KIN-YÛ ADR
--A New ADR System in the Japanese Financial Industry--

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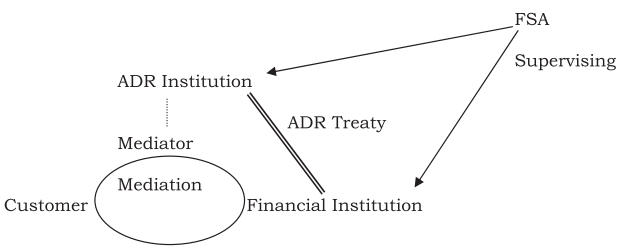
1. Introduction

Kin-Yû ADR, or a special ADR system in the Japanese financial industry, began on October 1, 2010 so as to encourage "fast, simple and flexible" dispute resolution. This is one of the milestones of recent trends of pro-ADR policies of the Japanese Government. *Kin-Yû* ADR proceedings are, in essence, mediation between a financial institution (*e.g.*, banking, trust, insurance, or securities company) and its customer. However, unlike standard mediation, the financial institution owes a legal obligation to cooperate for "fast, simple and flexible" dispute resolution. The financial institution must appear at hearings and provide information requested by the mediator unless the financial institution has reasonable grounds not to do so. Moreover, when the mediator prepares a "special settlement proposal" and the customer accepts it, the financial institution is bound by the proposal, unless, for example, the financial institution files for litigation in court against the customer, enters into an arbitration agreement with the customer, or settles with the customer within one month.

2. Basic Structure of Kin-Yû ADR

Kin-Yû ADRs cover disputes between customers and financial institutions regarding financial services that financial institutions engage in under licenses in accordance with sixteen acts supervised by the Financial Services Agency (the "FSA").[1,2] Customers include not only natural persons, but also corporate customers; accordingly, business to business disputes are covered by *Kin-Yû* ADRs. Disputes with a financial institution not relating to financial services conducted by the financial institution are outside the scope of *Kin-Yû* ADRs.



(a)ADR Treaty

A financial institution's "legal obligation to cooperate" is founded on an ADR treaty with an ADR institution, such as the Japanese Bankers Association for banks and the Life Insurance Association of Japan for life insurance companies.[3] A financial institution must conclude an ADR treaty with an ADR institution (Article 12-3 of the Banking Act). Although no agreement exists between the financial institution and the customer, the financial institution is bound by the ADR treaty and must cooperate.[4,5] The ADR institution is designated on a sector by sector basis and supervised by the FSA for being independent and impartial (Articles 52-62, and 52-78 through 52-84 of the Banking Act). Some financial sectors have no designated ADR institutions. In such a case, the financial institution is required to take particular measures deemed appropriate or conclude an ADR treaty with a particular ADR institution certified by the Ministry of Justice (*e.g.*, the Japan Commercial Arbitration Association), with the National Consumer Affairs Center of Japan, or with an ADR center operated by a local bar association.

The ADR treaty between the designated ADR institution and the financial institution must provide as follows:

(i) The ADR institution shall commence (a) claim management proceedings related to the financial services upon request by a customer of the financial institution or (b) dispute resolution proceedings upon a request by either the customer or the financial institution (Article 52-67(2)(i) of the Banking Act);

(ii) When the ADR institution or mediator requests that the financial institution respond to the claim management proceedings or the dispute resolution proceedings, the financial institution must not refuse such request without reasonable grounds (Article 52-67(2)(ii) of the Banking Act);

(iii) When the ADR institution or mediator requests that the financial institution prepare reports or submit books, documents or any other materials in the claim management proceedings or

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[1] *The sixteen acts are: the Banking Act, Long Term Credit Bank Act, Shinkin Bank Act, Labor Bank Act, Small and Medium-Sized Enterprise Cooperatives Act, Agricultural Cooperatives Act, Fishery Cooperative Act, Norinchukin Bank Act, Trust Business Act, Act on Engagement in Trust Business by a Financial Institution, Insurance Business Act, Financial Instruments and Exchange Act, Act on Regulation of Mortgage Security Business, Money Lending Business Act, Act on Settlement of Funds, and Mutual Loan Business Act.*

[2] *For the sake of convenience, article numbers of the Banking Act are cited in this article. A translation of the Banking Act prepared by the Japanese government is posted at: http://www.japaneselawtranslation.go.jp.*

[3] *Other designated ADR institutions are: the Trust Companies Association of Japan, the General Insurance Association of Japan, Hoken (insurance) Ombudsman, the Small Amount & Short Term Insurance Association of Japan, Japan Financial Services Association, and the Financial Instruments Mediation Assistance Center.*

[4] *It is notable that a consumer may cancel an arbitration agreement between the consumer and a business unless the arbitration agreement is concluded after the commencement of arbitration (Article 3 of the Supplementary Provisions of Arbitration Act).*

[5] *This mechanism is a little like investment treaty arbitration: even when an investor and a state have no arbitration agreement, since the state is a party to an investment treaty that provides that disputes between the state and the investor may be settled by arbitration, the investor may commence arbitration against the state.*

the dispute resolution proceedings, the financial institution must not refuse such request without reasonable grounds (Article 52-67(2)(iii) of the Banking Act);

(iv) A mediator may prepare a settlement proposal in dispute resolution proceedings, and recommend that the parties accept such proposal (Article 52-67(2)(iv) of the Banking Act);

(v) A mediator may prepare a "special settlement proposal" with reasons, and present it to the parties, in cases where the mediator finds no possibility of reaching a settlement and where the mediator finds it reasonable in light of the nature of the case, the intention of the parties, the status of proceedings, or any other circumstances (Article 52-67(2)(v) of the Banking Act);

(vi) The financial institution must report to the ADR institution on related court litigation, if any (Article 52-67(2)(vi) through (ix) of Banking Act);

(vii) The financial institution must conduct public relation activities regarding *Kin-Yû* ADR and provide necessary information to its customers (Article 52-67(2)(x) of the Banking Act); and

(viii) The ADR institution may, upon a customer's request, investigate whether the financial institution honored the settlement terms, and if the financial institution has not, recommend that the financial institution do so (Article 52-67(2)(xi) of the Banking Act, Article 34-70 of the Banking Rules).

If a financial institution fails to conclude an ADR treaty, the FSA, as a supervising authority to the financial institution, will exercise its power (Article 26 of the Banking Act). Also, if the financial institution breaches the ADR treaty and has no reasonable grounds for doing so, the ADR institution must disclose to the public, and report to the FSA without delay, the name of the financial institution and the facts related to the breach, upon conclusion of a related hearing (Article 52-68 (1) of the Banking Act). In serious cases, the financial institution's license may be revoked (Article 27 of the Banking Act).

(b)Dispute Resolution Proceedings (Mediation)

A customer of a financial institution may file a request for mediation with the ADR institution that has concluded an ADR treaty with the financial institution. The ADR institution must promptly notify the financial institution of the request (*see*, Article 52-67(4)(ix) of the Banking Act). The financial institution does not have the liberty to disregard the request without reasonable grounds.

A financial institution may also file a request for mediation with the relevant ADR institution. The ADR institution must promptly notify the customer and inquire whether the customer will respond to the request (*see,* Article 52-67(4)(viii) of the Banking Act). The customer has the liberty to disregard the request.

If litigation is pending (the concurrence of litigation and mediation), the court may, upon request by both parties, stay the court proceedings for a fixed period of not longer than four months (Article 52-75 of the Banking Act).

Once ADR proceedings have been initiated, the ADR institution appoints a mediator. Several mediators, rather than a sole mediator, may be appointed in accordance with the rules of the ADR institution. At least one mediator must be an experienced Japanese attorney[6] or a specialist in consumer claims. Only when several mediators are to be appointed, a specialist in the disputed financial services may be appointed as a mediator. It is interesting that the ADR centers of the three bar associations in Tokyo appoint two mediators for certain cases: generally, one is an attorney who often works for financial institutions and the other is an attorney who often works for consumers.[7]

The parties appear before the mediators and explain their positions. The proceedings are confidential (Article 52-73(7) of the Banking Act). Separate caucuses are quite often used. The mediator may request that the financial institution prepare reports or submit books, documents or other materials. The financial institution does not have the liberty to refuse such request without reasonable grounds. After holding the hearing, the mediator prepares a settlement proposal. The mediator may additionally prepare a special settlement proposal. Section (c) below lays out the unique features of such "special" settlement proposals. When the mediator finds no prospect of reaching settlement, the mediator promptly terminates the *Kin-Yû* ADR proceedings and notifies the parties.

Filing the request for mediation itself does not toll the statute of limitations, however, the party that filed the request for mediation may retroactively toll the statute of limitations by filing for litigation in court within one month after the termination of the mediation proceedings (Article 52-74 of Banking Act).[8]

(c)Special Settlement Proposals

A special characteristic of *Kin-Yû* ADRs is the special settlement proposal. When a special settlement proposal is presented to the parties, the financial institution is required to accept the special settlement proposal, unless:

(i) the customer does not accept the special settlement proposal;

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[6] *For cases with small amounts in dispute, an experienced judicial scrivener that handles cases in small claims court may be appointed as a mediator.*

[7] *The two-mediator method of Kin-Yû ADRs follows that of medical (mal-practice) ADRs (one for doctors and the other for patients) which has had great success. The parties regard the two-mediator tribunal as representing the interests of both parties. Moreover, the mediators may more easily understand both positions by openly exchanging opinions. It should be noted that neither of the two mediators represent either party and they are required to be independent and impartial.*

[8] *Since this article regarding the period of the statute of limitations does not apply to some ADR institutions, it is advisable that research be conducted before filing a request for mediation.*

(ii) the financial institution files for litigation in court[9] within one month from the day when the financial institution became aware of the customer's acceptance of the Settlement Proposal, and the litigation is pending on that day (*i.e.*, the financial institution does not withdraw from litigation immediately after filing);

(iii) litigation that had been pending before the special settlement proposal is pending on that day; or

(iv) an arbitration agreement has been entered into or a settlement has been reached between the parties by that day (Article 52-67(6) of the Banking Act).

A special settlement proposal is essentially a mini-arbitral award that may be telling of a potential decision which could be rendered in future litigation. The parties will likely seriously consider whether they should accept the special settlement proposal. Whether the mediator should present the special settlement proposal is at the mediator's sole discretion. However, a mediator must consider the fact that presenting the special settlement proposal may result in immediate litigation if the customer accepts it but the financial institution does not. Litigation requires a great deal of effort and is costly for both the customer and the financial institution.

In practice, rather than simply issuing a mini-arbitral award based on the facts presented in the proceeding, some mediators choose to closely communicate with both parties, show a draft of a special settlement proposal, and after confirming that the draft is acceptable to both parties, formally present the final special settlement proposal. If the mediator does so, the "special settlement proposal" will have almost the same function as a "settlement proposal". It is notable, however, that a mediator may use the draft special settlement proposal as a tool for persuading the financial institution. Since the financial institution is required to file a lawsuit when a special settlement proposal is presented, the financial institution is put under pressure and must seriously consider the draft special settlement proposal. The draft also brings a certain pressure to an economically rational customer who would consider the burden of labor and costs of potential litigation.

3.Some Comments and Conclusion

Are *Kin-Yû* ADRs good for financial institutions and customers? I believe the answer is yes. The most important feature of a *Kin-Yû* ADR is providing a channel for communication between customers and financial institutions under an established and trustworthy system.

ADR was, and still is, often regarded in Japan as a dispute resolution method for the party that does not have a strong position to state its case. In other words, a party who wants to avoid seeming weak has to file for litigation. Since *Kin-Yû* ADRs are established as a standard trustworthy dispute resolution mechanism endorsed by the FSA, such a prejudicial view will become obsolete. Without a trustworthy channel for communication, financial institutions are sometimes too conservative to respond to any potentially-hostile inquiry by customers and try to avoid problems (although, in reality, ignoring customer's qualms sometimes brings about much more severe disputes). On the other hand, through a trustworthy mediator, financial institutions and customers may openly exchange their views on a case (of course, the mediator does not give all of the information that it has received from one party to the other party) and may find a solution. This cannot be accomplished through one-on-one negotiations.

Moreover, Japanese financial institutions are prohibited from compensating customer's losses relating to financial services, unless the loss was caused by illegal or unjustified conduct of the financial institution; and the violation of which may result in severe criminal penalties, including imprisonment (prohibition of compensating losses, Article 13-4 of the Banking Act and Article 39 of the Financial Instruments and Exchange Act). Even when a financial institution believes that it has engaged in illegal or unjustified conduct and wants to compensate losses, there is a risk that the FSA will take a different view of its conduct. Through *Kin-Yû* ADR proceedings scrutinized by an independent and impartial mediator, financial institutions may reduce the risk of their actions being viewed as prohibited compensations of loss.

Litigation is the most favored dispute resolution method in Japan. The Japanese judiciary has a reputation of being fair, intelligent and diligent. Complex litigation, however, may take two or more years just to clear the district court level. Parties submit voluminous documents, which requires a great deal of labor and cost. When both parties' positions appear clear after the exchange of documents, parties quite often settle the case through mediation proceedings held by judges (who will pass a final judgment if the parties fail to reach settlement). *Kin-Yû* ADRs may omit this needless exchange of documents.

Fast, fair and reasonable dispute resolution is beneficial both for financial institutions and customers. *Kin-Yû* ADRs are still in their early stages, but quite a number of filings have already been made.[10] I hope for their success in the near future.

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[9] *In many cases, the financial institution will seek a declaratory judgment that the financial institution owes no obligation to the customer, instead of seeking payment from the customer.*

[10] *The Japanese Bankers Association received 11334 consultations, 2305 requests for claim management proceedings, and 254 requests for dispute resolution proceedings from October 2010 to April 2011. The Financial Instruments Mediation Assistance Center received 3422 consultations, 680 requests for claim management proceedings, and 192 requests for dispute resolution proceedings for the same period. (Source: http://www.zenginkyo.or.jp/adr/conditions/index/conditions01_2301_1.pdf and http://www.finmac.or.jp/pdf/finmac_no4.pdf.)*

On the other hand, some ADR institutions have received few to no requests for dispute resolution proceedings. It may depend on factors such as the particular financial sector, how many financial institutions have concluded an ADR treaty with the ADR institution, and how public relation activities with respect to customers have been conducted.