of Intervention?", European Company and Financial Law Review (ECFR) 2020, 99–124; *Jean-Pierre Bußalb*, "Produktintervention und Vermögensanlagen", Wertpapier-Mitteilungen (WM) 2017, 553–558.

103 *Buck-Heeb* (fn. 61), 286. According to a press report, an aggrieved retail investor who had in the past constantly and successfully dealt with contracts for difference (CFD), the trade of which was subsequently restricted and partly banned by BaFin, filed an administrative claim against the Agency in 2018 trying to establish an exception to the ban for semi-professional traders, see Frankfurter Allgemeine Zeitung, No. 282, 4 December 2018. p. 27.

104 For the parties with multiple interests participating in the legislative or administrative process as *ex ante* monitors, see *Hideki Kanda*, "Politics, Formalism, and the Elusive Goal of Investor Protection: Regulation of Structured Investment Funds in Japan",

2-2. Japan

2-2-1. The FIEA and the ASFI (APFS)

In Japan, the FIEA[105] and the ASFI (APFS)[106] are applied to matters regarding information duties on financial products, in addition to the Companies Act (*Kaisha-hō*)[107] and other related legal rules.[108] Disclosure rules are applied to listed companies both in primary and secondary markets pursuant to the FIEA.[109] The requirements for registration statements, prospectuses and periodic reports are further specified in the Cabinet Office Ordinance on Disclosure of Corporate Affairs (*Kigyō naiyō-tō no kaiji ni kansuru naikaku-fu-rei*).[110]

The basis of Japanese capital market law is laid out by the FIEA, the purpose of which is to ensure fairness in the issuance of securities and the transactions of financial instruments (*kin'yū shōhin*)[111] and to facilitate a smooth distribution of securities. It also seeks to achieve fair price formation for financial instruments through the full implementation of capital market functions, thus contributing to the sound development of the national economy and the protection of investors.[112] To achieve this aim, the FIEA sets rules regarding disclosure of corporate affairs and regulates financial instruments businesses (*kin'yū*

University of Pennsylvania Journal of International Business Law 12 (1991), 569, 584. For decision making in Japanese finance as a form of "regulatory cartel", see *Curtis Milhaupt/Geoffrey Miller*, "A Regulatory Cartel Model of Decisionmaking in Japanese Finance", Journal of Japanese Law 4 (1997), 18–29. On bureaucratic paternalism and economic crisis, see *Harald Baum*, "Der japanische 'Big Bang' 2001 und das tradierte Regulierungsmodell: ein regulatorischer Paradigmenwechsel?", Rabels Zeitschrift für ausländisches und internationales Privatrecht (RabelsZ) 64 (2000), 633, 643–650. For the regulatory model from the 1950s to the early 1990s and changes and reforms since the mid-1990s, see *Baum/Kanda* (fn. 46), 67–71.

105 See *supra* note 54.

106 See *supra* notes 58 and 60.

107 Act No. 86/2005. For a comprehensive overview, see *Ichirō Kawamoto/Yasuhiro Kawaguchi/Takayuki Kihira*, Corporations and Partnerships in Japan, 2nd ed., 2016.

108 For an overview of capital market regulation in Japan, see *Baum/Kanda* (fn. 46). An extensive overview can be found from the *Japan Securities Research Institute*, Securities Market in Japan 2018, 2018; available at https://www.jsri.or.jp/publish/english/pdf/english_09.pdf [accessed 30 April 2021].

109 For a brief overview, see *Toshiaki Yamanaka/Gen Goto*, Information Duties under Japanese Capital Markets Law, in: Dernauer/Baum/Bälz (ed.) (fn. 17), p. 209, 210–211.

110 Ordinance of the Ministry of Finance No. 5/1973.

111 Financial instruments include securities, securities or certificates indicating claims based on a deposit contract, currencies and commodities (Sec. 24 of Art. 2 of the FIEA).

112 Art. 1 of the FIEA.

shōhin torihiki-gyō)[113] and financial instruments exchanges (*kin'yū shōhin torihiki-jo*).[114]

The ASFI (APFS) is applied to matters regarding the sales of broader types of financial instruments to customers, or to an agency or intermediary service therefor (*kin'yū shōhin no hanbai tō,* hereinafter, "financial instrument sales").[115] The primary purpose of the ASFI (APFS) is to protect customers by specifying matters which financial instrument providers (*kin'yū shōhin hanbai gyōsha tō*)[116] should explain at or before the time of the financial instrument sales and by imposing strict liability on them for damages where a customer incurs any loss due to the breach of those explanatory duties.[117] When they intend to carry out financial instrument sales on a regular basis, important matters (*jūyō jikō*) should be explained to customers under the ASFI (APFS) at or before the time that the financial instrument sales are carried out.[118] However, when the customer is a person specified as the one who has expertise in the financial instrument sales (*tokutei kokyaku*, "specified customer(s)"), those explanatory duties are not imposed.[119]

The fundamental characteristics of these two acts differ. The FIEA is a comprehensive statute that deals with matters regarding business in financial instruments, including their trading on an exchange. In contrast, the ASFI (APFS) specifically intends to protect customers of financial instrument providers by modifying general tort law provisions under the Civil Code (*Minpō*),[120] by providing strict liability for financial instrument providers and by the presumption of causality and damages for financial instrument sales.[121]

113 See Sec. 8 of Art. 2 of the FIEA.

114 See Sec. 16 of Art. 2 of the FIEA. See *Yamanaka/Goto* (fn. 109), p. 210.

115 For the definition of financial instrument sales, see Sec. 2 of Art. 2 of the ASFI (Sec. 2 of Art. 3 of the APFS). Financial instrument sales include the sales of securities (Item 5 of Sec. 1 of Art. 2 of the ASFI (Item 5 of Sec. 1 of Art. 3 of the APFS)).

116 Financial instrument providers mean the persons carrying out financial instrument sales as a conduct of their business (Sec. 3 of Art. 2 of the ASFI (Sec. 3 of Art. 3 of the APFS)).

117 Art. 1 of the ASFI (Art. 1 of the APFS). See *infra* at 5–2-2.

118 Sec. 1 of Art. 3 of the ASFI (Sec. 1 of Art. 4 of the APFS). See *infra* at 4–2-2.

119 Sec. 7 (1) of Art. 3 of the ASFI (Sec. 7 (1) of Art. 4 of the APFS). See *infra* at 3–2.

120 Act No. 89/1896.

121 For a more detailed comparison between the general tort law and the ASFI (APFS), see *infra* at 5–2-2. After the occurrence of the global financial crisis, the FIEA was amended, for example, to add chapter 3-3 (Credit Rating Agencies) by Act No. 58/2009 and chapter 5-6 (Trade Repositories) by Act No. 32/2010.

2-2-2. Duty of Good Faith

The FIEA regulates activities by both financial instruments business operators (*kin'yū shōhin torihiki gyōsha*)[122] and registered financial institutions (*tōroku kin'yū kikan*).[123]

The following requirements, for example, are imposed under the FIEA;[124] financial instruments business operators and registered financial institutions, and their directors and employees, must act in good faith and be fair to their customers in the course of their operations.[125]

2-2-3. Obligation to Clarify the Conditions of Transactions in Advance

When financial instruments business operators or registered financial institutions receive orders from a customer for a purchase or sale of securities, they must notify the customer clearly in advance whether they will conclude the purchase or sale with the customer as the counterparty, or whether they will act as a mediator, a broker or an agent for the transaction.[126]

2-2-4. Best Execution Policy

Both financial instruments business operators and registered financial institutions must establish a policy and method for executing orders from customers for the purchase and sale of securities and for derivatives transactions under the best terms and conditions (*sairyō shikkō hōshin tō*, "best execution policy").[127] They must disclose their best execution policy.[128]

122 Financial instruments business operators are clarified as persons who as part of their business, inter alia, sell and offer securities, provide management services and asset advice, and administer and maintain assets (Secs. 8 and 9 of Art. 2 and Art. 29 of the FIEA).

123 Chapter 3 of the FIEA. For the disclosure requirements imposed by the FIEA, see *Yamanaka/Goto* (fn. 109), p. 210 et seq. Registered financial institutions include banks, cooperative financial institutions (*kyōdō soshiki kin'yū kikan*) and insurance companies (Sec. 11 of Art. 2 of the FIEA and Art. 1-9 of Order for Enforcement of the Financial Instruments and Exchange Act (*Kin'yū shōhin torihiki-hō shikōrei*)).

124 For a comprehensive analysis of the FIEA regulations, see *Baum/Kanda* (fn. 46), 73–102.

125 Sec. 1 of Art. 36 of the FIEA. See *Yamanaka/Goto* (fn. 109), p. 212.

126 Art. 37-2 of the FIEA.

127 Sec. 1 of Art. 40-2 of the FIEA.

128 Sec. 2 of Art. 40-2 of the FIEA.

2-2-5. *Conflict of Interests*

Regarding conflict of interests, the FIEA stipulates that if financial instruments business operators or registered financial institutions, or their officers or employees, do business in two or more business categories, they must not perform any of the activities specified in its provision.[129]

Specifically, these prohibited activities include: a) soliciting a customer to entrust them (meaning to request to provide intermediation, brokerage, or agency) in respect of a transaction (including a purchase and sale) of securities using information about a transaction of securities conducted by i) a customer who has received advice in connection with investment advisory business or ii) such a customer as an investment in connection with investment management business;[130] and b) with the aim of benefitting from business other than investment advisory business and investment management business, i) giving advice in connection with the investment management business they conduct that would involve an unnecessary transaction in light of the transaction policy, the amount of the transaction or the market conditions, or ii) making an investment in connection with the investment management business they conduct that involves an unnecessary transaction in light of the investment policy, the amount of invested assets, or the market conditions.[131]

In addition, the Financial Services Agency published a document titled "The Principles for Customer-Oriented Business Conduct" in 2017.[132]

The background for this initiative was a view that some financial service providers only technically follow the regulations under the FIEA and do not respect the interests of their customers. For example, some banks were said to have promoted particular mutual funds to their customers based on the amount of commission they receive and not on the suitability of that mutual fund to the customer. On other occasions, some banks recommended the products of asset management companies belonging to the same financial group over those of asset management companies operating outside of the group.[133]

129 Art. 44 of the FIEA. For prohibited activities involving other business and restrictions on activities involving parent or subsidiary corporations, see Arts. 44-2 and 44-3, respectively, of the FIEA.

130 Item 1 of Art. 44 of the FIEA.

131 Item 2 of Art. 44 of the FIEA.

132 *Financial Services Agency*, The Principles for Customer-Oriented Business Conduct [*Kokyaku hon'i no gyōmu un'ei ni kansuru gensoku*] (30 March 2017) (available in Japanese at https://www.fsa.go.jp/news/28/20170330-1/02.pdf [accessed 30 April 2021]). See *Yamanaka/Goto* (fn. 109), p. 213 et seq.

133 See *Yamanaka/Goto* (fn. 109), p. 213 et seq.

To correct this, the Principles request financial service providers to, for example, disclose in an understandable manner information regarding the reason for recommending particular financial products and sources of conflict of interests, such as commissions they receive from third parties. It must be noted, however, that this requirement is not a mandatory regulation but a soft-law recommendation and that the decision to adhere to these Principles is left to individual financial service providers.[134]

2-3. Comparative Analysis

For historical reasons, the regulatory structures are largely divergent among both jurisdictions. German capital markets law forms a complex multilayered mosaic or a kaleidoscope of regulations, whereas, in sharp contrast to this, Japan has consolidated most of its pertinent regulations in the FIEA in 2006. The ASFI has been conceived as a specific instrument for protecting customers in the area of sales of financial instruments, or in an agency or intermediary service therefor.

However, one might point out that the regulatory aims have largely converged among both jurisdictions in terms of securing a fair and efficient functioning of the capital markets with a special emphasis on investor protection. With respect to investment services, they stipulate similar duties accordingly: German investment services firms must act in the interest of their clients, and Japanese financial instruments business operators and registered financial institutions have to act in good faith and be fair to their customers.

Both jurisdictions address the issue of conflicts of interests. The present German regulation is – under the direct influence of EU law – more differentiated in its regulatory triad of a) organizational duties to avoid such conflicts, b) additional transparency duties as to other conflicts and c) further clear-cut prohibitions with respect to, among other things, remunerations practices – which typically raise the gravest concern of conflicting interests. In this regard, for example, the envisaged shift in Europe from commission-based investment advice to independent fee-based advice is not stipulated in the FIEA.

134 See *ibid.*, p. 214. The Principles were revised and updated in 2021. However, those revisions were made only to the notes to the Principles, whereas the Principles themselves were not changed. *Financial Services Agency*, The Principles for Customer-Oriented Business Conduct [*Kokyaku hon'i no gyōmu un'ei ni kansuru gensoku*] (15 January 2021) (available in Japanese at https://www.fsa.go.jp/news/r2/singi/20210115-1/02.pdf [accessed 30 April 2021]).

3. Persons to be Protected

3-1. Germany

3-1-1. A Flexible Regulatory Approach

The level of protection provided by the WpHG depends on the type of client.[135] This concept of layered levels of protection is upheld under MiFID II and accordingly under the amended WpHG of 2018.[136] The Directive stipulates that measures to protect investors should be adapted to the particularities of each category of investors, irrespective of the categories of clients concerned; further, the principles to act honestly, fairly and professionally and the obligation to be fair, clear and not misleadingly apply to the relationship with any clients.[137]

The WpHG defines a "client" as any natural or legal person for whom investment services firms provide investment or ancillary services.[138] The Act distinguishes between three different classes of clients: professional clients, retail clients and eligible counterparties.[139]

"Professional clients" are investors whom an investment services enterprise can assume to possess sufficient experience, knowledge and expertise to make their own investment decisions and to properly assess the risks that they incur.[140] These are, first, specific types of enterprises listed in the relevant WpHG provision which, in order to be able to operate in the financial markets, are subject to authorization or supervision requirements.[141] Second, non-supervised enterprises that meet certain quantitative criteria are also regarded as pro-

135 The German legislature (like the EU legislature) sharply distinguishes between consumer and investor protection. Capital markets regulation is addressed to investors regardless of whether or not these are consumers. If they fall under the latter category as well, an additional layer of consumer protection may apply under certain circumstances, *e.g.*, in the context of door-to-door selling; for a discussion of this issue, see *Petra Buck-Heeb*, "Vom Kapitalanleger- zum Verbraucherschutz", Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht (ZHR) 176 (2012), 66–95.

136 Sec. 67 WpHG provides the definitions of the different types of clients.

137 Recital 86 of MiFID II.

138 Sec. 67 (1) WpHG.

139 For the details in Japan, see *infra* at 3–2.

140 Sec. 67 (2) WpHG.

141 These are, among others, investment services firms, other authorized or supervised financial institutions, insurance undertakings, collective investment undertakings and their management companies, pension funds and management companies of such funds, and other institutional investors (Sec. 67 (2) (i) WpHG).

fessional clients.[142] Third, governments, central banks and international as well as supranational institutions and the like are qualified as professional clients.[143]

"Retail clients" are those clients who are not professional clients.[144] This includes not only natural persons but also legal persons. "Eligible counterparties" are, broadly speaking, specific types of professional investors that are deemed as highly experienced, such as securities firms, insurance firms, etc.[145]

Retail clients enjoy a higher level of protection than professional clients. Therefore, the categorization is of central importance, but it is not a fixed one. Professional clients have the right to request and agree with the investment services firm that they be categorized as retail clients.[146] In the same way, eligible counterparties can request to be treated as (normal) professional or as retail clients and to conclude a corresponding agreement with the investment services firm.[147]

On the other hand, retail clients may also request that they be categorized as professional clients, provided certain conditions are fulfilled.[148] Since such a change of categorization from retail to professional client lowers the level of protection, the investment services firm is required to conduct a prior assessment as to whether the pertinent client possesses the experience, knowledge and expertise to make an investment decision in general, or with respect to a specific type of transaction, and as to whether he or she is capable of adequately assessing the risks involved.[149]

3-1-2. Professional Clients and Eligible Counterparties

The most relevant practical consequence of the different categorizations of clients is related to the duty of investment services firms to obtain from their clients all necessary information regarding their knowledge and experience so that the appropriateness of the intended investment advice or financial portfolio management can be judged.[150] In the case of professional clients, investment

142 At least two of the following three criteria have to be exceeded: balance sheet total of €20,000,000; net turnover of €40,000,000; own funds of €2,000,000 (Sec. 67 (2) (ii) WpHG).
143 Sec. 67 (2) (iii)-(v) WpHG.
144 Sec. 67 (3) WpHG.
145 Sec. 67 (4) WpHG.
146 Sec. 67 (5) WpHG.
147 Sec. 68 (1) WpHG.
148 Sec. 67 (6) WpHG.
149 *Ibid.*
150 Art. 54 (2) Delegated Regulation (EU) 2017/565; see *infra* at 4–1-1.

services firms may assume that, in respect of the products, transactions or services for which they are classified as professional clients, they have the degree of knowledge and experience that is necessary for them to understand the risks inherent in the transactions or in the financial portfolio management; firms may further assume that these clients are financially able to bear such risks consistent with their investment purposes.[151]

If investment services firms do certain kinds of business with eligible counterparties, they are exempted from some but by no means all of the conduct-of-business rules.[152] European rule-makers expressed the view that the financial crisis had shown limits also in the ability of non-retail clients to appreciate the risk of their investments.[153] While it is confirmed in MiFID II that the conduct-of-business rules should be enforced in respect of those investors most in need of protection,[154] it is also seen as appropriate to better calibrate the requirements that are applicable to various categories of clients. To that extent, some of the information requirements of investment services firms should be extended to the relationship with eligible counterparties.[155] The relevant requirements should in particular relate to the safeguarding of clients' financial instruments and funds as well as to information and reporting requirements concerning more complex financial instruments and transactions.[156]

3-2. Japan

3-2-1. Regulatory Approach

Under the FIEA, customers are classified into specified investors (*tokutei tōshika*) and those other than specified investors (what we call general investors). There are, in addition, customers who are allowed to change their status from the former to the latter or from the latter to the former.[157]

A number of regulations under the FIEA are not applied to financial instruments business operators or to registered financial institutions if the customer is a specified investor.[158] Specified investors include qualified institutional in-

151 Art. 54 (3) and Art. 56 (1) Delegated Regulation (EU) 2017/565.

152 Sec. 68 (1) (2) WpHG in connection with Art. 71 Delegated Regulation (EU) 2017/565.

153 Recital 104 of MiFID II.

154 *Ibid.*

155 *Ibid.*

156 *Ibid.*

157 See Tomonobu Yamashita/Hideki Kanda (ed.), *Kin'yū shōhin torihiki-hō gaisetsu* [Financial Instruments and Exchange Act], 2nd ed., 2017, chapter 4, p. 411 (*Hideki Kanda*).

158 Art. 45 of the FIEA.

vestors (*tekikaku kikan tōshika*),[159] the Japanese government,[160] the Bank of Japan[161] and the legal entities specified by a Cabinet Office Order.[162]

Those specified legal entities (including listed companies) may request that a financial instruments business operator or a registered financial institution treat them as a general investor with regard to different types of contract that may be classified as a financial instruments transaction contract (*kin'yū shōhin torihiki keiyaku*).[163] On the other hand, a legal entity (excluding a specified investor) or a specified individual may request a financial instruments business operator or a registered financial institution to treat them as a specified investor with regard to different types of financial instruments transaction contracts.[164] Thus, the FIEA adopts a flexible regulatory approach.

Customers include specified customers under the ASFI (APFS).[165] When a customer is a specified customer, the primary explanatory duty under the ASFI (APFS) is not imposed.[166] The classifications are further considered in the following subsections.

159 Item 1 of Sec. 31 of Art. 2 of the FIEA. Qualified institutional investors are defined as persons specified by a Cabinet Office Order as having expert knowledge of and experience with investment in securities (Item 1 of Sec. 3 of Art. 2 of the FIEA). They include, for example, major financial instruments business operators, investment corporations, banks and insurance companies (Art. 10 of Cabinet Office Order on Definitions under Art. 2 of the FIEA (*Kin'yū shōhin torihiki-hō dai-ni-jyō ni kitei suru teigi ni kansuru naikaku-fu-rei* [renamed], Order of the Ministry of Finance No. 14/1993)).

160 Item 2 of Sec. 31 of Art. 2 of the FIEA.

161 Item 3 of Sec. 31 of Art. 2 of the FIEA.

162 Item 4 of Sec. 31 of Art. 2 of the FIEA. The legal entities include, for example, a company that issues share certificates which are listed on a financial instruments exchange (Item 7 of Art. 23 of Cabinet Office Ordinance on Definitions under Art. 2 of the FIEA). Thus, listed companies are included in the definition of specified investors. See *infra* at 3-2-2.

163 Sec. 1 of Art. 34-2 of the FIEA. For the definition of a financial instruments transaction contract, see Art. 34 of the FIEA. The different types of financial instruments transaction contracts are defined under Art. 53 of the Cabinet Office Order on Financial Instruments Business, etc. (*Kin'yū shōhin torihiki-gyō-tō ni kansuru naikaku-fu-rei*, Cabinet Office Order No. 52/2007).

164 Sec. 1 of Art. 34-3 and Sec. 1 of Art. 34-4 of the FIEA. The specified individuals (Sec. 1 of Art. 34-4 of the FIEA) are defined under Arts. 61 and 62 of the Cabinet Office Order on Financial Instruments Business, etc. See *infra* at 3-2-3.

165 The ASFI defines "customer" (*kokyaku*) as the counterparty in sales of financial instruments (Sec. 4 of Art. 2 of the ASFI). This provision is deleted in the APFS. For the definition of specified customers, see Item 1 of Sec. 7 of Art. 3 of the ASFI (Item 1 of Sec. 7 of Art. 4 of the APFS).

166 Specifically, the explanatory duty stipulated in Sec. 1 of Art. 3 of the ASFI (Sec. 1 of Art. 4 of the APFS) is exempted (Item 1 of Sec. 7 of Art. 3 of the ASFI (Item 1 of Sec. 7 of Art. 4 of the APFS)).

3-2-2. Specified Investors and Specified Customers

Institutional investors can be included in the category of specified investors under the FIEA,[167] and listed companies are included.[168] A number of regulations under the FIEA are not applied if a counterparty customer is a specified investor.[169]

Specifically, those regulations include the following: clarification in advance of the conditions of transactions,[170] delivery of documents prior to the conclusion of a contract,[171] delivery of documents upon the conclusion of a contract,[172] delivery of documents in connection with the receipt of a security deposit,[173] written cancellation[174] and the suitability rule.[175]

Specified investors under the FIEA are included in the category of specified customers under the ASFI (APFS).[176] Therefore, the primary explanatory duty under the ASFI (APFS) is not imposed on them.

Regardless of whether a counterparty customer is a specified investor or not, aspects such as the duty of good faith[177] and the regulations on conflict of interests[178] are applied under the FIEA. General tort law provisions are similarly not made inapplicable by the fact that the counterparty customer is a specified investor or a specified customer.

3-2-3. Other Possible Specified Investors and Specified Customers

Retail investors are generally not included in the categories of specified investors under the FIEA or specified customers under the ASFI (APFS). Some

167 See *supra* note 159 and accompanying text.
168 See *supra* note 162.
169 See *supra* note 158 and accompanying text.
170 Art. 37-2 of the FIEA.
171 Art. 37-3 of the FIEA.
172 Art. 37-4 of the FIEA.
173 Art. 37-5 of the FIEA.
174 Art. 37-6 of the FIEA.
175 Item 1 of Art. 40 and Item 1 of Art. 45 of the FIEA. See *infra* at 4-2-1.
176 Item 1 of Sec. 7 of Art. 3 of the ASFI (Item 1 of Sec. 7 of Art. 4 of the APFS) and Sec. 1 of Art. 11 of Order for Enforcement of the Act on the Sales, etc. of Financial Instruments [financial instrument sales] (*Kin'yū shōhin no hanbai-tō ni kansuru hōritsu shikōrei*, Cabinet Order No. 484/2000).
177 Sec. 1 of Art. 36 of the FIEA. See *supra* at 2-2-2.
178 Arts. 44, 44-2 and 44-3 of the FIEA. See *supra* at 2-2-5.

of them are, however, allowed to change to specified investors under the FIEA.[179]

Specifically, any of the following individuals (excluding qualified institutional investors) may request that a financial instruments business operator or a registered financial institution treat that individual as a specified investor with regard to different types of financial instruments transaction contracts: a) an individual that is the proprietor of a business and that has concluded a silent partnership agreement (*tokumei kumiai keiyaku*) as prescribed in Art. 535 of the Commercial Code (*Shōhō*)[180] (excluding those specified by a Cabinet Office Order[181]), or any other individual specified by the Cabinet Office Order[182] as being similar thereto[183] and b) an individual which satisfies the requirements specified by the Cabinet Office Order[184] as a person equivalent to a specified investor, in light of such individual's knowledge and experience and the state of that individual's assets.[185]

3-3. Comparative Analysis

With respect to the persons protected and to the extent prescribed by capital markets laws in Germany and Japan, the following regulatory convergences can be observed. Firstly, they both adopt a flexible regulation by differentiating persons according to their various needs to be protected and by allowing them to change the default legal status – either to a lower or to a higher level of protection. Secondly, even within the flexible regulatory framework, the following fundamental principles are mandatorily provided in both jurisdictions: avoiding conflicts of interests and acting in good faith or in the best interest of

179 See *supra* note 157 and accompanying text.

180 Act No. 48/1899.

181 Sec. 1 of Art. 61 of Cabinet Office Order on Financial Instruments Business, etc.

182 Sec. 2 of Art. 61 of Cabinet Office Order on Financial Instruments Business, etc.

183 Item 1 of Sec. 1 of Art. 34-4 of the FIEA.

184 Art. 62 of the Cabinet Office Order on Financial Instruments Business, etc. The requirements are: a) that, judging reasonably from the status of the transactions or any other circumstances, the total amount of the assets of the individual less the total amount of its liabilities is likely to be 300 million yen or more (Item 1 of the same Article); b) that, judging reasonably from the status of the transactions or any other circumstances, the total amount of the individual's assets is likely to be 300 million yen or more (Item 2 of the same Article); and that c) one year has elapsed from the day when the individual concluded with the financial instruments business operator or the registered financial institution a financial instruments transaction contract which is of the same contract type for the first time (Item 3 of the same Article).

185 Item 2 of Sec. 1 of Art. 34-4 of the FIEA.

clients and investors. Thirdly, the highest level of protection and the most comprehensive information duties are applied to retail clients, or general investors or general customers.

4. Information to be Provided

4-1. Germany

4-1-1. Information Duties Under the WpHG

4-1-1-1. Retail Investors and the "Appropriateness Rule"

Investment services firms that provide either *investment advice* or *financial portfolio management* are required to obtain from its clients all necessary information in order to recommend financial instruments or investment services that are appropriate for their clients ("appropriateness rule"), as will be explained in the text that follows.[186] This is one of the central regulations for protecting retail investors, and it roughly corresponds with the "suitability rule" under Japanese law, even though they are divergent in details.[187] For an investment services firm that provides neither investment advice nor financial portfolio management but *other financial services*, the appropriateness rule also applies, but less strictly.[188] As an exception, the obligations set forth in the provision do not apply if an investment services firm provides, at the initiative of the client, only principal brokering, proprietary trading, contract brokering or investment brokering services in respect of non-complex financial instruments (*e.g.*, shares which are admitted to trading on an organized market) and if the firm informs the client that an appropriateness test is not carried out ("execution only").[189]

If an investment services firm plans to provide investment advice or financial portfolio management, it has to determine in advance whether the product or investment service offered or demanded is appropriate for the client.[190] For this, the investment services firm must undertake an assessment whether the pertinent investment service satisfies all of the following three criteria: a) it meets the investment objectives of the client in question, including the client's risk tolerance, b) it is such that the client is financially able to bear any related

186 Art. 54 (2) Delegated Regulation (EU) 2017/565.
187 See *infra* at 4-2-1, 4-2-2 and 4-2-3-1.
188 Sec. 63 (10) WpHG.
189 Sec. 63 (11) WpHG.
190 Sec. 64 (3) WpHG.

investment risks consistent with his or her investment purposes and c) it is such that the client has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his or her portfolio.[191]

It is the responsibility of the investment services firm to determine what kind of information it needs to obtain from its client in order to undertake a proper and reliable assessment of its client's understandings and objectives ("know your customer").[192] In particular, the investment services firm has to determine whether that client has the necessary experience and knowledge in order to understand the risks involved in relation to the product or investment service offered or demanded.[193] With regard to the client's knowledge and experience in the investment field, it is stipulated that the information must demonstrate a) the types of service, transactions and financial instruments with which the client is familiar, b) the nature, volume and frequency of the client's transactions in financial instruments and the period over which they have been carried out and c) the level of education and the current or former relevant profession of the client.[194]

An investment services firm is entitled to rely on the information provided by its clients unless it is aware or ought to be aware that the information is manifestly out of date, inaccurate or incomplete.[195] It has to maintain records of the appropriateness assessments undertaken, which are to include, among other details, the result of any appropriateness assessment as well as any warning given to the client where the investment service or product purchase was assessed as potentially inappropriate for the client.[196] The investment services firm has no obligation to carry out investigations of its own in this regard.[197]

If the investment services firm does *not obtain* the required information, it *may not* recommend a financial instrument when it provides investment advice nor may it make any recommendation when providing financial portfolio management.[198] If the firm *does obtain* this information, it may recommend to a client *only* those financial instruments and investment services that are appropriate for the client based on the information obtained.[199] The overarching regulatory

191 *Ibid.*
192 *Fuchs* (fn. 63), § 31 mn. 36.
193 Art. 56 (1) Delegated Regulation (EU) 2017/565.
194 Art. 55 (1) Delegated Regulation (EU) 2017/565.
195 Art. 55 (3) Delegated Regulation (EU) 2017/565.
196 Art. 56 (2) Delegated Regulation (EU) 2017/565.
197 Art. 55 (3) Delegated Regulation (EU) 2017/565.
198 Art. 54 (8) Delegated Regulation (EU) 2017/565.
199 Art. 54 (9) Delegated Regulation (EU) 2017/565.

aim is thus information, but it is not based on paternalism. If the investor has received all relevant information in an appropriate form, he or she has to bear the economic consequences of the investment decision ("information model").[200]

4-1-1-2. Scope of Information Duties

All information, including marketing communications, which investment services firms make available to their clients must be fair, clear and not misleading. Marketing communications must be clearly identifiable as such.[201] Furthermore, investment services firms are required to provide to clients – in a comprehensible form and in a timely manner – information that is reasonably appropriate for these clients to understand the nature and risks of the types of financial instruments or investment services that are being offered or demanded, and to take investment decisions on this basis.[202] This information must relate to a) the investment services firm and its services, b) the types of financial instruments and proposed investment strategies, including the risks associated therewith, c) the execution venues and d) the costs and associated fees.[203] Regarding the risks of the financial instruments, the investment services firms have to provide information not only about the risks specifically inherent to the given product but also about the general risk that its issuer might become insolvent, such that repayment is impossible and the capital invested will be lost.[204] All relevant aspects of the various types of information to be provided are set out in great detail in Delegated Regulation (EU) 2017/565.[205] Somewhat surprising is an additional new requirement originating in MiFID II which seems to state the obvious: investment services firms must understand the products they offer or recommend.[206]

Investment services firms may only recommend to their clients those financial instruments appropriate for the latter when providing investment advice or portfolio management.[207]

200 *Fuchs* (fn. 63), § 31 mn. 211.
201 Sec. 63 (6) WpHG.
202 Sec. 63 (7) WpHG.
203 *Ibid.*
204 One could argue that the latter general risk is self-evident, see *Harald Baum*, "Garantie-Zertifikate und 'Emittentenrisiko': Hinweispflicht in Werbefoldern?", Der Gesellschafter. Zeitschrift für Gesellschafts- und Unternehmensrecht (GesRZ) 2010, 311–319.
205 Art. 48 Delegated Regulation (EU) 2017/565.
206 Sec. 63 (5) WpHG.
207 Art. 54 (10) Delegated Regulation (EU) 2017/565.

4-1-1-3. Key Information Document

Germany introduced in 2011 the obligation for investment services firms, when providing investment advice to retail clients, to supply them with a brief and easily understandable information sheet concerning the financial instruments to which a buy recommendation relates.[208] This has to be done well before a transaction regarding those instruments is concluded.[209] The information provided must not be false or misleading, and it must be in accordance with the information given in the prospectus.[210] The obligation to supply such an information sheet arises only in relation to retail and not to professional clients, and only with respect to certain types of financial instruments.[211] The length of the document depends on the complexity of the instrument in question: up to two pages as a rule, with the maximum length being three pages in a pre-defined format.[212] These restrictions regarding length are mandatory.[213]

The German initiative was a national one as a reaction to the global financial crisis and was not induced by EU law at that time. Due to the implementation of MiFID II, this obligation applies now for *all* financial instruments that are *not* covered by the EU's *Regulation on Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs)*, which became effective on 1 January 2018 and is directly applicable in the Member States.[214] The Regulation also only applies if the products covered are offered to non-professional investors.[215]

The main purpose of both kinds of short information documents is to reduce the amount and the complexity of information – induced by government regulation – so as to avoid an "information overload" especially for general retail investors.[216]

208 See *Fuchs* (fn. 63), § 31 mn. 183 et seqq.

209 Sec. 64 (2) WpHG.

210 *Ibid.*

211 The details are regulated in Sec. 4 WpDVerOV.

212 Sec. 4 (1) WpDVerOV.

213 *Ibid.*

214 Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs), Official Journal L 352, 9.12.2014, p. 1.

215 Art. 5 of Regulation (EU) 1286/2014.

216 See *supra* at 1–3.

4-1-2. Information Duties Under Court Decisions

4-1-2-1. "Functional" Civil Law

Those information duties applicable under the WpHG and its supplementary regulations differ in scope, and partially, in content from those under German court decisions. Capital market regulation is intended to guaranty a *general* and a *preventive* protection that is granted *ex ante*, which is typical for public law. This contrasts with the *individual* protection which courts provide *ex post* in a given case, which is characteristic of private law enforcement.

From the traditional German point of view, the regulatory regime of the WpHG qualifies as a regulation that falls into the domain of public law – as opposed to that of private law. German legal scholarship draws a clear distinction between mandatory public law and private law, with the latter being largely not mandatory and left to party autonomy. The EU, however, does not know such a clear distinction.[217] The EU legislature has refrained from unifying civil law in the field of capital markets regulation because of the lack of competence. The Treaty on the Functioning of the European Union of 2012[218] does *not* provide a general competence for a unification of private law. There are some limited exceptions in fields such as consumer protection or product liability, but European lawmakers have generally recognized the substantial conceptual differences between the private law regimes in the Member States and have been hesitant to interfere in the contractual relations between citizens out of fear of disrupting the consistency of national private law regimes. This lack of harmonization allows the German courts to deal with liability of investment firms to their clients under *national* civil law without being bound, at least not directly, by EU law.[219]

However, the conduct-of-business rules set out in Sec. 63 et seqq. WpHG, though public law in nature, clearly have some connection with the contractual

217 For a discussion see *Stefan Grundmann*, "The Banking Union Translated into (Private Law) Duties: Infrastructure and Rulebook", European Business Organization Law Review (EBOR) 16 (2015), 357–382; *Florian Möslein*, "Third Parties in the European Banking Union: Regulatory and Supervisory Effects on Private Law Relationships Between Banks and their Clients or Creditors", European Business Organization Law Review (EBOR) 16 (2015), 547–574; *Olha O. Cherednychenko*, Financial Regulation and Civil Liability in European Law: Towards a More Coordinated Approach?, in: Olha O. Cherednychenko/Mads Andenas (ed.), Financial Regulation and Civil Liability in European Law, 2020, 2–46; *Evariest Callens*, "Recalibrating the Debate on MiFID's Private Enforceability: Why the EU Charter of Fundamental Rights is the Elephant in the Room", European Business Organization Law Review (EBOR) 21 (2020), 759–787.

218 Official Journal of the European Union, C 326, 26.10.2012.

219 For the complications arising out of this differentiation, see *infra* at 4–1-2-3.

relations between investment services firms and its customers, and thus with private law. Accordingly, these rules are often qualified as "functional" civil law.[220] The central questions that arise are whether the rules actually create civil law effects which interfere in the contractual relations and whether the courts have to consider that.[221]

If one sees the MiFID as a legal instrument that creates such effects, it becomes deducible that investors are entitled to claim damages from investment firms in breach of the conduct of business rules under the WpHG. The Directive is – somewhat surprisingly – quiet on these matters. Art. 70 of MiFID II (former Art. 51 of MiFID I) postulates only that the Member States must ensure in their national laws that their competent authorities may impose administrative sanctions and measures applicable to all infringements of the Directive, MiFIR and national provisions adopted in the implementation of these.[222] The Member States have to ensure that these measures are effective, proportionate and dissuasive.[223] The European Court of Justice (ECJ) ruled in May 2013 that the Member States are free to decide whether or not they want to implement civil law sanctions for a violation of conduct-of-business rules.[224] If they do, however, the civil law effects have to be effective and proportionate.

4-1-2-2. The "Bond Judgment" Jurisprudence

The investor protection newly created by the "functional" civil law of the WpHG does not, however, explore judicial *terra nova*, instead fitting squarely with the complex and partly older case law developed by the German courts over the past decades on the basis of *general* private law. Since the early 1990s, numerous scandals have invited a flood of decisions by the German Federal Court of Justice and by appellate courts dealing with the duties of investment firms when providing investment services and especially when giving investment advice.[225]

220 For an explanation of the term, see *Johannes Köndgen*, "Privatisierung des Rechts. Private Governance zwischen Deregulierung und Rekonstitutionalisierung", Archiv für die civilistische Praxis (AcP) 206 (2006), 477, 515. An English overview of the discussion can be found in *Harald Baum,* "Public vs. Civil Law: The German Controversy About the Interaction Between Capital Market Regulation and Contract Law", Hikakuhō Zasshi [Comparative Law Review] 48/3 (2014), 41–79; available at http://id.nii.ac.jp/1648/00007951/ [accessed 30 April 2021].

221 See *infra* at 4-1-2-3.

222 Art. 70 (1) MiFID II.

223 *Ibid.*

224 ECJ, 30 May 2013, C-604/11, ECLI:EU:C:2013:344. See also ECJ, 19 December 2013, *Hirmann*, C-174/12, ECLI:EU:C:2013:856.

225 An overview over the recent case law regarding information and advisory duties can be found in *Torsten Henning*, "Die neuere Rechtsprechung des Bundesgerichtshofs zu

Correspondingly, the courts have elaborated in great detail the rights of investors for damages in cases of a violation of the investment firms' duties.

The first major decision was the "Bond Judgment" reached by the Federal Court of Justice in 1993.[226] In its decision, the Court formulated the basic duty that investment advice has to be tailored, first, according to the need of the specific investor and, second, to the characteristics of the investment product in question.[227] This rule is still held valid today. The form in which such information and advice is provided is either an explicit or, more typically, an implied advisory contract between the bank and its client. German courts regularly assume the implicit conclusion of such a contract at the moment when the bank and its client initiate an advisory talk about financial products. The result of this 27-year-old evolution of case law is a highly refined structure of rights and obligations in the area of investment services based on private law rules, namely contract and agency law, as interpreted and developed by the courts. Capital markets regulation played only a very marginal and indirect role in this context.

4-1-2-3. Interaction of "Functional" and General Civil Law

A major question is therefore how the interaction of supervisory law and civil law can be managed, and it has yet to be clarified how "functional" civil law can be integrated with the traditional general civil law framework in the presence of the pronounced dichotomy between public and private law that emerged in the early nineteenth century in German law.[228] This is a largely unsolved fundamental issue permeating all German capital market regula-

Aufklärungs- und Beratungspflichten bei Kapitalanlagen", Wertpapier-Mitteilungen (WM) 2019, Sonderbeilage 4, 3. For an overview over earlier decisions of the Federal Court of Justice, see *Volker Lang/Peter Balzer*, Die Rechtsprechung des XI. Zivilsenats zum Wertpapierhandelsrecht seit der Bond-Entscheidung, in: Mathias Habersack/Hans-Ulrich Joeres/Achim Krämer (ed.), Entwicklungslinien im Bank- und Kapitalmarktrecht. Festschrift für Gerd Nobbe, 2009, p. 639–680.

226 Bundesgerichtshof (Federal Supreme Court), 6 July 1993 – XI ZR 12/93, Entscheidungen des Bundesgerichtshofs in Zivilsachen (BGHZ) 123, 126; confirmed by Bundesgerichtshof, 9 May 2000 – XI ZR 159/99, Wertpapier-Mitteilungen (WM) 2000, 1441; Bundesgerichtshof, 19 February 2008 – XI ZR 170/07, Wertpapier-Mitteilungen (WM) 2008, 825 and later decisions; for an analysis, see *Lang/Balzer* (fn. 225).

227 *Ibid.*

228 See *Kai Rothenhöfer*, Interaktion zwischen Aufsichts- und Zivilrecht, in: Harald Baum/Andreas M. Fleckner/Alexander Hellgardt/Markus Roth (ed.), Perspektiven des Wirtschaftsrechts. Beiträge für Klaus J. Hopt, 2008, p. 55–85; *Harald Baum*, "Das Spannungsverhältnis zwischen dem funktionalen Zivilrecht der 'Wohlverhaltensregeln' des WpHG und dem allgemeinen Zivilrecht", Österreichisches BankArchiv (ÖBA) 2013, 396–406; for an extended discussion, see *Julius Forschner*, Wechselwirkungen von Aufsichtsrecht und Zivilrecht, 2013.

tion.[229] The duties of investment services firms under private law as elaborated by the courts and their obligations under the conduct-of-business rules qualified as "functional" civil law and part of the supervisory law overlap to a certain extent, but they are *not* identical. Thus, the question is whether *only* a conduct that fulfills *both* the private *and* the public law requirements is appropriate or one that which fulfills at least *one* of the two, and, if the former, whether the *more relaxed* or the *stricter* standard should be the guideline.

Three opposing views can be observed. The Federal Court of Justice postulates a strict primacy of civil law in relation to the WpHG conduct-of-business rules.[230] According to the Federal Court, the conduct rules qualify exclusively as public law and establish only public law duties that have absolutely *no* civil law effects of their own.[231] In the view of the Federal Court, the conduct rules thus have neither a limiting nor an extending effect with respect to the civil law liability of investment firms.[232] In line with this reasoning, the Federal Court does not qualify the conduct rules as protective norms in the sense of Sec. 823 Para. 2 Civil Code, *Bürgerliches Gesetzbuch* (BGB), because they are not designed – under the Court's interpretation – to grant civil law investor protection.[233] In a more recent decision of 2014, the Federal Court states somewhat more ambiguously that, at least with respect to inducements offered by third parties,[234] the pertinent public law standard of transparency laid down in the conduct-of-business rules is also an element of the contractual duties between an investment services firm and its client.[235]

The second opinion, diametrically opposed to the first one, emphasizes an unrestricted primacy of the "functional" civil law of the WpHG over the general civil law. Proponents of this view argue that the conduct-of-business rules have

229 See *Stefan Grundmann*, "Wohlverhaltenspflichten, interessenkonfliktfreie Aufklärung und MiFID II", Wertpapier-Mitteilungen (WM) 2012, 1745–1755; *Petra Buck-Heeb*, "Aufsichts- und zivilrechtliche Normen im Bank- und Kapitalmarktrecht: einheitliche oder gespaltene Auslegung?", Wertpapier-Mitteilungen (WM) 2020, 157–164.

230 See especially the Federal Court's reasoning in the decision of 17 September 2013 – XI ZR 332/12, JuristenZeitung (JZ) 2014, 252, paras. 15–24; for a comment see *Christian Kropf*, "Keine zivilrechtliche Haftung der Banken im beratungsfreien Anlagegeschäft", Wertpapier-Mitteilungen (WM) 2014, 640–644.

231 The Federal Court's reasoning in the decision of 17 September 2013 – XI ZR 332/12, JuristenZeitung (JZ) 2014, 252, at paras. 16–18.

232 *Ibid.*

233 See *infra* at 5–1-2.

234 Cf. *supra* at 2–1-3-3.

235 Bundesgerichtshof, 3 June 2014 – XI ZR 147/12, Zeitschrift für Bankrecht und Bankwirtschaft (ZBB) 2014, 421; for a discussion, see *Grundmann* (fn. 26), mn. 249; *Robert Freitag*, "Überfällige Konvergenz von privatem und öffentlichem Recht der Anlageberatung", Zeitschrift für Bankrecht und Bankwirtschaft (ZBB) 2014, 357–365.

to be qualified not only as public law rules but simultaneously also as general civil law rules – though located outside the BGB – because of MiFID's expressed legislative aim of investor protection.[236] Under this view, the conduct rules are regarded as fixing duties for the investment firms to take care of their customers' interests, duties which have direct effects in contract law.

The third view builds a compromise between these two contradictory views: it does not claim a primacy of public law in the form of "functional" civil law, but much more modestly assumes a "diffusion" ("*Ausstrahlung*") of the pertinent public law rules into the general civil law and its application. This is probably the leading opinion in German academia today.[237] The "diffusion" is accordingly reduced to a *potential* but *not* mandatory interaction between both spheres of law. Supervisory law *might* influence contract law, but it does not necessarily do so.[238] The civil courts should have the freedom to deviate from the duties defined in the conduct-of-business rules as they deem appropriate.[239]

4-1-2-4. The "Spread Ladder Swap Judgment"

In a controversial decision of 2011, the Federal Court of Justice extended the parameters of the "Bond Judgment" for information duties of investment services firms when advising clients in complex and purely speculative swap transactions without underlying business transactions.[240] The Court interpreted the fact that the swap in question had an initial negative market value hidden in its complex structure as an indication of a severe conflict of interest on the part of the bank selling the swap, and it held the bank liable for damages without any limitations because of its failure to inform the investor about this conflict in advance.[241] It did not make a difference for this finding that the per-

236 See, *e.g.*, *Grundmann* (fn. 229), 1752; *Dorothee Einsele*, "Verhaltenspflichten im Bank- und Kapitalmarktrecht – öffentliches Recht oder Privatrecht?", Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht (ZHR) 180 (2016), 233–269; *Thomas M. J. Möllers*, in: Heribert Hirte/Thomas M. J. Möllers (ed.), Kölner Kommentar zum WpHG, 2nd ed. 2014, § 31 mn. 15.

237 See, *e.g.*, *Koller* (fn. 92), § 63 mn. 9; for a detailed discussion, see *Forschner* (fn. 228), p. 113 et seqq.; *Fuchs* (fn. 63), Vor §§ 31 bis 37a mn. 76 et seq.

238 See *Rolf Sethe*, Anlegerschutz im Recht der Vermögensverwaltung, 2005, p. 749.

239 See *Grigoleit* (fn. 22), p. 39 et seq.

240 Bundesgerichtshof, 22 March 2011 – XI ZR 33/10, Entscheidungen des Bundesgerichtshofs in Zivilsachen (BGHZ) 189, 13; for a detailed analysis of that decision, see *Grigoleit* (fn. 22), p. 25 et seqq. The decision was confirmed by further decisions of the Federal Court of Justice in 2015. For an overview, see *Peter Clouth*, Aufklärungs- und Beratungspflichten bei Swaps, in: Christian Grüneberg/Mathias Habersack/Peter O. Mülbert/Arne Wittig (ed.), Bankrechtstag 2015, 2016, p. 163–205.

241 BGH, 22 March 2011 – XI ZR 33/10, BGHZ 189, 13 (fn. 240), p. 26 et seqq.

tinent investor was a medium-sized company represented by its financial officer (a learned economist) and not a retail investor. The Federal Court further stated that the bank must make sure that its client a) fully understands the risk of the financial instrument involved in all its aspects and b) has achieved basically the same understanding and knowledge with respect to the product as the bank has.[242]

With respect to this second line of reasoning by the Federal Court, the decision has been criticized as overstretching the information duties of investment services firms and as an invitation for frivolous suits.[243] It indicates a paradigmatic shift in the practical application of the information model.[244] In the past, before the decision, banks were only obliged to deliver appropriate information on the financial instruments that they promote and sell to their clients. Once that was done, clients could not hold them liable for any losses resulting from the purchase of that instrument. Now, that is no longer sufficient, and banks must also make sure their clients have fully understood the information supplied. At least with regard to complex financial instruments, this is probably impossible, and thus the ruling leads to a *de facto* prohibition of such products (which may or may not be a good thing – probably a good one – but it is hardly a policy decision to be made by the courts instead of the legislature).[245]

4-2. Japan

4-2-1. Information Duty and Suitability Rule Under the FIEA

With regard to information duties, financial instruments business operators or registered financial institutions seeking to conclude a financial instruments transaction contract are required to deliver in advance to their customers documents describing the summary of the contract, the applicable fees, the nature and the extent of risks that will be borne by the customer and other relevant information.[246] Financial instruments business operators and registered finan-

242 *Ibid*., p. 30.

243 *Grigoleit* (fn. 22), p. 62 et seq. For frivolous investor suits, see *infra* at 5–1-3 and 5-1-4.

244 See *Jens Koch*, "Grenzen des informationsbasierten Anlegerschutzes", Zeitschrift für Bank- und Kapitalmarktrecht (BKR) 2012, 485, 487 et seqq.

245 See *ibid.*, 490 et seq.

246 Sec. 1 of Art. 37-3 of the FIEA. More specifically, if a financial instruments business operator or a registered financial institution seeks to conclude a financial instruments transaction contract, it must deliver a document stating the following particulars to the customer in advance, pursuant to Art. 79 of the Cabinet Office Order on Financial Instruments Business, etc. (provided, however, that this does not apply in cases specified by Art. 80 of the same Cabinet Office Order as those in which its not doing so

cial institutions, and their directors and employees, are prohibited from concluding a financial instruments transaction contract without explaining the above information to customers other than specified investors in a manner and to the extent necessary for the customer to understand, considering the customer's knowledge, experience, the status of the customer's properties and the purpose of concluding the contract.[247]

The FIEA stipulates that financial instruments business operators or registered financial institutions should conduct their business in such a manner that the state of their business operations does not result in the following: the issuance of a solicitation in connection with an act that constitutes a financial instruments transaction which is found to be inappropriate in light of customer knowledge, customer experience, the state of customer assets, or the purpose for which a financial instruments transaction contract is concluded, which results in or is likely to result in insufficient investor protection.[248] This is the suitability rule (*tekigōsei no gensoku*) under the FIEA.

does not compromise the protection of investors): a) the trade name or name as well as the address of the financial instruments business operator or the registered financial institution; b) an indication that it is a financial instruments business operator or a registered financial institution, and its registration number; c) an outline of the relevant financial instruments transaction contract; d) the particulars specified by Art. 81 of the same Cabinet Office Order with regard to any fees, remuneration or other consideration payable by the customer in connection with the financial instruments transaction contract; e) an indication of any risk that a loss will be incurred due to fluctuations in the money rate, the value of currencies, quotations on the financial instruments market (*kin'yū shōhin shijō*), or other indicators, in connection with an act that constitutes a financial instruments transaction (*kin'yū shōhin torihiki kōi*) carried out by the customer; f) an indication of any risk that the amount of the loss set forth in the preceding item will exceed the amount of customer margin or any other security deposit specified by a Cabinet Office Order that is payable by the customer; and g) the particulars of the contents of the relevant financial instruments business, other than what is set forth in the preceding items, which are specified by Arts. 82 to 96 of the Cabinet Office Order on Financial Instruments Business, etc. as material particulars that may have an impact on customers' judgment (Sec. 1 of Art. 37-3 of the FIEA).
This provision was stipulated because of the view that it is appropriate to impose an explanatory duty as a conduct regulation under the FIEA, which has the same content as in the ASFI. *Mitsui/Ikeda* (fn. 57), p. 286 et seq.

247 Item 9 of Art. 38 of the FIEA; Item 1 of Sec. 1 of Art. 117 of the Cabinet Office Order on Financial Instruments Business, etc. See *Yamanaka/Goto* (fn. 109), p. 212.

248 Item 1 of Art. 40 of the FIEA.

4-2-2. Information Duties and Suitability Rule Under the ASFI (APFS)

When a financial instrument provider intends to carry out financial instrument sales as a component of its business, specified matters (referred to as important matters) under the ASFI (APFS) should be explained.[249]

For example, if the relevant financial instrument sales involve a risk of incurring a loss of principal or a loss exceeding the initial principal, due to fluctuations in the interest rate, the value of currencies, quotations on a financial instruments market, or such other indicators, the following matters should be explained: a) the fact that there is a risk of incurring a loss of principal or a loss exceeding the initial principal, b) the relevant indicator and c) the important portions of the structure of transactions pertaining to the financial instrument sales which generate the risk of incurring a loss of principal or a loss exceeding the initial principal where fluctuations in that indicator are the direct cause thereof.[250]

The explanation in the preceding paragraph should be provided in a manner and to the extent necessary for the customer to understand, in light of the person's knowledge and experience or the nature of the person's property or the purpose of concluding a contract on the financial instrument sales.[251] This is the suitability rule under the ASFI (APFS).

When a financial instrument provider (intends to) conduct(s) financial instrument sales as a component of its business, it is prohibited from providing a customer with conclusive evaluations on uncertain matters or with information that misleads the person into believing the certainty of such matters with regard to the matters related to the relevant financial instrument sales.[252] This is referred to as the provision of conclusive evaluations, etc. (*danteiteki handan no teikyō-tō*).

4-2-3. Cases on Information Duties

4-2-3-1. Supreme Court Judgment of 14 July 2005[253]

While it is generally accepted in Japanese law that violation of administrative regulations does not necessarily give rise to civil liability,[254] the Supreme Court has held that a securities company (*shōken gaisha*) (presently, a financial instru-

249 Sec. 1 of Art. 3 of the ASFI (Sec. 1 of Art. 4 of the APFS). This is the primary explanatory duty under the ASFI (APFS). See *supra* at 3-2-1 and 3-2-2.

250 Items 1 and 2 of Sec. 1 of Art. 3 of the ASFI (Items 1 and 2 of Sec. 1 of Art. 4 of the APFS).

251 Sec. 2 of Art. 3 of the ASFI (Sec. 2 of Art. 4 of the APFS).

252 Art. 4 of the ASFI (Art. 5 of the APFS). The term "intends to" is deleted in the APFS.

253 Supreme Court Judgment of 14 July 2005, Minshū 59-6-1323.

254 See Yamashita/Kanda (fn. 157), p. 414 [*Hideki Kanda*].

ments business operator) is liable to its customer under tort law when its employee solicited and prompted a customer to make a securities transaction while significantly deviating from the suitability rule, for example by aggressively encouraging the customer to make a clearly excessively risky investment contrary to the will and the circumstances of that customer.[255]

4-2-3-2. Supreme Court Judgment of 22 April 2011[256]

The Supreme Court has held that a contracting party who violated the duty to explain under the principle of good faith[257] by failing to provide to the other party before the conclusion of the contract information that would have influenced the decision of the other contracting party whether or not to conclude the contract could be liable under tort law, but not under contract law, for non-performance of a contractual obligation.[258]

When financial instruments business operators or registered financial institutions fail to follow information duties under the FIEA, it is likely that such failure will be considered as a breach of the duty of one contracting party to provide explanation to the other party, which is recognized as one form of the principle of good faith, and that the financial instruments business operator or the registered financial institution will be held liable under tort law.[259]

4-2-3-3. Supreme Court Judgments of 7 and 26 March 2013[260]

It is pointed out that, traditionally, most lawsuits claiming compensation for loss caused by a failure to provide an explanation of financial instruments were filed by retail investors.[261]

255 Minshū 59-6-1323, 1331. See *Yamanaka/Goto* (fn. 109), p. 214. It has been pointed out that, with regard to a violation of the Securities and Exchange Act – before the enactment of the FIEA –, the Supreme Court held that a private law effect such as tort liability could arise under certain conditions when there is a violation of administrative regulations, Supreme Court Judgment of 4 September 1997, Minshū 51-8-3619; further, whether a private law effect arises should be determined by considering the purpose of the individual provisions (of administrative regulations) whose violation is at issue and by considering the mode of the violation in the particular case. Yamashita/Kanda (fn. 157), p. 414 [*Hideki Kanda*].

256 Supreme Court Judgment of 22 April 2011, Minshū 65-3-1405.

257 Sec. 2 of Art. 1 of the Civil Code.

258 Minshū 65-3-1405, 1408. See *Yamanaka/Goto* (fn. 109), p. 214 et seq., note 41.

259 See *Yamanaka/Goto*, (fn. 109), p. 214.

260 Supreme Court Judgments of 7 March 2013, Shūmin 243-51 and of 26 March 2013, Shūmin 243-159, respectively. See *Yamanaka/Goto* (fn. 109), p. 215.

261 *Yamanaka/Goto* (fn. 109), p. 215.

It is also indicated that, while similar lawsuits have also recently been filed by non-retail investors, the Supreme Court seems to be reluctant to grant relief in such cases.[262] For example, in two cases where small unlisted stock companies (*kabushiki gaisha*) brought actions against a major bank contending a breach of information duties regarding a simple interest rate swap transactions, the Supreme Court did not find any breach by the defendant bank because the fundamental structure or principle itself was so simple that it was generally understandable without difficulty, at least for a manager of an enterprise, and the risk of concluding the contract could be justifiably attributed to that enterprise.[263]

4-2-3-4. Supreme Court Judgment of 15 March 2016[264]

In another case, a large listed stock company in the consumer loan business sued Merrill Lynch International and its Japanese subsidiary (Merrill Lynch Japan Securities Co., Ltd.) for a huge amount of losses arising from the purchase of a structured bond, which was arranged by Merrill Lynch International and sold by the Merrill Lynch Japan Securities Co., Ltd. to enable the plaintiff to offset its own bond; the losses occurred when the value of the structured bond plummeted in the course of the global financial crisis.[265]

The plaintiff claimed the breach of information duties by the defendants, and the Tokyo High Court partly affirmed the claim with a 50% discretionary discount.[266] The Tokyo High Court considered whether there was a breach of information duties or not based on the explanations of employees of the Merrill Lynch Japan Securities Co., Ltd. and the understandings of employees of the plaintiff, who directly received the information.[267] The Court's judgment was substantially based on two points; a) the explanation was provided too late and b) a term sheet was provided in English and not translated into Japanese.[268] This judgment was generally criticized.[269]

262 *Ibid.*

263 Supreme Court Judgments of 7 March 2013, Shūmin 243-51, 58 and of 26 March 2013, Shūmin 243–159, 167.

264 Supreme Court Judgment of 15 March 2016, Shūmin 252-55. See *Toshiaki Yamanaka*, *Han'hi* [Case Note], Jurisuto [Jurist] 1509 (2017), 107 (in Japanese); *Yamanaka/Goto* (fn. 109), p. 215 et seq.

265 Shūmin 252-55, 58–63; Tokyo High Court Judgment of 27 August 2014, Hanrei Jihō 2239-118, 120–134.

266 Hanrei Jihō 2239-118, 135–141. The discount is under Sec. 2 of Art. 722 of the Civil Code.

267 Hanrei Jihō 2239-118, 136, 139–140. See *Yamanaka* (fn. 264), 109.

268 See *Yamanaka* (fn. 264), 109.

269 For the criticisms, see *ibid.*, 109 et seq.

By contrast, the Supreme Court considered the characteristics of the plaintiff, including a) the fact that the plaintiff was listed on both the Tokyo Stock Exchange First Section and the London Stock Exchange, and was conducting financial businesses internationally and b) no facts suggested that it would have been impossible or difficult for the plaintiff to postpone or cancel the argued transaction and c) that the plaintiff must have been able to understand the explanation given by the defendants, even if the employee of the plaintiff in charge of the purchase did not have detailed knowledge of financial transactions.[270] Based on these facts, the Supreme Court did not find a breach of information duties and reversed the lower court decision.[271]

This Supreme Court judgment stated that the information to be provided in this particular case include the following: a) the basic structure of the structured bond, b) the risk of incurring 100% loss of the principal in the worst-case scenario and c) the risk of advancement of redemption before the date set in the initial contract.[272] This judgment was positively commented on in the case notes[273] and has been understood as one that did not establish a general ruling but solved the particular case.[274] It is an interesting judgment on the information duties of financial institutions in a case where the customer is also a professional investor.

4-2-3-5. Brief Summary

Japan's Supreme Court did not establish a detailed general ruling for determining whether there is a breach of information duties, and the lower courts consider individual facts in individual cases. One might observe that the lower courts generally require an explanation that allows customers to understand the conditions under which the risks accompanying financial products could materialize and the possibilities of this happening, and that allows them to independently consider whether or not the investment is appropriate; however, it is difficult to find a specific criterion on the scope of information duties.[275] In this setting, one might also point out that the scope of information duties depends on the facts in each particular case.[276]

270 Shūmin 252-55, 64–65. See *Yamanaka* (fn. 264), 110.
271 Shūmin 252-55, 64–66. See *Yamanaka* (fn. 264), 110.
272 Shūmin 252-55, 55, 64. See *Yamanaka* (fn. 264), 110.
273 For the positive comments, see *Yamanaka* (fn. 264), 110.
274 See Shūmin 252-55, 55; Hanrei Jihō 2302-43, 46 [comment]; *Yamanaka* (fn. 264), 109 et seq.
275 See *Yamanaka* (fn. 264), 109.
276 See *ibid.*

4-3. Comparative Analysis

A similar duty is stipulated in both jurisdictions under what is called the "appropriateness rule" under German law or the "suitability rule" under Japanese law.

German law takes a further step to assure that the information for a solid investment decision is supplied by stipulating that the investment services firm providing investment advice or portfolio management has to obtain from the client all relevant information ("know your customer") at the first possible occasion; otherwise, the firm must abstain from providing advice or management services. In Japan, the FIEA or the ASFI (APFS) does not provide for this; however, financial instruments business operators, registered financial institutions and financial instrument providers have to consider customer knowledge, customer experience, the state of customer assets and the purpose for concluding a financial instruments transaction contract or a contract on the sales of financial instruments.[277]

Under German law, the information to be supplied has to be fair, clear and not misleading. German or European law additionally addresses the information overload caused by the manifold information duties and the complexity of financial instruments by obliging investment services firms to supply their retail clients with an information document ("PRIIPs") which is mandatorily short and easy to understand when they provide investment advice. In Japan, financial instruments business operators and registered financial institutions are required to deliver documents under the FIEA, the mandatory contents of which are also specified.[278]

Japanese law, like its German counterpart, makes a fundamental distinction between private and public law; however, it does not have to grapple with the vexed problem of what is called "functional" civil law in Germany.[279] German courts had to develop their concepts surrounding investor protection on the basis of general private law (what is called "Bond Judgment" jurisprudence), and the partly inconsistent rules of functional civil law were shaped under the WpHG along the lines of the EC/EU law. The development of capital market regulation in Japan did not occur in a similar historical setting, its having been reshaped as early as the late 1940s.[280]

277 See *supra* notes 248 and 251 and accompanying text.
278 See *supra* note 246 and accompanying text.
279 See *supra* note 228 and accompanying text.
280 See *supra* at 1–4.

Of special interest is a comparison of the "Spread Ladder Swap Judgment" issued by the German Federal Court of Justice in 2011[281] and the Merrill Lynch judgment of the Japanese Supreme Court of 2016.[282] In both cases, professional investors tried to recoup from their investment advisors losses that were incurred in risky investments. The German Federal Court of Justice granted relief in a mostly criticized decision, while the Japanese Supreme Court rejected any breach of information duties by considering the characteristics of the plaintiff.[283] What the Japanese court pointed out is different from what can be deduced from the "information model", since it considered whether the stock company must have been able to understand the explanation provided by the investment services firm, based on the characteristics of the company.[284] This judgment was understood as one that did not establish a general ruling but solved the particular case;[285] however, under this framework, even when all the relevant information is provided, an investment services firm may possibly be held liable for the damages if the customer is found to have been unable to understand the explanation provided.

5. Private Enforcement

5-1. Germany

5-1-1. Virtually No Direct Private Enforcement of Capital Markets Regulation

German capital markets regulation does *not* have a general provision granting compensation for "*fraud on the market*", such as the one under the Securities Acts in the U.S. The investor protection provisions of the WpHG – in the traditional understanding – do not generally grant compensation rights for investors for their violation except in some situations. Such a rare exception exists in compensation for defective "ad hoc statements" pertaining to insider information.[286] Otherwise, there is virtually no direct private enforcement of capital markets regulation.[287]

281 See *supra* at 4–1-2-4.
282 See *supra* at 4–2-3-4.
283 See *supra* notes 270 and 271 and accompanying text.
284 See *supra* note 270 and accompanying text.
285 See *supra* note 274 and accompanying text.
286 Secs. 97 and 98 WpHG.
287 For an overview, see *Petra Buck-Heeb*, "Neuere Rechtsprechung zur Haftung wegen fehlerhafter oder fehlender Kapitalmarktinformation", Neue Zeitschrift für Gesellschaftsrecht (NZG) 2016, 1125–1133; *Philipp Maume*, "Staatliche Rechtsdurchsetzung

5-1-2. Scarce Private Enforcement under Tort Law

General tort law is a theoretically possible means for addressing wrongdoing by investment services firms. The relevant provision is Sec. 823 BGB – the provision for general liability for damages. However, this is of little practical importance in the context of investor protection as it does not provide for compensation of pure economic loss. Compensation can be granted only in combination with a violation of one of the conduct-of-business rules and with a relevant violation of a provision of the WpHG qualifying as a "*Schutzgesetz*", *i.e.* a "protective law" in the sense of Sec. 823 (2).[288] Views are split on whether at least some of the conduct-of-business rules may qualify as a *Schutzgesetz*. A majority in academia answers this question in the affirmative.[289] The Federal Court of Justice, however, in accordance with its qualification of these rules as largely irrelevant under general civil law,[290] has repeatedly rejected such a qualification.[291] Thus, that particular avenue is in practice very difficult to pursue at least for the time being.[292]

Another tort law alternative, though again a rather theoretical possibility, is a claim under Sec. 826 BGB. This provision grants compensation for damages intentionally caused if they are contrary to common decency ("*guten Sitten*"). The provision is a special rule for exceptional cases. Accordingly, its preconditions are strict and seldom fulfilled. The courts are very reluctant to grant compensation under this provision.[293]

im deutschen Kapitalmarktrecht: eine kritische Bestandsaufnahme", Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht (ZHR) 180 (2016), 358–395.

288 For a discussion of the "*Schutzgesetz*" concept, see *John Bell/André Janssen,* Markesinis's German Law of Torts. A Comparative Treatise, 5th ed. 2019, p. 72 et seq.; *Harald Koch*, The Law of Torts, in: Joachim Zekoll/Gerhard Wagner (ed.), Introduction to German Law, 3rd ed., 2019, p. 269, 279; for a detailed discussion in German, see, *e.g.*, *Frank A. Schäfer*, Die Pflicht zur Aufdeckung von Rückvergütungen und Innenprovisionen beim Vertrieb von Fonds in Rechtsprechung und Gesetzgebung, in: Habersack/Joeres/Krämer (ed.) (fn. 225), p. 725–740.

289 Cf., *e.g.*, *Möllers* (fn. 236), § 31 mn. 22 et seqq.; *Fuchs* (fn. 63), Vor §§ 31 bis 37a mn. 101 et seqq.

290 See *supra* at 4–1-2-3.

291 BGH, 17 September 2013 – XI ZR 332/12, JuristenZeitung (JZ) 2014, 252, 254 (para. 21); BGH, 19 February 2008, Wertpapier-Mitteilungen (WM) 2008, 825 (fn. 226); for a critique, see*, e.g. Klaus J. Hopt*, "50 Jahre Anlegerschutz und Kapitalmarktrecht: Rückblick und Ausblick", Wertpapier-Mitteilungen (WM) 2009, 1873, 1880; for a concurring view, see, *e.g.*, *Rothenhöfer* (fn. 228), p. 63 et seqq.

292 The legal situation has not changed as a result of the 2018 reform of the WpHG, see *Koller* (fn. 92), § 63 mn. 12.

293 An example of a rare decision that *grants* compensation under Sec. 826 BGB is Bundesgerichtshof, 19 July 2004 – II ZR 402/02, Entscheidungen des Bundesgerichtshofs

5-1-3. Indirect Private Enforcement Under Contract Law

In sharp contrast, but limited to the area of *contractual* relations between investment services firms and their clients and thus covering only a part of the information duties related to capital markets, general civil law in the form of contract law and agency does play an important role in investor protection.

Since the early 1990s, German courts have – in hundreds of decisions – constantly refined and transformed this set of private law rules into an elaborate network of contractual and pre-contractual duties of information, care and advice.[294] The Federal Court of Justice issued more than 30 (!) decisions dealing with inducements, namely "kick-backs",[295] in the context of securities investment advice.[296] Especially after the collapse of Lehman Brothers in 2008, German courts were swamped with investor suits brought against investment services firms, with investors trying to collect their losses by claiming violations of information duties.[297] Insofar as information duties based on capital market regulation are reflected in information obligations under contract law, they are indirectly enforced in this way.

5-1-4. "Right of Regret"

The private law investor protection offered by the German courts is functioning well, sometimes even too well. Courts have increasingly shown an overshooting tendency, whereby they make peripheral violations of information duties a basis for granting investors damages or even a right to rescind the contract.[298] This leads to the reverse problem of a misuse of information duties

in Zivilsachen (BGHZ) 160, 149 – *Informatec* (comment by *Holger Fleischer*, "Konturen der kapitalmarktrechtlichen Informationsdeliktshaftung", Zeitschrift für Wirtschaftsrecht (ZIP) 2005, 1805). An often-cited example for a decision *rejecting* compensation under that provision is Bundesgerichtshof, 13 December 2011 – XI ZR 51/10, Der Betrieb (DB) 2012, 450 – *IKB* (comment by *Alexander Hellgardt*, Der Betrieb (DB) 2012, 673). For a general overview *see Buck-Heeb* (fn. 287).

294 See *supra* at 4-1-2-2.

295 The term is used to describe the payment of commission by a third party to an investment services firm without indicating this to the client.

296 For a discussion, see *Grundmann* (fn. 26), mn. 249.

297 See *infra* at 5–1-4.

298 See, *e.g.*, Bundesgerichtshof, 27 September 2011 – XI ZR 182/10, Entscheidungen des Bundesgerichtshofs in Zivilsachen (BGHZ) 191, 119; for a critical comment see *Harald Baum*, "Reuerecht und Emittentenrisiko – Grenzen der Aufklärungspflicht aus prospektrechtlicher und beratungsvertraglicher Sicht", Der Gesellschafter. Zeitschrift für Gesellschafts- und Unternehmensrecht (GesRZ) 2015, 11–29.

and a perversion of investor protection with the possibility to step back *ex post* without any costs from failed investments.[299]

The pertinent court decisions are in danger of creating, *contra legem*, a "right of regret" ("*Reuerecht*") and general liberation of contractual duties violating the principle of *pacta sunt servanda*. Investors seize upon the chance to make a profit with their investments, but in case of failure they refuse to bear the negative economic consequences and try to shift the loss to the investment services firms as their contract partners and/or advisors. In effect, this strategy amounts to nothing else but a socialization of their losses to the detriment of the public, *i.e.* other customers and owners (often pension funds and other retail investors) of investment services firms. Courts in Germany (and elsewhere in the EU) are swamped with such frivolous suits not only in the area of capital markets but also in other consumer-related fields. This is an unexpected deviation from the information model.

5-2. Japan

5-2-1. Private Enforcement: Overview

It is pointed out that German and other European courts have been swamped with thousands of (sometimes frivolous) damages claims raised by aggrieved investors based on (perceived or real) violations of information duties in the primary as well as secondary capital markets over the last two decades.[300] In contrast, while Japan has seen substantial securities litigation, it has been nowhere near these levels.[301]

It is noted that, traditionally, most lawsuits claiming compensation for loss caused by a failure to provide an explanation of financial instruments have been filed by retail investors.[302] While similar lawsuits have also recently been filed by non-retail investors, the Supreme Court seems to be reluctant to grant relief in such cases.[303]

299 For a detailed analysis, see *Harald Baum*, "Das prospektrechtliche Widerrufs- bzw. Rücktrittsrecht im Spannungsverhältnis zwischen Anlegerschutz und Reuerecht: gestörte Vertragsparität zu Lasten der Kreditinstitute", Österreichisches BankArchiv (ÖBA) 2018, 86–102.

300 *Baum/Kanda* (fn. 46), 110 et seq.

301 See *ibid.* (fn. 46), 111.

302 *Yamanaka/Goto* (fn. 109), p. 215.

303 See *ibid.* and *supra* at 4–2-3.

5-2-2. Private Enforcement under Tort Law or the ASFI (APFS)

A general tort law provision stipulates that a person who has intentionally or negligently infringed any right of others, or any legally protected interest of others, is liable to compensate the damages resulting as a consequence.[304] In order to obtain damages under this general tort law provision, it is in principle necessary for the plaintiff to claim and establish a) the infringement, b) the intention or the negligence of the defendant, c) causality between the infringement and the damage and d) the amount of the damage.[305] It is pointed out that in some cases the courts reject recovery of such losses as pure economic loss, which can be defined as economic loss of the plaintiff in a situation where he/she has suffered neither personal injury nor damages to tangible property, but in others they are more generous toward plaintiffs.[306]

The ASFI (APFS) modifies the general tort law provision. Specifically, in order to obtain damages under Art. 5 of the ASFI (Art. 6 of the APFS), the plaintiff has only to claim and establish either the breach of information duties under Art. 3 of the ASFI (Art. 4 of the APFS) or an infringement of the prohibition on the provision of conclusive evaluations, etc. under Art. 4 of the ASFI (Art. 5 of the APFS).[307] It is not necessary for the plaintiff to assert intentional conduct or negligence on the part of the defendant, which means that the strict liability of the financial instrument providers is stipulated.[308] The plaintiff also does not need to establish causality between the infringement and the damage nor the amount of the damage.[309] This is because of the legal setting establishing that, in cases where a customer claims compensation for damages pursuant to the Art. 5 of the ASFI (Art. 6 of the APFS), the amount of loss of principal is presumed to be the amount of loss incurred by the customer due to the failure of the financial instrument provider to give an explanation on important matters or due to a provision of conclusive evaluations, etc. by the financial instrument provider.[310]

Another tort law provision stipulates the vicarious liability of an employer.[311] Specifically, it provides that a person who employs others for a certain business

304 Art. 709 of the Civil Code.

305 See *Kazuyo Ikeda*, Chikujō kaisetsu shin kin'yū shōhin hanbai-hō [Commentary on the New ASFI], 2008, p. 4.

306 *Yoshihisa Nomi*, Japan, in: Vernon Valentine Palmer/Mauro Bussani (ed.), Pure Economic Loss: New Horizons in Comparative Law, 2009, p. 71–87.

307 See *Ikeda* (fn. 305), p. 5.

308 See *ibid.*, p. 4.

309 See *ibid.*

310 Sec. 1 of Art. 6 of the ASFI (Sec. 1 of Art. 7 of the APFS). See *Ikeda* (fn. 305), p. 5.

311 Sec. 1 of Art. 715 of the Civil Code.

is liable for damages inflicted on a third party by his/her employees with respect to the execution of that business; provided, however, that this does not apply if the employer exercised reasonable care in appointing the employee or in supervising the business, or if the damages could not have been avoided even if he/she had exercised reasonable care.[312] In order to obtain damages from the employer under this provision, it is in principle necessary for the plaintiff to claim and establish that the damage was inflicted with respect to the execution of the employer's business; the plaintiff must also establish a) the infringement, b) the intentional conduct or the negligence of the defendant, c) causality between the infringement and the damage and d) the amount of the damage.[313] If the employer successfully claims and establishes that he/she exercised reasonable care in appointing the employee or in supervising the business, or if the damages could not have been avoided even if he/she had exercised reasonable care, then he/she will not be liable for the damage.[314]

The ASFI (APFS) modifies this provision on the liability of an employer. Specifically, when damages are claimed under Art. 5 of the ASFI (Art. 6 of the APFS), the employer may not claim and establish the exercise of reasonable care by referring to this provision in order to avoid liability.[315] The enforcement of the explanatory duty under the ASFI (APFS) depends on civil liability claims for damages and is characterized as a voluntary private enforcement mechanism.[316]

312 *Ibid.*

313 See *Ikeda* (fn. 305), p. 5. See *supra* note 305 and accompanying text.

314 See *Ikeda* (fn. 305), p. 6.

315 See *ibid.*, p. 6. See *supra* note 314 and accompanying text.

316 The FIEA presently stipulates various enforcement mechanisms for its regulations (see *Baum/Kanda* (fn. 46), 85 et seqq.). For the breach of the information duty under the FIEA (Sec. 1 of Art. 37-3 of the FIEA; see *supra* at 4–2-1.): a person who violates the information duty provision by a) failing to deliver a written document, b) delivering a written document that does not contain the particulars prescribed in the provision or c) delivering a written document that contains a false statement is subject to criminal punishment by imprisonment with required labor for not more than six months, by a fine of not more than 0.5 million yen, or by both (Item 12 of Art. 205 of the FIEA). If the representative of a corporation or the agent, employee or other worker of a corporation violates the same Item 12 of Art. 205 of the FIEA in connection with the business or property of the corporation, in addition to the offender being subject to punishment, the corporation is subject to punishment by a fine of not more than 0.5 million yen (Item 6 of Sec. 1 of Art. 207 of the FIEA).

5-3. Comparative Analysis

In Germany, as well as in other various European jurisdictions, courts are swamped with damages claims by all kinds of investors.[317] Many of these are frivolous claims making (mis)use of formal legal positions with the aim of socializing personal losses to the detriment of the public. There is an actual danger of creating *contra legem* a "right of regret". By contrast, a similar legal development is not observed in Japan.

Both jurisdictions are divergent in several points. First, when damages are claimed under civil law, investors primarily invoke contract law and not tort law in Germany, while those in Japan employ tort. This is because of the legal setting whereby compensation for pure economic loss may only exceptionally be granted under German tort law, while such damages may usually be granted under Japanese tort law.[318] Second, the strict lability of investment services firms is stipulated, and the amount of loss of principal is presumed to be the amount of loss incurred by the customer due to the failure of the financial instrument provider under the ASFI (APFS) in Japan;[319] by contrast, German courts have developed a complex and inadequate framework regarding causality issues without such statutory development. Third, the level of civil litigation appears to be too high in Germany mainly because of the development of a factual right of regret,[320] while such a development has not been observed in Japan.[321]

6. Conclusion

This article has examined the legal rules and regulations governing investment services in Germany and Japan. For historical reasons, the regulatory structures are largely divergent in both jurisdictions; the regulatory aims, however, largely converge in both jurisdictions in terms of securing a fair and efficient functioning of the capital markets with a special emphasis on investor protec-

317 See *supra* at 5–1-4. Germany introduced the "Capital Investor Model Proceedings Act" (*Kapitalanleger-Musterverfahrensgesetz – KapMuG*) in 2005 as an efficient court proceeding to handle cases of mass damages. This was, however, a *reaction* to the onset of numerous lawsuits brought by retail investors and *not* its cause. An English overview of the KapMuG can be found in *Harald Baum*, "The German Capital Markets Model Case Act – A Functional Alternative to the US-Style Class Action for Investor Claims?", http://dx.doi.org/10.2139/ssrn.2909545 [accessed 30 April 2021].

318 See *supra* at 5–1-2 and 5-2-2; *supra* notes 291 and 306 and accompanying text.

319 See *supra* notes 308 and 310 and accompanying text.

320 See *supra* at 5–1-4.

321 See *supra* at 5–2-1.

tion. Both jurisdictions address the central issue of conflict of interests, though the current German law is technically more differentiated in this regard. The envisaged shift in Europe from commission-based investment advice to independent fee-based advice is not stipulated in the FIEA in Japan.

With respect to the persons protected and the extent of protection under capital markets laws in Germany and Japan, both jurisdictions adopt a flexible regulation by differentiating persons according to their various need of protection and by allowing them to change the default legal status. But even in the flexible regulatory framework, the fundamental principles of avoiding conflicts of interests, acting in good faith and acting in the best interest of clients or investors are mandatorily provided in both jurisdictions.

Regarding the information to be provided, a similar duty is stipulated in both jurisdictions, what is called the "appropriateness rule" under German law and the "suitability rule" under Japanese law.

German law takes a further step to assure that the information for a solid investment decision is supplied by stipulating that the investment services firm providing investment advice or portfolio management has to obtain from the client all relevant information ("know your customer") at the first possible occasion. In Japan, we do not find a corresponding statutory obligation; however, financial instruments business operators, registered financial institutions and financial instrument providers have to consider customer knowledge, customer experience, the state of customer assets and the purpose for concluding a financial instruments transaction contract or a contract on the sales of financial instruments.

Under German law, as under Japanese law, the information to be supplied has to be fair, clear and not misleading. Further, banks and others are required to deliver information documents, the mandatory contents of which are legally specified.

Japanese law, like its German counterpart, makes a fundamental distinction between private and public law; however, it does not have to grapple with the vexed problem of what is called "functional" civil law in Germany. Here we can see a historically different path-dependent development. Of special interest is a comparison of the "Spread Ladder Swap Judgment" issued by the German Federal Court of Justice in 2011 and the Merrill Lynch judgment of the Japanese Supreme Court of 2016. In both cases, professional investors tried to recoup from their investment advisors losses that were incurred in risky investments. The German Federal Court of Justice granted relief in a mostly criticized decision, while the Japanese Supreme Court rejected any breach of information duties by considering the characteristics of the plaintiff.

The two jurisdictions are divergent as regards several points. First, when damages are claimed under civil law, investors primarily invoke contract law and not tort law in Germany, while those in Japan employ tort. This is because of the legal setting whereby compensation for pure economic loss may only exceptionally be granted under German tort law, while such damages may usually be granted under Japanese. Second, the strict lability of investment services firms is stipulated, and the amount of loss of principal is presumed to be the amount of loss incurred by the customer due to the failure of the financial instrument provider under the ASFI (APFS) in Japan; by contrast, German courts have developed a complex and inadequate framework regarding causality issues without such statutory development. Third, the level of civil litigation appears to be too high in Germany mainly because of the development of a factual right of regret, while such a development has not been observed in Japan.