Conflicts of Interest in Financial Institutions under the Anglo-American Law

Jun Uede (Kobe City University of Foreign Studies)

Financal institutions play an essential role in the country's economy. Therefore, the need to maintain and promote the integrity of, and the public confidence in, the financial industry is obvious. However, where a financial institution is engaged in two or more aspects of financial activities, a potential conflict of interest and abuse might arise. Where a financial institution acts in the capacity of agent, trustee or other fiduciary in regard to the client, it is not allowed to put itself in a position where its interest and duty conflict. In certain circumstances, however, the interest of the client might be endangered by the fact that the financial insitution is engaged in another function. For example, where a financial institution combines the position of underwriter and of investment manager, its self-interest in minimising its potential loss could directly conflict with its legal obligation to protect the interest of the investment client. The institution holding securities left unsold, due to an unsuccessful issue, will inevitably be tempted to avoid loss by dumping such securities onto the fiduciary accounts over which it exercises control. Similarly, where a financial institution engages in the business of acting both as broker (agent) and as dealer (principal) in securities transactions, it might be tempted to induce its brokerage clients to purchase securities left unsold, by abusing the fiduciary position inherent in the broker.

Conflict of interest problems are not limited to self-dealing as such, but may take more subtle forms. For example, where a financial institution engages both in the stockbroker and investment manager functions, it might be tempted to generate commissions by causing excessive transactions for its clients' accounts. Again where a financial institution combines the commercial banker and investment manager functions, temptation to promote good relations with a commercial client could influence the institution's investment decisions and thus prevent it

from exercising discretion in the best interest of the investment clients.

This paper examines various types of conflict of interest problems and the regulations of such abuses through an analysis of the relevant American and British cases. This paper concludes that a rigid "Fire Wall" policy as well as administrative surveillance is indispensable to control such abuses in Japan.