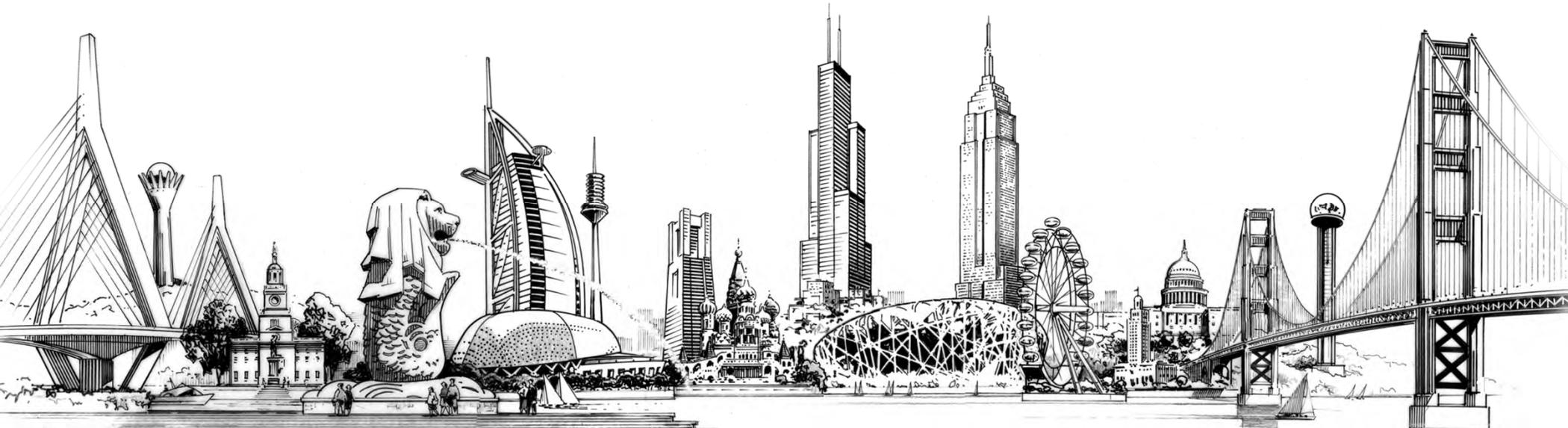


# Morgan Lewis

## GOING GLOBAL: RAISING CAPITAL AND SETTING UP AN INVESTMENT OFFICE IN TOKYO

**March 10, 2016**

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# Agenda

1. Overview of securities regulations relevant to asset management and fund distribution in Japan
2. Regulation of capital-raising activities in Japan by foreign fund managers
3. Use of article 63 to distribute fund securities in Japan
4. Establishment of a presence in Japan: forms of organization, establishment of an office, and FIBO registration
5. Insider trading considerations in Japan
6. Cross-border services – US regulation
7. UK regulation

# What We Will Discuss

- A little background concerning Morgan Lewis–Tokyo’s investment management practice and the scope of our assistance to clients wishing to participate in the Japanese market
- Overview of Japan’s Securities Regulatory System as it impacts fund-related activities in Japan
  - Sources of law and regulation governing fund management and distribution
  - Regulatory and self-regulatory bodies supervising different facets of the fund industry in Japan
  - Classifications of fund securities and major business registrations required to handle each type of activity
- Review of general distribution rules applicable to approaching investors in Japan, including relevant investor classifications and potential exemptions, filing requirements, and types of Financial Instrument Business Operators (FIBOs) in Japan
- How the Article 63 exemption can permit direct marketing of LP form fund interests to certain Japanese investors and the recent changes to this regime
- Corporate forms of presence in Japan and a very high-level review of the procedures for obtaining FIBO registrations in these entities
- An overview of some of the Japanese employment law considerations that arise once you establish a presence in Japan
- A review of Japanese insider trading regulation and its application to fund managers trading on the Japanese market, both inside and outside Japan

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**OVERVIEW OF SECURITIES  
REGULATIONS RELEVANT TO ASSET  
MANAGEMENT AND FUND  
DISTRIBUTION IN JAPAN**

**CHRISTOPHER WELLS**

# Our Practice

- We service more than 100 fund management clients in the United States, Europe, and Asia
- Most Tokyo clients are asset management firms, but we also do work for banks, insurance groups, securities firms, and other financial intermediaries
- Our main practice areas include:
  - General financial regulatory advice
  - Licensing and registration of financial intermediaries handling and investing for funds
  - Making filings in connection with trading activities, capital raising and annual reporting
- We provide compliance training, “mock” audits, and related services
- We also provide services in certain related practice areas, including:
  - Corporate and branch establishment and maintenance
  - Employment law advice, employment-related documentation, and related matters
  - Real estate (premises leasing) negotiations and renewals

# Overview of Fund Regulatory Regime in Japan

- Fund-related securities businesses are heavily regulated under two principal laws:
  - **Financial Instruments and Exchange Act (FIEA)** provides for:
    - Which securities business activities are regulated with respect to (i) investment and (ii) capital-raising activities in Japan (i.e., who can offer securities-related business services and who can solicit investors);
    - The standards and methods for obtaining business registrations;
    - How fund products must be presented to investors (i.e., how solicitation must occur) in private placements and public offerings;
    - How investors are classified for purposes of solicitation activities;
    - What disclosure and registration of fund securities in Japan must be made with Japanese governmental authorities and in what contexts; and
    - What activities are prohibited for both registered intermediaries and investors generally
  - **Investment Trust and Investment Corporation Law – ITICL** provides for:
    - Structure of interests in investment trusts and investment corporations in Japan; and
    - Required notifications to Japanese regulators about the offering of these products in Japan
- Subordinate regulations (Cabinet Orders and Ordinances) under these laws provide greater detail about specific requirements and create an overall framework

# Regulatory Supervision and Self-Regulation

- Applicable regulatory and self-regulatory authorities in Japan include:
  - **Financial Services Agency (FSA)**:
    - Established under the Prime Minister's Office with authority to:
      - Issue business registrations to FIBOs under the FIEA
      - Supervise and monitor the conduct and activities of registered FIBOs
  - **Securities Exchange Surveillance Commission (SESC)**
    - The "independent" arm of the FSA responsible for financial market oversight (trading regulator)
    - Conducts inspections of FIBOs and makes recommendations to the Commissioner of the FSA for sanctions, etc., where appropriate
  - **Japan Securities Dealers Association (JSDA)**: Self-regulatory body with oversight responsibility for Type 1 FIBOs including administration of licensing examinations and training (similar role to FINRA)
  - **Type 2 Association**: Recently established industry self-regulatory body with oversight responsibility for Type 2 FIBOs
  - **Japan Investment Advisors Association (JIAA)**: Industry self-regulatory body with oversight responsibility for asset managers and investment advisors
  - **Japan Investment Trust Association**: Industry self-regulatory body with oversight responsibility for asset managers that conduct investment trust management business

# FIEA Registrations (2 for Distribution and 2 for Asset Management)

- FIEA distinguishes between two major categories of securities:
  - **¶1 Securities** Defined in Article 2(1) of the FIEA: includes equity securities, debt securities, and most derivatives; in general, investment funds in the form of trusts or shares are ¶1 Securities
  - **¶2 Securities** Defined in Article 2(2) of the FIEA: “less liquid” securities such as partnership and limited partnership (LP) interests; in general, LP form funds will be characterized as ¶ 2 Securities
- There are four main business registrations under the FIEA:
  1. **Type 1 Registration:** This registration permits a registrant to conduct the business of brokerage, agency, and intermediation of ¶1 Securities (i.e., corporate and trust form funds).
  2. **Type 2 Registration:** This registration permits a registrant to conduct the business of brokerage, agency and intermediation of ¶2 Securities (i.e. LP, form funds).
  3. **Investment-Management Registration:**
    - This registration permits a registrant to manage assets on a discretionary basis (DIM activities) for investors pursuant to an investment management agreement.
    - This registration also covers an authority to manage domestic investment trusts/corporate funds.
    - A foreign manager may not enter into an asset management relationship with any Japanese investor directly; the manager may only make such arrangements through a Japan registered Discretionary Investment Manager (DIM)
    - Firms that wish to invest actively in Japanese markets for non-Japanese investors from a Japan base require the Asset Management Registration
  4. **Investment Advisory and Agency Registration:**
    1. The “Advisory” portion of this registration permits a registrant to conduct the business of giving investment advice for a fee.
    2. The “Agency” portion of the registration permits and registrant to “intermediate” the conclusion of an Investment Management Agreement or an Investment Advisory Agreement between a Japanese DIM and a foreign DIM.

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# **REGULATION OF CAPITAL RAISING ACTIVITIES IN JAPAN BY FOREIGN FUND MANAGERS**

**TOMOKO FUMINAGA**

# Capital-Raising Activities in Japan

- There are two approaches to raising capital in Japan:
  - (1) Securities Distribution Approach
    - Sell funds directly to investors through distributors
  - (2) Asset Management Approach
    - Acquire an investment management mandate and, based on the mandate, invest in funds
- Depending on the type of target investors, the approach to be taken would be different
  - => Under Japanese law, pension funds are required to manage assets by one of the following methods: (i) investing in an insurance, (ii) investing in a trust, or (iii) delegating investment authority to a DIM
  - => If the target investors are pension funds, the asset management approach would be more appropriate

# Securities Distribution Approach

## (1) Establish its own distributor

- Market corporate or trust-type funds => Register as Type 1 FIBO
  - Regulations are heavy
    - ❖ Must be a Kabushiki Kaisha (KK) or a foreign equivalent
    - ❖ Must have a board of directors and a statutory auditor
    - ❖ Must have a capital requirement (JPY 50M)
    - ❖ Must have an NAV requirement (JPY 50M)
    - ❖ Must have a capital adequacy ratio (minimum 140%)
    - ❖ Must notify major shareholders
  - If 50 or more investors are solicited, a securities registration statement must be filed (15-day window)
  - Regardless of making a public offering or a private placement, file a notification under the Investment Trusts and Investment Corporations Act
  - Required to be a member of the JSDA

# Securities Distribution Approach (Cont.)

## (1) Establish its own distributor (Continued)

- Market LP funds => Register as Type 2 FIBO
  - Regulations are less heavy
    - ❖ Capital requirement of JPY 10M
  - If 500 or more investors are acquired, a securities registration statement must be filed (15 day window)
  - No filing under the Investment Trusts and Investment Corporations Act
  - Required to be a member of the Type II Financial Instruments Firms Association

## (2) Hire a local distributor

- Need to pay distribution fees
- As with handling other funds, not necessarily focused only on the group's funds

# Foreign Securities Firm Exemption

- Foreign securities firms may approach Type 1 or Type 2 FIBO
- Foreign securities firms may approach certain types of institutional investors but only from offshore
  - => Must carefully check whether the target investor and the action fall within the scope of this exemption because it is a very narrowly tailored and very complicated exemption
- A foreign securities firm may accept orders if an investor voluntarily approaches the foreign securities firm
- Asset managers cannot rely on this exemption

# Type of Offering of Securities

- Public Offering => Required to file a securities registration statement
  - Corporate or trust-type funds – solicit 50 or more investors
  - LP funds – solicit 500 or more investors
- Private Placement
  - Corporate or trust-type funds
    - (1) Small number of private placements – solicit less than 50 investors
    - (2) Qualified Institutional Investor (QII) private placements – only solicit QIIs
    - (3) Hybrid – solicit less than 50 investors and an unlimited number of QIIs
  - LP funds – solicit less than 500 investors

# Asset Management Approach

## (1) Establish its own asset manager

- Regulations are heavy (similar to Type 1)
  - Must be a KK or a foreign equivalent
  - Must have a board of directors and a statutory auditor
  - Capital requirement of JPY 50M
  - NAV requirement of JPY 50M
  - Must notify major shareholders

(Note) No capital adequacy ratio requirement

- Cannot sell funds
- Required to be a de facto member of the Japan Investment Advisers Association

# Asset Management Approach (Cont.)

## (2) Rely on the exemption under Article 61 of the FIEA (Article 61 Exemption)

- Foreign asset managers may provide a discretionary/nondiscretionary investment management service to Japan DIMs under the Article 61 Exemption
- If a Japan DIM has a mandate from a pension fund and a foreign asset manager acquires a mandate from the Japan DIM (i.e., the foreign asset manager is sub delegated the authority to manage the assets contributed by the pension fund), a foreign asset manager may indirectly provide the investment management service to the pension funds



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# **USING ARTICLE 63 TO DISTRIBUTE FUND SECURITIES IN JAPAN**

**TOMOKO FUMINAGA**

# Legal Framework

The offering of interests in a collective investment scheme (typically, LP interests) in Japan and managing assets contributed by Japanese investors under such collective investment scheme are regulated by Japanese law.

## **Principle:**

Required to be registered in Japan as a financial instrument business operator

## **Exemption: Specifically Permitted Business for QIIs under Article 63 of the FIEA (Article 63 Exemption)**

File a notification under Article 63 of the FIEA

- Without registering as a financial instruments business operator, an Article 63 notification allows a filer to
  - conduct private placements of interests in collective investment schemes, and
  - manage the assets under such collective investment schemeswith respect to QIIs and up to 49 general investors

# Current Status

The Article 63 Exemption is broadly used and works well:

As of January 31, 2016

Type 1 Business Firm	Type 2 Business Firm	Investment Advisor/Agent	Investment Manager	Article 63 Filers
280	1,157	989	342	2,723

- ⇒ The number of Article 63 filers has been greater than or almost the same as the number of registered financial instruments business operators.
- ⇒ More than 60% of collective investment scheme interests sold in Japan are managed by Article 63 filers.
- ⇒ On the other hand, the Article 63 Exemption has caused a great deal of problems (such as improper solicitation, misappropriation of funds, poor operation, abuse of Article 63 Exemption). Almost 20% of Article 63 filers have been named on the problematic firms list.
- ⇒ Stricter rules became effective on March 1, 2016 (with a 6-month grace period for some requirements).

# The New Rule

## (1) New Requirements for Article 63 Filers

- Not to fall within any of the disqualifications categories, such as:
  - Had a license canceled in the financial area, or violated relevant laws within the last 5 years
  - Being a member of anti-social forces
  - (In the case of a foreign entities) failing to appoint a representative in Japan
  - (In the case of a foreign entities) failing to obtain confirmation by a foreign regulator that it will respond to the Japanese regulators' request to cooperate in an investigation
- Indicate (i) a business office where the Article 63 filer actually conducts business, (ii) a description of relevant portfolios, and (iii) the name, type, and number of all QIIs
- Attach required documents (oath of Article 63 filer and its officers and employees, constitutional documents of Article 63 filers, corporate registration, etc.)
- Disclose the Article 63 Notification to the public (after filing the new form Article 63 Notification during the grace period)

# The New Rule (Cont.)

## (2) Expansion of the Conduct Regulations

- Deem Article 63 filers financial instruments business operators
- Comply with the conduct regulations normally applicable to financial instruments business operators (such as delivery of an explanatory document before and upon entering into a contract, suitability test, asset segregation confirmation, not making conclusive statements regarding uncertain matters, fiduciary duty, and subject to prohibited activities)
- Prepare and maintain books and records for 10 years (can be prepared in English)
- Prepare and file annual business reports with the regulators (from the business year starting after March 1, 2016)
- Prepare and maintain a copy of the business report (or equivalent explanatory documents) available to the public (from the business year starting after March 1, 2016)

# The New Rule (Cont.)

## **(3) Administrative Sanctions/Penalties**

- Impose business improvement orders, business suspension orders, and business cessation orders on Article 63 filers
- Order the production of reports, file materials, or conduct inspections of Article 63 filers
- Court order to cease or suspend the conduct of the business if there is an urgent situation requiring steps to prevent the escalation of damages or harm to investors
- Impose more severe penalties on a person who fails to file an Article 63 Notification or files a false notification

## **(4) Limit the Scope of Investors**

- Eliminate cases where protection of investors would be hindered by the Article 63 Exemption

# The New Rule (Cont.)

## Possibility of Relying on Other Exemptions or Arrangements

- In practice, many Article 63 filers have elected to file Article 63 Notifications even when such filings may not have been strictly necessary, because of the:
  - greater flexibility of Article 63 filers marketing activities in Japan, and
  - minor cost and low administrative burdens.
- However, under the new rules, an Article 63 Exemption is a much more complicated filing with materially burdensome ongoing obligations.
- It may be recommendable to reexamine the Article 63 filers' existing business activities to confirm if they need to continue to operate under the Article 63 Exemption
  - if an LP Fund is closed for investment
  - if a Type 2 Financial Instruments Business Operator has been retained
  - if an LP Fund does not have any Japan investors
  - if the composition of the Japan investors permits the use of the "*de minimis* exemption."

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**ESTABLISHING A PRESENCE IN JAPAN:  
FORMS OF ORGANIZATION,  
ESTABLISHMENT OF AN OFFICE AND  
FIBO REGISTRATION**

**CAROL TSUCHIDA**

# Establishing a FIBO Presence in Japan

- In order to conduct regulated activities as a FIBO in Japan, a registered presence in Japan is required for most substantive activities.
- There are a number of forms that this presence may take, both as Japanese and non-Japanese entities.
- Once a presence is registered, staffing and other organizational tasks are required.
- The four major FIBO registrations follow a relatively similar path through the following phases:
  1. Initial draft of the application;
  2. Discussions with the regulators and amendments to the application;
  3. Formal submission of the application;
  4. Formal reviewing period and formal review of the application; and
  5. Completion of the registration.

# Forms of Organization - Japanese

- FIBO registrants must be organized as certain types of entities, which may vary based on the type of FIBO registration being sought.
- There are a number of forms that this presence may take, both as Japanese and non-Japanese entities.
- A KK, is the Japanese equivalent of a standard joint stock company

**Advantages:**

1. Acceptable for all four major FIBO registrations
2. Clear and robust statutory requirements
3. Familiarity to Japanese regulators and counterparties; perception of stability

**Disadvantages:**

1. Onerous statutory requirements (i.e. representative directors, statutory auditors, and shareholder meetings)
2. Double-taxation
3. Lack of familiarity for foreign participants

Note: It used to be required that at least one representative director must be a resident in Japan, but this requirement was eliminated last year.

- A Japanese *godo kaisha* is the Japanese equivalent of a US LLC, which offers limited liability to its members and can be described as a hybrid between a corporation and partnership

**Advantages:**

1. Simpler statutory requirements than the KK
2. Can be treated as a tax pass-through ("check the box" entity for US tax purposes)

**Disadvantages:**

1. Can only obtain Investment Advisory and Agency (IAA) FIBO and Type 2 FIBO registrations, but not the other two registrations
2. Less well perceived as having stability or a significant presence

# Forms of Organization – non-Japanese

- The FIEA allows foreign established entities that are equivalent to the acceptable Japanese forms of entities to register as FIBO
- In order for a foreign entity to register as a FIBO conducting Type 1 or DIM activities, the foreign entity must register a Japan branch
- An offshore Type 2 organization is required to appoint someone as a Japan representative
- The most common form of foreign entity used is a foreign joint stock corporation, such as a Cayman Islands exempted company or a Delaware corporation
- In order to establish a Japan branch, the foreign joint stock corporation would be incorporated in its foreign jurisdiction in the normal course
- Following incorporation, a corporate resolution is passed by the foreign entity to establish a Japan branch and a registration is filed with the legal affairs bureau
- Requirements to register a Japan branch are:
  - a physical address in Japan
  - the appointment of a representative in Japan, who is someone equivalent to the branch manager and resides in Japan
  - the date of the branch establishment
- If using a foreign stock corporation, as is commonly done, certain additional steps are required in order for the Japan branch to qualify as a FIBO registrant:
  1. There must be a board of directors (consisting of at least three directors); and
  2. There must be a statutory auditor appointed

# Establishing the Japan Presence – Office Space

- Each entity, whether a Japanese entity or a Japan branch of a foreign entity, is required to have a physical office address in Japan
- For the initial stages of the establishment, temporary or serviced offices may be used
- Floor plans of the office space will be required in the FIBO registration process
- Clear separation from persons or offices that are not a part of the FIBO registrant is required
- In the leasing process, as a matter of practice, leases are typically executed in Japanese and there is generally a lack of flexibility in negotiating terms with the big landlords
- It should be noted that for many leases, in addition to typical deposits, “key money” payments equal to a number of months of rent may be required to be paid to landlords
- Japanese leases also include an obligation that tenants to restore the premises upon termination of the leases

# Establishing the Japan Presence – Staffing

- All of the FIBO registrations require certain levels of staffing by Japan-resident personnel
- The number of personnel varies, depending on the particular FIBO registration being obtained
- Typically, the Type 1 FIBO (which markets only funds managed by its affiliates) and (DIM FIBO (which sub-delegate major part of the authority to manage assets) registrations require six or more Japan hires, with at least one full-time compliance officer
- The Type 2 FIBO and JIAA FIBO registrations can be done with fewer personnel, and a full-time Japan-resident compliance officer may not be necessary, as part-time or regional compliance officers with the requisite knowledge of Japanese requirements may be acceptable to the regulators
- The first hires are typically the representative in Japan (Japan branch of a foreign corporation) or the representative director (Japanese corporation), and/or the compliance officer
- Other personnel may be staffed more gradually depending on the registration being sought and the registrant's particular business model, but must be employed before the formal submission of the application

# Establishing the Japan Presence – Employment Agreements – Overview

## Employment Relationships

- In Japan, the employment relationship has some similarities to those in other advanced countries, but there are a number of key differences that employers should be cognizant of prior to hiring any employees
- In Japan, employment relationships are primarily based on contracts, but statutes and court-established rules frequently modify and restrict the concept of freedom of contract in the field of employment relationships
- Overall, although certain statutory rights may be limited, the courts and arbitral tribunals are employee friendly
- The Labour Contract Law, sets forth basic principles governing employment contracts, and stipulates the requirements under which dismissals and disciplinary actions will be considered void
- The Labour Standards Act establishes compulsory minimum standards (such as paid leave) that employers must observe
- In addition, if an employer has 10 or more employees, the employer is required to establish in written form its “Rules of Employment” according to certain statutory minimum standards, and these Rules of Employment take precedence over less favorable contractual terms
- The Rules of Employment (after the 10th employee) and a number of ancillary agreements, such as an agreement to allow an employer to require employees to work overtime or on a discretionary work-hours system (more suitable for professionals), are required to be filed with the local Labour Standards Inspection Office
- The key difference in many jurisdictions is that there is no concept of “at will” employment, and dismissals for cause are typically quite difficult

# Establishing the Japan Presence – Employment Agreements – Certain Provisions

## Treatment of Typical Employment Provisions

- **Discrimination:**
  - Employers are prohibited from discriminating on the basis of gender, race, membership in a labour union, nationality, creed, social status, and family origin
  - Compared to the United States, there are fewer protected classes
- **Harassment:**
  - There are laws against sexual harassment similar to those in other jurisdictions
  - In addition, there is a concept of “power harassment” which has recently received greater attention
- **Protective Provisions:**
  - Protective provisions, such as noncompetition, nonsolicitation, and confidentiality provisions, are enforced in Japan, largely on a case-by-case basis dependent on the particular facts
  - Injunctions are typically more difficult to obtain and it is rare to be able to enjoin an employee from leaving an employer or from beginning employment in a new firm; the typical remedies are limited to monetary damages

# FIBO Registration Process

- Although there are particular differences in the registration process for the four major FIBO registrations, the general flow follows the below steps:
  1. Establishment of a Japan presence by registering the entity in Japan
  2. Drafting of an initial FIBO registration application (typically 1 month)
  3. Initial visit to the regulators to present the FIBO registration outlines and initial FIBO registration application documents
  4. Negotiation and comments from the regulators (typically 1-3 months)
  5. Invitation to submit the formal application from the regulators
  6. Formal review period (typically approximately 2 months)
  7. Grant of formal registration
  8. Registration or membership in any required self-regulatory organizations, such as the JSDA, or the Type 2 Association or the JIAA, depending on the particular FIBO registration being sought

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# **INSIDER TRADING CONSIDERATIONS IN JAPAN**

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# Insider Trading

## Legislative Intent

**Any person who becomes aware of nonpublic material information as a result of his/her special situation that is significantly advantageous compared to other general investors with respect to his/her trading activities. If trading by such individual becomes widespread, the confidence of the public in the securities market will become impaired and the market may not be able to effectively accomplish its function.**

### **In the narrow sense:**

- i. Insider trading by company related persons, etc.**
- ii. Insider trading by persons related to public tender offerers, etc.**

### **In the broad sense: i, ii +**

- iii. Duty to submit trading reports of officers and substantial shareholders of listed companies, etc. (Article 163)**
- iv. Disgorgement of any short swing profits by officers and substantial shareholders of listed companies, etc. (Article 164)**
- v. Prohibition of short sales by officers and substantial shareholders of listed companies, etc. (Article 165)**

# Insider Trading by Company Related Persons

The definition of “Insider Trading” is set forth in Article 166(1) of the FIEA :

Any person who is a “company related person” who becomes aware . . . of any material fact relating to the business, etc. of a listed company, etc . . . shall not trade the specified securities . . . of said listed company . . . or otherwise assign or accept the same for value or engage in the purchase or sales of securities, OTC derivative transactions (“trading”) . . . until after said material fact . . . is publicly disclosed. The same shall apply to a person who becomes aware of any material fact . . . for **one year** from the date the person . . . ceases to be a company related person.

## Key Elements:

- ① Company Related Person/Recipient of Information from a Corporate Insider
- ② Material Information
- ③ Disclosure to Public
- ④ Trading in Specified Securities, Etc.

# Company Related Person/Recipient of Information from a Corporate Insider

- Generally, a person needs to be an insider, i.e. a “company-related person”
- A “company-related person” is:
  - i. **any officer, agent, or employee** (Officers, etc.) of a Listed Company, its Parent Company or its Subsidiary, if he/she comes to know a material fact in the course of his/her duties;
  - ii. any **shareholder** who has a right of access to the accounting book of the Listed Company (3% or more voting rights), if it comes to know a material fact in exercising its book inspection rights;
  - iii. any person having **authority** pursuant to any laws and regulations over the activities of the Listed Company, if he/she comes to know a material fact in exercising such statutory rights;
  - iv. any party (or its officer or agent) who has **concluded a contract** with, or is in the process of concluding a contract with, the Listed Company, if comes to know a material fact in the course of the execution, negotiation, or performance of such agreement;
  - v. An Officer, etc. of a person listed in item ii or iv above who is a juridical person where such an Officers, etc. has come to know a material fact in the course of his/her duty; and
  - vi. any person who was a company related person in i. to v. above, but who ceased to be a company-related person **less than one year before**

# Company-Related Person/Recipient of Information from a Corporate Insider (Cont.)

- However, if a company-related person had deliberately communicated information via others (like a messenger), the recipient is considered a tippee even if he/she did not receive the information directly from the company-related person.
- Tippees:
  - Persons receiving transmission of a material fact from a company-related person.
  - An Officer, etc. of the same company as the person receiving information in the course of his/her duties who came to know the information in connection with the ordinary course of his/her business.
- The company-related person must intend to transmit information.
- The following elements are necessary to punish the tippee under Article 166(1):
  - (i) The fact is a material fact;
  - (ii) The information is provided by a company-related person; and
  - (iii) The company-related person came to know the fact based on his/her position

# Material Information – Listed Company or Subsidiary

## “Listed Company”

- **an issuer of securities, such as corporate bonds, preferred contribution certificates, share certificates or warrants, that are listed on a financial instruments exchange and that fall under the category of OTC traded securities, or as otherwise designated by the Cabinet Order (Article 163(1))**

## “Subsidiary”

- **generally means a company where more than 50% of its voting shares are controlled by a single entity.**
  - **FIEA defines a subsidiary more broadly as a member of the corporate group of another company in the most recent registration or similar filing with the Japanese regulators (Article 166(5))**
- **There are five categories of information contained in each item of Article 166(2) of the FIEA and examples of each:**
    1. **Information regarding company decisions (decision-based material information), such as:**
      - **Plans to issue shares, convertible corporate bonds, and share divisions;**
      - **Reductions in capital, repurchases of shares, and distributions;**
      - **Mergers, business transfers, and dissolutions; and**
      - **Commercialization of a new product or technology.**

# Material Information – What Is a “Material Fact”?

2. **Information regarding the occurrence of certain events (**Event-Based Material Information**), such as:**
  - Damages resulting from natural or other disasters that occurred during the course of business
  - Changes in major shareholders or management changes.
  - Discovery of resources.
  - Suspension of transactions with the main clients or transaction partners.
3. **Information regarding **differences in projected values**, such as changes in financial projections of sales revenue or distributions.**
4. **Information in relation to operations, business or assets, other than those listed above, that may have a **significant effect on the investment decisions of investors**.**
5. **Information regarding subsidiaries.**

# Material Information – The “De Minimis” Threshold

The type of information that is considered “material” may not require you to wait until legal “disclosure” if such information falls within one of the “*de minimis*” categories set forth in the Cabinet Order regarding Trading of Securities, etc. (i.e., as being information that may only have a minor effect on the investment decisions of investors).

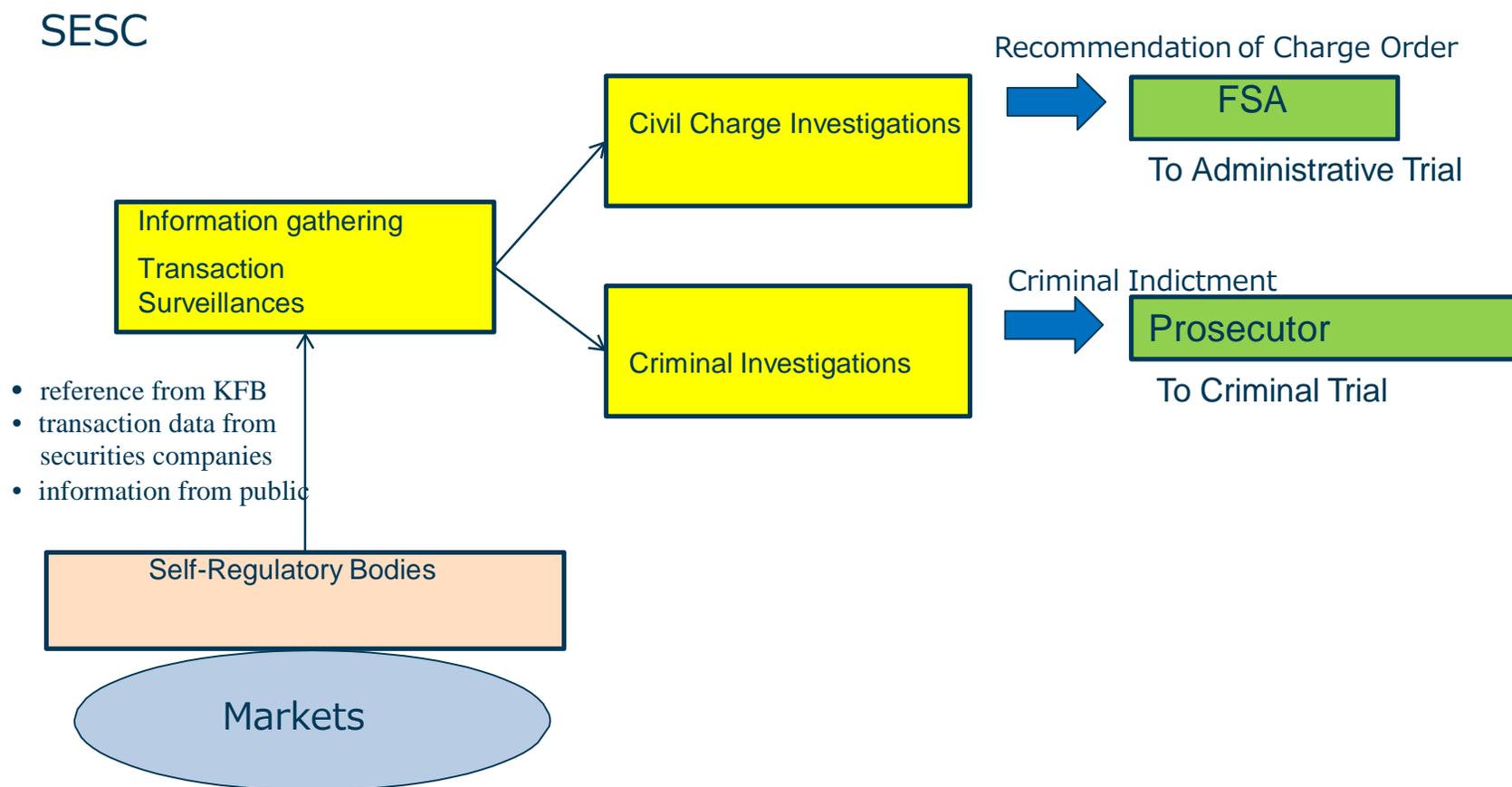
## “*De minimis*” threshold:

If the amount of damages anticipated will be less than an amount equivalent to 3% of the net assets of the Listed Company as of the last day of the most recent financial year, then you can trade before disclosure by the company.

## “Disclosure” means:

- 12 hours have passed since the Listed Company made disclosure of the material nonpublic information through two press institutions (daily newspapers or broadcast media);
- the Listed Company has delivered the information to its share exchange (such as the Tokyo Stock Exchange) and the exchange has made such information available for public inspection (Tdnet: ([https://www.release.tdnet.info/inbs/l\\_main\\_00.html](https://www.release.tdnet.info/inbs/l_main_00.html))); or
- the relevant material nonpublic information is disclosed in a public securities filing such as a securities registration statement (EDINET: <http://disclosure.edinet-fsa.go.jp/>).

# How are insider trading cases dealt with?



# Global Enforcement

Scope of Application: Not limited to those resident in Japan.

## ※ J. Bridge Corp Case; Tokyo District Court; December 10, 2009

- The Director and CEO of J. Bridge learned that after recalculation J. Bridge's projected turnover and ordinary profit differed from the most recently announced figures and sold shares in the company using an account in the name of a British Virgin Islands company held with a Singaporean financial institution.
- The Director and CEO collaborated with the Monetary Authority of Singapore based on a memorandum of understanding.
- The Director and CEO received a three-year prison sentence (suspended for five years) and was fined 2 million yen with an additional surcharge of 37.5 million yen.

# **CROSS-BORDER SERVICES – US REGULATION**

# Extraterritorial Scope of US Adviser Regulation

**Global expansion of investment management firms raises issues relating to the sometimes unclear scope of the extraterritorial reach of US Adviser regulation:**

1. Firms increasingly seek to establish "satellite" offices in key markets
  2. Firms often rely on "global" investment teams for different mandates
- ❖ Section 203(a) of the Investment Advisers Act of 1940 (Advisers Act) prohibits an investment adviser from operating an investment advisory business unless the adviser is registered with the US Securities and Exchange Commission (SEC) or qualifies for an exemption from registration
    - The most widely used exemption from registration was the "Private Adviser Exemption"
      - The Private Adviser Exemption was repealed by the Dodd-Frank Act as part of a program to regulate advisers of private funds
      - The Private Adviser Exemption was replaced with a much more limited series of exemptions, applicable only to advisers with AUM in the United States of less than \$150M who **only** advise private funds or certain very small foreign private advisers
  - ❖ SEC guidance in a series of no-action letters (the Unibanco Letters) permit certain "Dual-Hatting" arrangements, whereby services are provided cross-border by personnel of unregistered advisers
    - "Dual-Hatting" refers to a situation where a person is employed by one adviser entity (sometimes called a "Participating Affiliate") but may participate in the provision of advisory services to the client of another related advisory entity

# The “Unibanco Letters”

**The Unibanco Letters comprise a series of related SEC staff no-action positions taken over a six-year period:**

- ❖ Uniao de Bancos de Brasileiros, SEC No-Act (pub. avail. July 28, 1992)
- ❖ Mercury Asset Management, plc, SEC No-Act (pub. avail. Apr. 16, 1993)
- ❖ Royal Bank of Canada, SEC No-Act (pub. avail. June 3, 1998)

**Taken together, the Unibanco Letters provide relief and guidance covering two common “Dual-Hatting” situations:**

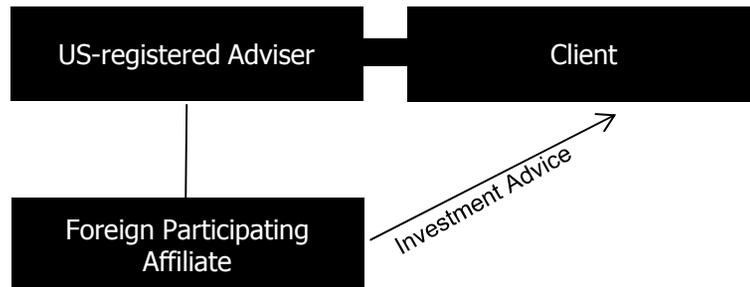
1. Relief to US-registered advisers and their affiliated holding companies to allow them to **make use of personnel and other resources** of affiliated but unregistered advisers in the course of providing discretionary advisory services to US clients through a US-registered adviser
2. Relief to (i) US-registered advisers and (ii) unregistered advisers who provide Participating Affiliate services, each of which is domiciled outside the United States, in order allow such advisers to provide advisory services to non-US clients without complying with the Advisers Act

# “Classic” Unibanco Arrangement

## “Classic” Unibanco Arrangement:

- ❖ Adviser is organized in the United States
- ❖ Adviser is registered under the Advisers Act
- ❖ Adviser is the “contracting” entity with clients
- ❖ Foreign Participating Affiliate assists in providing investment advice to the registered adviser’s clients

**Question:** Must the foreign Participating Affiliate be registered under the Advisers Act?

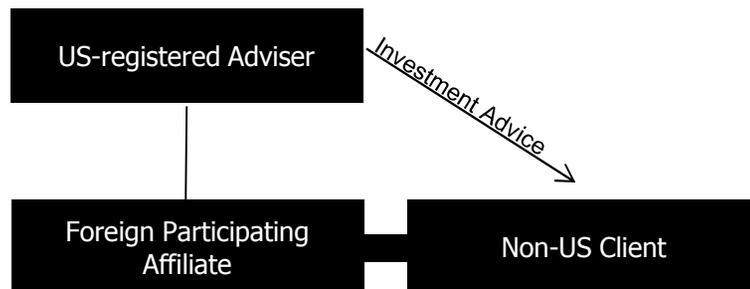


# “Reverse” Unibanco Arrangement

## “Reverse” Unibanco Arrangement:

- ❖ Adviser is organized in the United States
- ❖ Adviser is registered under the Advisers Act
- ❖ Foreign Participating Affiliate is the “contracting” entity with non-US clients
- ❖ Foreign Participating Affiliate may or may not be registered under the Advisers Act
- ❖ US adviser assists in providing investment advice to the Foreign Participating Affiliate’s non-US clients

**Question:** Must the Foreign Participating Affiliate comply with Advisers Act when managing accounts of non-US clients?



# Specific Conditions of Unibanco Letters

**The relief granted in the Unibanco Letters includes several specific conditions to reliance on the relief that result in the following rules of the road:**

1. A US-domiciled, SEC-registered adviser must comply in all respects with all the requirements of the Advisers Act with respect to *United States clients and foreign clients*
2. A non-US-domiciled, SEC-registered adviser must comply in all respects with all the requirements of the Advisers Act with respect to *United States clients, but may comply with foreign law with respect to foreign clients*
3. If SEC registered, an adviser must maintain all books and records in accordance with Rule 204-2 under the Advisers Act with respect to *United States clients and foreign clients*
4. Upon request, an SEC-registered adviser would promptly provide any and all books and records undertaken to be kept and those required by foreign law to be kept
5. An SEC-registered adviser would not hold itself out to *foreign clients* as being registered under the Advisers Act
6. The SEC-registered adviser will be deemed an “associated person” of each Participating Affiliate and each employee of the Participating Affiliate, including research analysts, whose functions or duties relate to the determination and recommendations that the registered adviser makes to its *United States clients*, or who has access to any information concerning which securities are being recommended to *United States clients* prior to the effective dissemination of the recommendations (including dealing room personnel, if trades for *United States clients* are placed for execution with any affiliate of the registered adviser)
7. (i) The SEC-registered adviser will make clear in any communications between Dual Employees and its *United States clients* that the communications are from the registered adviser, not any Participating Affiliate; (ii) when dealing with *United States clients* or potential *United States clients* of the registered adviser, Dual Employees will make clear that they are acting in their capacity as personnel of the registered adviser, not a Participating Affiliate; and (iii) the registered adviser will disclose to its *United States clients* in its Form ADV and any brochure provided to *United States clients* that Participating Affiliates may recommend to their clients, or invest on behalf of their clients in, securities that are the subject of recommendations to, or discretionary trading on behalf of, the registered adviser’s *United States clients*

# Practical Considerations Under Unibanco Letters

**In addition to the specific conditions under the Unibanco Letters, advisers also should consider practical investor protection principles:**

- ❖ The key consideration is whether the SEC would find that activities should trigger Advisers Act registration for US-inbound activities, and whether Advisers Act protections should attach for US-outbound activities
- ❖ The determination of whether an adviser's involvement in the provision of investment advice requires registration is **highly fact sensitive**
  - Given this fact sensitivity, a "Unibanco Analysis" generally is not a determination of whether an isolated business activity triggers a registration requirement - it is a matter of determining where on the "**Unibanco spectrum**" the adviser's delivery of investment services lies

**Key Considerations under the Unibanco Letters:**

- ❖ Whether the registered entity is staffed with personnel (whether physically located in the United States or abroad) who are capable of providing investment advice, i.e., that the adviser providing services that make use of the Participating Affiliate's personnel is not trying to avoid registration and compliance
- ❖ The extent to which personnel of a Participating Affiliate may be deemed to be exercising investment discretion
- ❖ Whether the client receiving investment advice would expect the Advisers Act to govern its relationship with a non-US adviser

# Additional Considerations

**Attention should be paid to the local adviser regulation and local tax implications of Dual-Hatting personnel in a given country**

- ❖ The presence of Dual-Hatting personnel in a country may raise (i) permanent establishment tax issues for the US-Registered Investment Adviser (RIA) and (ii) questions about whether the US RIA has to be authorized in the foreign jurisdiction
- ❖ There may be alternatives to relying on Participating Affiliate arrangements that present less risk
  - Foreign advisers may register under the Advisers Act and serve in subadviser or co-adviser arrangements with US affiliates
  - Consideration may be given to registering as a “relying adviser” attached to the registration of the US affiliate, although proposed regulations would then require Advisers Act compliance with respect to both US and foreign clients
  - Foreign advisers may substantively comply with Advisers Act requirements with respect to foreign clients

# UK REGULATION

# UK Law: Licensing of Fund Management Companies

Section 19 of the Financial Services and Markets Act 2000 (the FSMA):

“No person may carry on a regulated activity [by way of business] in the UK or purport to do so unless he is an authorized person or an exempt person” (the General Prohibition)

An “authorized person” is typically an entity authorized by the Financial Conduct Authority (the FCA)

Banks, investment banks, and insurers are authorized by the Prudential Regulation Authority and regulated by it and the FCA

# UK Law: Licensing of Fund Management Companies (Cont.)

Contravention of the General Prohibition is a criminal offense

It is a defense for a person to prove that he exercised due diligence and took all reasonable precautions to avoid committing the offense

Violators subject to:

- If convicted on indictment, imprisonment of up to two years or an unlimited fine, or both
- On summary conviction, imprisonment of up to six months or a fine of up to £5,000, or both

# UK Law: Licensing of Fund Management Companies (Cont.)

Civil law consequences include:

- An agreement made by an unauthorized person in breach of the General Prohibition will generally be unenforceable against the customer. The customer can still recover any money paid or property transferred and obtain compensation for any loss.
- Agreements made by authorized persons may also be unenforceable if an agreement is entered into as a result of a third party's unauthorized regulated activity.

# UK Law: Licensing of Fund Management Companies (Cont.)

List of regulated activities under FSMA include:

- Arranging deals in investments
- Advising on investments
- Dealing in investments as principal or agent
- Counseling on discretionary investment management of assets belonging to another person (both separate accounts and pooled vehicles)
- Managing an alternative investment fund (AIF) or undertakings for collective investment in transferable securities (UCITS) fund
- Acting as trustee or depositary of an AIF or UCITS fund
- Operating a collective investment scheme
- Safeguarding and administering investments

# UK Law: Licensing of Fund Management Companies (Cont.)

List of specified investments under FSMA include:

- Shares
- Debt instruments
- Options
- Futures
- Contracts for differences
- Units in a collective investment scheme

# UK Law: Territorial Scope of the General Prohibition

Only regulated activities carried on in the UK fall within the territorial scope of FSMA

## Outward

Section 418 of FSMA extends its territorial scope outward only, whereby persons based in the UK who carry on regulated activities overseas need to be regulated in the UK, by deeming activities that would otherwise be carried on outside the UK to be carried on in the UK. Three cases are relevant:

- Day-to-day management in the UK: all persons who have their head or registered office in the UK but who only carry on regulated activities in non-European Economic Area (EEA) countries will need to be authorized if they direct the day-to-day management of the activities from UK establishments

# UK Law: Territorial Scope of the General Prohibition (Cont.)

- Establishment maintained in the UK: even if a person does not have a head or registered office in the UK and is not dealing with UK customers, it will still need to be authorized if the activity is carried on from an establishment maintained by it in the UK
- Managing an AIF: where the person is managing an AIF and:
  - The AIF has its registered office in EEA, or the AIF (wherever domiciled) is marketed in UK/EEA
  - The person's registered office is in the UK or its head office is in the UK
  - The activity is carried on from an establishment maintained in a non-EEA country

# UK Law: Territorial Scope of the General Prohibition (Cont.)

## Inward

The “inward” scope of FSMA is implicit in the terms of section 19 (which deploys the term “in the UK”) and therefore captures non-UK-based persons doing business in the UK but can be elaborated on by secondary legislation (e.g., the UK carve-out for overseas persons)

## Guidance on where certain activities are carried on

Where business has a cross-border element, e.g., where a client is based outside the UK or elements of the activity occur outside the UK, it is challenging to determine where the activity is conducted

# UK Law: Territorial Scope of the General Prohibition (Cont.)

It is commonly considered:

- Dealing in investments will be carried on at the place where acceptance of the offer is received by the offeror, where a communication of an acceptance is instantaneous
- Where a communication of an acceptance is delayed, dealing in investments will be carried on at the place where the communication was posted
- Arranging deals is normally carried on at the place where the arranger is located when the arrangements are made
- Discretionary investment management is carried on at the place where the investment manager reviews portfolios and makes investment decisions

# UK Law: Territorial Scope of the General Prohibition (Cont.)

- Investment advice is given at the place where it is received
- A person in the UK who is safeguarding and administering investments will be carrying on that activity in the UK even though his client is overseas

# UK Law: The Overseas Persons Carve-Out

The overseas persons carve-out can be relied on by third-country firms (TCFs):

- That do not maintain a permanent place of business in the UK
- That carry on certain activities that would otherwise be regulated (and require them to become authorized) either:
  - With or through an authorized (or exempt) person; or
  - As a result of a “legitimate approach,” which is an approach to, by, or on behalf of an overseas person that is in compliance with the UK financial promotion regime or an unsolicited approach

# UK Law: The Overseas Persons Carve-Out (Cont.)

## Interaction between section 418 of FSMA and the overseas persons carve-out

If the overseas-person exclusion applies, the activity will not be a regulated activity and the section 418 outward scope provisions will not apply. For example, an overseas investment adviser giving advice to UK clients may have concluded he is deemed to be carrying on that activity in the UK under section 418. However, if he can fall within the overseas person exclusion the activity will not be a regulated activity in the first place, and accordingly section 418 will not apply.

# UK Law: The Overseas Persons Carve-Out (Cont.)

## Current UK access regime for TCFs

TCFs can navigate the general prohibition:

- By establishing a UK subsidiary that obtains authorization and can exercise passport rights EEA-wide.
- By establishing a permanent place of business a UK branch - that obtains authorization. The branch will not benefit from passporting rights EEA-wide.
- For cross-border business in the UK with UK clients and counterparties without any authorisation, by reliance on the overseas persons carve-out for particular services/activities carried on in the context of a “legitimate approach” or carried on “with or through” an authorized (or exempt) person.

# UK Law: What's Next? – MIFID 2 – New TCF Access Regime

- MIFID 2 prescribes harmonized requirements regarding the ability of TCFs to access EEA markets and will change the structure of regulation re: TCFs
- MIFID 2 deals separately with (a) per se professional clients and eligible counterparties (“wholesale”) and (b) retail and elective professional clients
- EEA countries have some discretion relating to access by TCFs to retail and elective professional clients

## Wholesale

National third-country regimes will continue until a positive decision by European Commission RE: equivalence of the relevant third-country standards to EEA prudential and business conduct standards

Transitional period of three years following a positive equivalence decision - Existing national regime continues to run

# UK Law: What's Next? – MIFID 2 – New TCF Access Regime (Cont.)

A TCF registered with the European Securities and Markets Authority (ESMA) from an equivalent third country may provide cross-border investment services to wholesale clients EEA-wide without being required to establish a branch anywhere in the EEA

If a negative decision – existing national regime, whether liberal or restrictive – continues to apply until a positive decision by the European Commission:

- ESMA must register a TCF that has applied only where the following conditions are met:
  - The European Commission has adopted an equivalence decision re: that third country (focusing on prudential and business conduct requirements) and the third country must also provide reciprocal access to its market
  - The TCF is authorized in the jurisdiction where its head office is established to offer the investment services to be provided in the EEA and it is subject to effective supervision and enforcement ensuring full compliance with the requirements applicable in that third country

# UK Law: What's Next? – MIFID 2 – New TCF Access Regime (Cont.)

- Cooperation arrangements have been established between ESMA and the relevant regulator covering the exchange of information and access to information regarding TCFs, notification by third-country regulators to ESMA that a TCF is in breach of licensing conditions, and coordination of supervisory activities including on-site inspections

## Retail and elective professional clients

A member state may decide between the continuation of its own national regime (which may or may not require a local branch) and the MIFID 2 branch regime under which a branch must be established in the relevant EEA country, which would need local authorization and supervision including prudential requirements

# UK Law: What's Next? – MIFID 2 – New TCF Access Regime (Cont.)

For all client types, MIFID 2 does not restrict the provision of cross-border investment services to EEA clients by TCFs where it is at the clients' "own exclusive initiative" and to that extent allows reverse solicitation by a TCF without authorization or registration

*Proposed UK approach to exercising MIFID 2 discretion*

The UK government is not inclined to apply the branch requirement regime for retail and elective professional client business

Consequently:

- The UK overseas persons carve-out will not need to be abrogated and substituted with a narrower "own exclusive initiative" concept - good news for TCFs wishing to access the UK
- The UK retail client base will not be protected by the MIFID 2 branch regime

# UK Law: What's Next? – MIFID 2 – New TCF Access Regime (Cont.)

- TCFs from equivalent jurisdictions that establish branches in the UK will not be able to passport their wholesale businesses across Europe. However, a TCF can instead establish a subsidiary in the UK with appropriate authorizations in order to obtain the passport.

# UK Law: Delegation by UK-Authorized Firms to Overseas Firms

## General

When there is a delegation, a UK firm should assess whether the recipient is suitable to carry out the delegated task

The extent and limits of any delegation should be made clear to those concerned

There should be arrangements to supervise the delegation and monitor the discharge of the delegate's functions/tasks and obtain sufficient information from the delegate

# UK Law: Delegation by UK Authorized Firms to Overseas Firms (Cont.)

## Outsourcing “critical” functions

A more detailed regime requiring an outsourcing firm to take reasonable steps to avoid undue additional operational risk and also avoid any adverse effect arising on the quality of its internal control and the FCA’s ability to monitor the firm’s compliance with its regulatory obligations

A firm must exercise due skill, care and diligence when entering into, managing, or terminating any arrangement for the outsourcing of critical or important operational functions or of any relevant services and activities to a delegate

A firm must ensure that the respective rights and obligations of the firm and of the delegate are clearly allocated and set out in a written agreement

# UK Law: Delegation by UK-Authorized Firms to Overseas Firms (Cont.)

A firm must ensure that the following conditions are satisfied:

- The delegate must have the ability, the capacity, and any authorization required to perform the outsourced functions, services, or activities reliably and professionally
- The delegate must carry out the outsourced services effectively, so the firm must establish methods for assessing the standard of performance of the delegate
- The delegate must properly supervise the outsourced functions and adequately manage the risks associated with the outsourcing

# UK Law: Delegation by UK-Authorized Firms to Overseas Firms (Cont.)

- Appropriate action must be taken if it appears that the delegate may not be carrying out the functions effectively and in compliance with applicable laws and regulatory requirements
- The firm must retain the necessary expertise to supervise the outsourced functions effectively and to manage the risks associated with the outsourcing, and must also supervise those functions and manage those risks
- The delegate must disclose to the firm any development that may have a material impact on its ability to carry out the outsourced functions effectively and in compliance with applicable laws and regulatory requirements

# UK Law: Delegation by UK-Authorized Firms to Overseas Firms (Cont.)

- The firm must be able to terminate the arrangement for the outsourcing where necessary without detriment to the continuity and quality of its provision of services to clients
- The delegate must cooperate with the FCA and any other relevant competent authority in connection with the outsourced activities
- The firm, its auditors, the FCA, and any other relevant competent authority must have effective access to data related to the outsourced activities, as well as to the business premises of the delegate; and the FCA and any other relevant competent authority must be able to exercise those rights of access

# UK Law: Delegation by UK-Authorized Firms to Overseas Firms (Cont.)

- The delegate must protect any confidential information relating to the firm and its clients
- The firm and the delegate must establish, implement, and maintain a contingency plan for disaster recovery and periodic testing of backup facilities where that is necessary, having regard to the outsourced function, service, or activity

# UK Law: Delegation by UK-Authorized Firms to Overseas Firms (Cont.)

If a firm and the delegate are members of the same group, the firm may take into account the extent to which it controls the delegate or may influence its actions

A firm must make available on request to the FCA and any other relevant competent authority all information necessary to enable it to supervise the compliance of the performance of the outsourced activities with the regulatory system

# UK Law: Delegation by UK-Authorized Firms to Overseas Firms (Cont.)

## Delegation by a UK FCA-authorized manager of an alternative investment fund

An alternative investment management fund manager (AIFM) must not delegate its functions to the extent that it can no longer be considered to be the AIFM of the AIF and to the extent that it becomes a letter-box entity

An AIFM must ensure that the following conditions are met when a delegate carries out any function on its behalf:

- The AIFM has notified the FCA of the delegation before the delegation arrangements become effective and
- The AIFM is able to justify its entire delegation structure with objective reasons

# UK Law: Delegation by UK-Authorized Firms to Overseas Firms (Cont.)

- The delegate has sufficient resources to perform the respective activity and the persons who effectively conduct the business of the delegate are of sufficiently good repute and experience
- The delegation of AIFM investment management functions is conferred only on a delegate that is authorized or registered for the purpose of asset management and subject to supervision (exceptions possible)
- Where the delegation of AIFM investment management functions is conferred on a third-country delegate, cooperation between the FCA and the regulator of the delegate is ensured (the FCA has entered into agreements with MAS and each of the US regulators)
- The delegation does not prevent the FCA from supervising the AIFM effectively and, in particular, does not prevent the AIFM from acting, or the AIF from being managed, in the best interests of its investors

# UK Law: Delegation by UK-Authorized Firms to Overseas Firms (Cont.)

- The AIFM is able to demonstrate that:
  - The delegate is qualified and capable of undertaking the functions in question
  - The delegate was selected with all due care
  - The AIFM can monitor the delegated activity effectively at any time, give further instructions to the delegate at any time, and withdraw the delegation with immediate effect in the interests of investors

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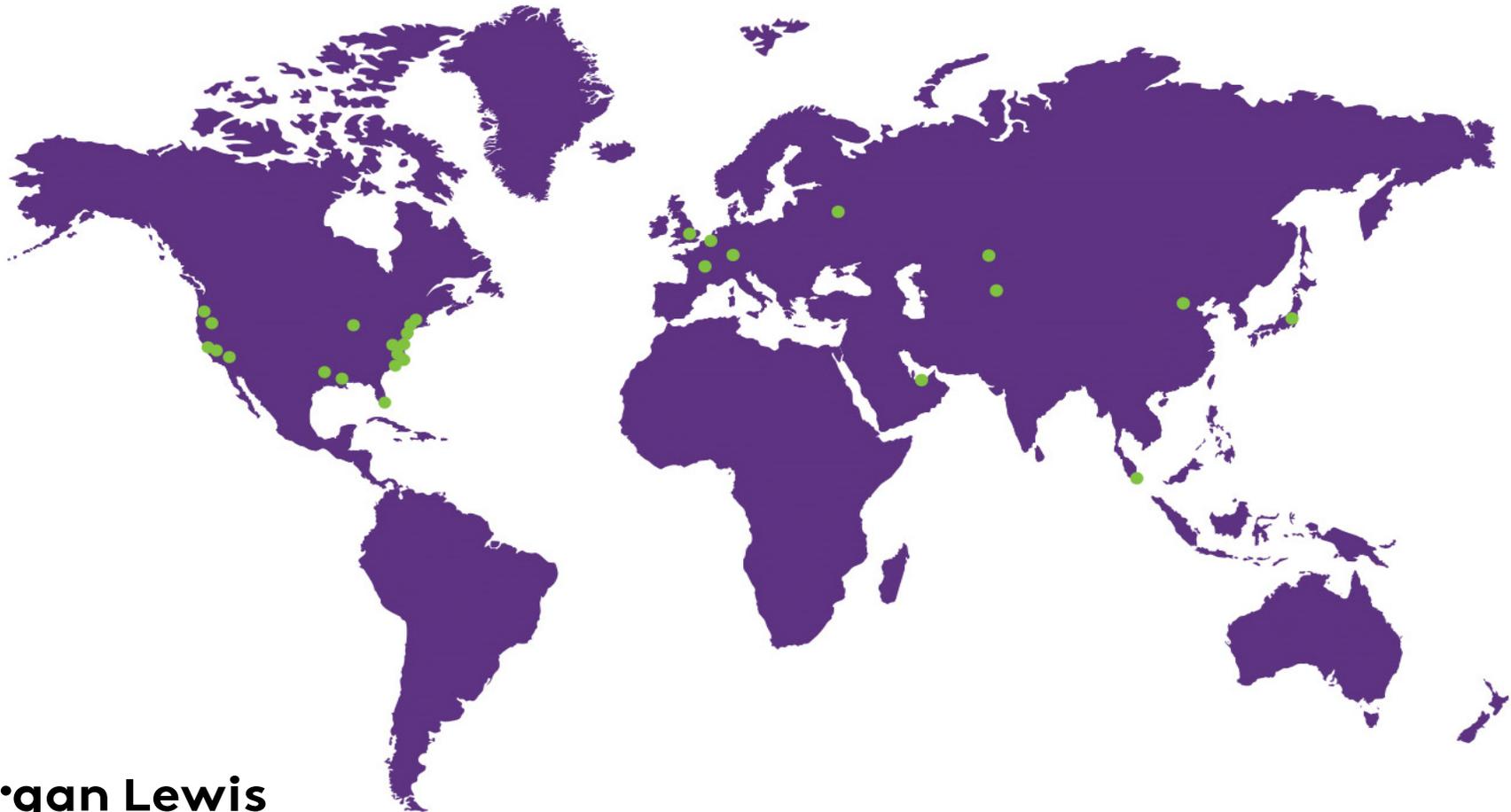
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## Our Global Reach

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