# The Murakami Fund Incident and the Regulation of Collective Investment Schemes

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## I. MURAKAMI FUND CHARGED WITH INSIDER TRADING

### *1. The Arrest of Mr. Murakami*

On 5 June 2006, Murakami Fund head *Yoshiaki Murakami* was arrested by the Special Section of Tokyo District Prosecutor's Office on suspicion of illegal insider trading in connection with Livedoor Co., Ltd.'s acquisition of a large stake in Nippon Broadcasting Co., Ltd. The arrest attracted considerable media attention, as Mr. Murakami was already quite well known in Japan for his acquisitions of large stock positions in various listed companies and for his aggressive brand of shareholder activism.

Prosecutors alleged that Mr. Murakami was in breach of Art. 167 of the Securities and Exchange Law (SEL)[1]. Articles 166 and 167 of the SEL regulate insider trading.

Art. 166 provides that "corporate insiders" who have come to know "material facts relating to the business of a listed company" should not engage in transactions involving securities issued by the company until those material facts have been "made public".

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1 As discussed below, the SEL (Law no. 25 of 1948) was extensively amended in June 2006, including a change in its name to the Financial Instruments and Exchange Law (FIEL). The amendment took effect on 30 September, 2007. However, neither Articles 166 and 167 nor the related subordinate Orders were substantially amended.

On the other hand, Art. 167 provides that "a person who has made a tender offer or associated person thereto" who has come to know of a fact relating to the implementation or withdrawal of a tender offer should not engage in transactions involving securities issued by the targeted company until the implementation or withdrawal of the tender offer has been made public. In other words, it is illegal insider trading when an insider as noted above has knowledge of a forthcoming tender offer for a listed company before that information becomes public, and uses such information to trade in said company's stock.

More precisely, Art. 167 applies not only to tender offers but also to similar circumstances, namely when a person acquires shares in a listed company amounting to 5% or more of the total voting rights (Art. 31 SEL Order).

Although in principle the SEL and its subordinate Order require that the acquisition of more than 5% of shares outstanding be in the form of a tender offer, if the shares are acquired by ten or less persons over a 60-day period and ownership after the acquisition does not exceed one third, a tender offer is not mandatory (Art. 27-2 SEL). It can be construed from the Article that even if the shares are acquired by ten or less persons over a 60-day period, a tender offer is mandatory if ownership after the acquisition exceeds one third. However, market purchases through a stock exchange are, in principle, exempt from the tender offer requirement. Accordingly, although it is possible to accumulate greater than a 5% stake without going through the process of a tender offer, the impact that this would have on the share price is no different than if it were through a tender offer. Insider trading rules therefore apply to actions that are the equivalent of a tender offer.

Both Articles 166 and 167 were introduced in a 1988 amendment to the SEL and initially provided for criminal penalties of imprisonment for up to 6 months and/or a fine of up to 500,000 yen for any person in breach of either provision. The criminal provisions have been amended several times since then, and the latest amendment, made effective in July 2006, provides that any person engaged in unfair insider trading and in breach of the said Articles may be sentenced to up to 5 years imprisonment and/or imposed a fine of up to 5 million yen, and that profits obtained through illegal trading are subject to forfeiture. At the time of the alleged breach by Mr. Murakami, the maximum penalty under the law was 3 years imprisonment and/or a fine of up to 3 million yen.

### 2. *Background of the Case*

*Livedoor Co., Ltd.*'s sudden acquisition of a large stake in *Nippon Broadcasting Co., Ltd.* on 8 February 2005 was another incident in the Japanese stock market that captured the public's attention[2]. Livedoor (originally called *On the Edge Co., Ltd.*) was one of the

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2 For the details about the incident and the legal battle that followed, see SADAKAZU OSAKI, The Livedoor Incident and the Japanese Stock Market, *Nomura Capital Market Review*, Vol. 9 No. 1, 2006.

first listed companies in *Mothers*, a market for emerging companies established by the Tokyo Stock Exchange in November 1999. After going public, the company rapidly expanded its business through an aggressive M&A strategy. By acquiring a stake in Nippon Broadcasting, Livedoor aimed to exercise influence over the *Fuji Sankei Communications Group,* one of Japan's leading media groups.

Livedoor purchased 35% of Nippon Broadcasting's outstanding shares using the Tokyo Stock Exchange's *ToSTNeT-1* after-hours trading system. As mentioned above, a tender offer was mandatory in principle under the SEL if ownership after the acquisition exceeds one third, but despite this Livedoor did not make a tender offer. Furthermore, a few weeks before the acquisition Fuji Television Network had made a tender offer for Nippon Broadcasting's shares as part of a plan by the Fuji Sankei Group to consolidate its shareholdings. This prevented Fuji Television from buying any Nippon Broadcasting shares in the secondary market.

Livedoor justified its action (or inaction) by arguing that it was eligible for the exemption from the mandatory tender offer requirement provided for acquisitions made on markets operated by a stock exchange, since the ToSTNeT-1 was operated by the Tokyo Stock Exchange. No sooner did the details emerge than an article appeared in the *Sankei Shimbun* newspaper (part of the Fuji Sankei Group) under the headline "28-minute covert operation during out-of-hours trading." The article criticized Livedoor for having "slipped through the regulator's net" and quoted "market sources" as calling for the rules governing tender offers to be tightened to avoid more such cases.

Nippon Broadcasting's board of directors responded with a decision to issue stock acquisition rights to Fuji TV in order to dilute Livedoor's holdings. Livedoor filed for a temporary court injunction to stop the issuance, and both the Tokyo District Court and the Tokyo High Court granted the injunction. This legal battle presents an interesting case study of a hostile takeover defense under Japan's Commercial Code, although not the topic to be discussed in detail in this paper[3].

The prosecutors in the Murakami case alleged that Mr. Murakami learned from Livedoor executives (notably *Mr. Takafumi Horie,* CEO and *Mr. Ryoji Miyauchi,* CFO) in November 2004 of that company's intention to acquire at least a 5% stake in Nippon Broadcasting. Because the fact that Livedoor was planning to gain control over Nippon Broadcasting's stock was not generally known at the time, Mr. Murakami could possibly be considered a recipient of information related to actions equivalent to a tender offer, as described above.

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3 For a more detailed discussion of developments in court decisions on hostile takeover defense measures, see SADAKAZU OSAKI, The Bull-Dog Sauce Takeover Defense, in: Nomura Capital Market Review, Vol. 10 No. 3, 2007.

### 3. *Legal Deliberations over the Suspected Violations*

Mr. Murakami held a press conference on the day of his arrest and publicly admitted that he learned of Livedoor's plan in November 2004 and January 2005, during meetings with Livedoor executives.

Open to debate, however, is whether the Livedoor intentions communicated to Mr. Murakami constitute "facts related to the initiation of a tender offer or equivalent action" as prescribed in the SEL.

Under the law, "facts related to the initiation of a tender offer or equivalent action" include the decision to make a tender offer made by the offering person, or the governing entity of the offering corporation (Art. 167-2 SEL). As applied to this case, the question is whether Livedoor's governing entity had made the decision to make the tender offer when it communicated its intentions to Murakami.

Livedoor's board of directors, which is its formal governing entity, formally decided to acquire substantial shares of Nippon Broadcasting early in the morning on the day it actually made its acquision through the ToSTNeT-1 after-hours trading system. Naturally, the decision was not communicated to Mr. Murakami, nor did Mr. Murakami make any acquisition of Nippon Broadcasting shares after the decision was made but before it was made public (on the contrary, he actually sold substantial shares to Livedoor on that date).

An important legal precedent regarding this point is the 1999 Supreme Court decision on the Nippon Orimono Kako case.[4]

In 1995, the business of a listed company named *Nippon Orimono Kako Co., Ltd.* (now *ORIKA Capital Co., Ltd.*) was in duress. In order to continue operating, the company reached an agreement with another company on an M&A deal whereby the latter would invest in new shares issued by Nippon Orimono Kako. The accused, an auditor and advising attorney of the acquiring company, bought a number of shares in Nippon Orimono Kako, expecting a sharp rise in the share price when the deal was made public.

The accused argued that he was not in breach of insider trading rules since the company's "governing entity" mentioned in Art. 166 had not made any "decision" at the time of his purchase. The accused argued that at that time it was still uncertain whether the merger deal would be successfully completed. Nevertheless the Supreme Court interpreted the "governing entity of a company" pursuant to the SEL broadly, ruling that it "is not limited only to entities with decision-making authority prescribed by the Commercial Code, but can include entities able to make decisions seen as effectively equivalent to corporate decisions." The court was also flexible in its interpretation of "decisions" by such entities, ruling that such decisions "must have been made with the intention of realizing the issuance of shares, but there does not need to be an expectation that issuance of said shares is certain".

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4 Supreme Court judgment, 10 June 1999, Keishu 53-5, p. 415.

Applying the same logic to Mr. Murakami's case, even if the intentions conveyed to him by Livedoor were not a resolution of Livedoor's board of directors, but instead only the intentions of several of Livedoor's executives, including its president Mr. Horie, and furthermore even if the allocation for the needed funds and other steps necessary for the acquisition were not yet complete at that time, this could still be interpreted as a "decision" by the "governing entity".

### *4. The Tokyo District Court's Decision*

Mr. Murakami was indicted in June 2006, and denied all the charges made against him in court. The main pont of his argument was that although he received the idea of acquiring Nippon Broadcasting's shares from Livedoor's executives in November 2004, at that time the decision to make the acquisition had not been made by Livedoor's governing body, nor did the company have any reasonable expectation of raising the funds necessary for the acquisition.

On 19 July, 2007 the Tokyo District Court handed down its judgment on Mr. Murakami[5], sentencing him to two years imprisonment and imposing a fine of 3 million yen. The fine was the maximum allowed under the law. Although the term of imprisonment was not the maximum, imprisonment without suspension in a securities fraud case is rare. Furthermore, the court ordered confiscation of 1.1 billion yen in illegal profits made by Mr. Murakami, the largest confiscation ever ordered against an individual charged with breach of the SEL.

The Court said that Livedoor's two most important executives, Mr. Horie, the CEO and Mr. Miyauchi, the CFO, had reached an agreement to acquire a large block of Nippon Broadcasting shares after the idea had been suggested by Mr. Murakami in September 2004. The Court accepted the prosecution's argument that the agreement should be construed as a "decision" by the "governing entity" under the SEL. The Court also held that the "decision" was communicated to Mr. Murakami in the meeting held in November 2004, and that Mr. Murakami purchased shares in Nippon Broadcasting based on this information. The Court rejected Mr. Murakami's argument that the "decision" had not been made at that time because Livedoor could not reasonably expect to raise the funds necessary for the acquisition. The Court, citing the Supreme Court's decision in the Nippon Orimono Kako case mentioned above, said that "there does not need to be an expectation that acquisition of said shares is certain." The Court pointed out that the "decision" could not be construed as made if there had been no possibility of the acquisition at all, but that it could be interpreted as having actually been made if there had been any possibility of acquisition,.

Mr. Murakami immediately filed an appeal as soon as it was delivered. Some lawyers criticized the Court's decision, pointing out that it had unduly expanded the scope

5 The judgment has not been officially published yet.

of insider trading rules and made it difficult for listed companies and institutional investors to engage in frank discussions of company management. The legal battle between Mr. Murakami and prosecutors is still going on.

### *5. Structural Problems with the Murakami Fund*

Although the issue of the legality of Mr. Murakami's action in connection with Livedoor's acquisition of Nippon Broadcasting shares has yet to be resolved, it can be argued that the investment approach employed by the Murakami fund was inherently at risk of making unfair transactions. Basically, this investment approach was to acquire large stakes in specific companies – of 5%, 10%, and sometimes over 40% – and then use the influence thus obtained to pressure those companies.

This investment approach carried with it two major risks. The first concerned whether such pressure could succeed in boosting the share price. Mr. Murakami had always seen his mission as making proactive proposals aimed at increasing shareholder value, but whether his methods would lead to a better performance of the fund's investments depended on two unknowns: (1) whether management accepts the proposals and (2) whether the proposals really wind up raising shareholder value.

Another big risk concerned the question of how to smoothly exit from these large shareholding positions. If shareholder value increases according to plan, these are good positions to be in, even when holding for the long term, but the reality was that the Murakami Fund was the type of fund whose performance investors kept a very close eye on over a relatively short time period (six months to a year), and this made the disposition of holdings aimed at locking in investment returns a critical issue.

In the trades that had come under suspicion, Mr. Murakami was able to add to his holdings without worrying about the risk of being unable to exit his positions because of his ability to sell to Livedoor, a clear breach of trust in that it gave him an unfair advantage over other market participants, all of whom must constantly deal with the risk that they may not be able to sell at a gain. The question of whether such a trade should be tolerated is not a matter of administrative discretion, as would be the decision on whether to make a given road one-way in order to relieve traffic congestion, and it becomes obvious that it should not when viewed from the perspective of ensuring market fairness.

The trades at issue here are in no way minor, unintentional infractions of adjective law that can be blamed on the complexity of insider trading rules. On the contrary, even if the transaction in question were to be deemed legal under current insider trading rules, it might be regarded as an example of an "unjust means, scheme or contrivance", which is prohibited under Art. 157 SEL.

It always comes back to the basic problem with the Murakami Fund's investment approach, which is the challenge of trying to cleanly dispose of a large block of shares.

As long as the fund is motivated to improve its investment performance, there will be a substantial risk of it becoming involved in illegal insider trading. It is important to note that this structural problem was inherent in the investment philosophy of the Murakami Fund.

## II. THE REGULATION OF COLLECTIVE INVESTMENT SCHEMES IN THE FIEL

The Murakami Fund incident emboldened those demanding greater regulation of funds. Major newspapers called for tighter regulation of funds in their editorials. In fact, however, important revisions to fund rules were included in the Financial Instruments and Exchange Law,[6] which was passed by the Diet on 7 June, 2006, only two days after Mr. Murakami's arrest. The FIEL amends most of provisions in the SEL, including the title of the law itself. The FIEL went fully into force on 30 September, 2007.

### *1. Fund Rules to Protect Investors*

#### *a) The collective investment scheme concept*

The FIEL attempts to strengthen the protection of fund investors through the broad application of rules protecting users of collective investment schemes.

Specifically, rights based on partnerships, secret partnerships, investment business limited liability partnerships, and limited liability partnerships, as well as those membership rights and other rights of incorporated bodies where there is a right to receive either the distribution of profits arising from businesses allocating money (including similar items when established by administrative order) invested or subscribed by persons (investors) who have said rights, or the distribution of assets related to said invested businesses, are all deemed as securities subject to the FIEL (Art. 2-2-5 FIEL; unless otherwise noted, law references below refer to the FIEL ). In the summary of the draft legislation submitted to the Diet, these rights were referred to as ownership in collective investment schemes.

The definition of collective investment schemes is the centerpiece of the FIEL, which has expanded the scope of regulation from shares, bonds and other investment securities to investment vehicles in general. Funds such as the Murakami Fund that had not been regulated under the SEL will be covered by the FIEL because of their legal structure.

However, businesses in which all the investors are directly involved are exempt from the FIEL, even when the above definition applies (Art. 2-2-5 i and ii). The general idea of this exemption can be demonstrated with the example of a group of lawyers, accountants or other specialists forming a partnership to conduct a joint business, where each partner is involved in the operation of the business on a regular basis. Such a partnership can be viewed as a straight-forward business, as distinct from a fund, which

6 FIEL, Law no. 65 of 2006.

is an investment vehicle. Based on such thinking, a production committee formed to procure funds to produce a movie or animated TV program and comprising people in that business would probably not be viewed as a collective investment scheme subject to the FIEL.

Similar reasoning was expressed by the US Supreme Court in a classic case discussing the scope of "investment contracts" under the Securities Act of 1933. In *SEC* v. *W.J. Howey Co.*,[7] the Court held that when money is invested on the expectation of earning profits from a common enterprise that depends solely on the efforts of a promoter or third party, it should be regarded as an "investment contract".

*b) Disclosure Rules*

In order to protect fund investors effectively, certain disclosure rules are necessary. Under the FIEL, collective investment schemes that are primarily involved in the business of investing in securities and that make a public offering to a substantial number of investors (500 persons under Art. 1-7-2 FIEL Order) will be required to register as securities and to make ongoing disclosures subsequent to the registration (Art. 2-3-2, Art. 4, and Art. 24-1-3 and Art.24-1-4).

It should be noted that the concept of a public offering to be applied to collective investment schemes under the FIEL is completely different from that to be applied to traditional securities such as shares or bonds. In the case of share or bond issuance, when an issuer solicits 50 or more investors for investment, said issuance will be regarded as a public offering, and registration of the security offered is required. In the case of a collective investment scheme, on the other hand, the number of investors solicited does not matter in defining what constitutes a public offering. Only when there are 500 or more investors actually putting money into the scheme will the collective investment scheme be regarded as making a public offering.

Disclosure to fund investors is of course only an issue when there are multiple individual investors involved. There is no disclosure requirement when the only investors are qualified institutional investors, which as defined under the FIEL have a wealth of investment expertise and experience and the ability to request directly from the founder of the fund the information that they need; in other words, in a private placement with professionals. In addition, funds that invest in businesses that primarily make non-securities investments are exempted from disclosure requirement even if they are making public offerings.

Although funds that invest in businesses that primarily make non-securities investments are exempted from disclosure requirements, they are still required to provide prospective clients with documents explaining the content of their offer, and the documents must be submitted to the Financial Services Agency (FSA) in advance (Art. 37-3-3).

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7 328 U.S. 293 (1946).

### c) *Registration Requirements*

The handling of fund offerings and private placements as a business, as well as the offering and private placement of collective investment schemes as a business, are regulated under the FIEL (Art. 28-2-1) in the "financial instruments business, category 2" (a business that handles securities of lower liquidity than stocks and bonds). That is, when the founder (or general partner) of a fund solicits its own investors (or limited partners), the act of solicitation itself is subject to regulation, and the founder must be registered with the FSA.

Moreover, the FIEL considers the business of managing collective investment schemes as an "investment management business" (Art. 28-4-3), requires registration of that business with the FSA, and establishes as a prerequisite to registration that the business be a *kabushiki kaisha* (joint stock company) with a minimum capital of 50 million yen (Art. 29-4-1 and Art. 29-4-5, and Article 15-7 of the FIEL Order).

Founders or managers of a fund who are subject to the registration requirement must strictly adhere to rules related to the duty to explain when soliciting, principles of suitability, and prohibitions on compensating for client losses. There is also a requirement to submit business reports to the FSA and adhere to other supervisory control, including being subject to inspections and attending briefings. The supervisory control of funds is aimed not only at the protection of fund investors, but also at ensuring that fund activities do not have an undesirable impact on the market.

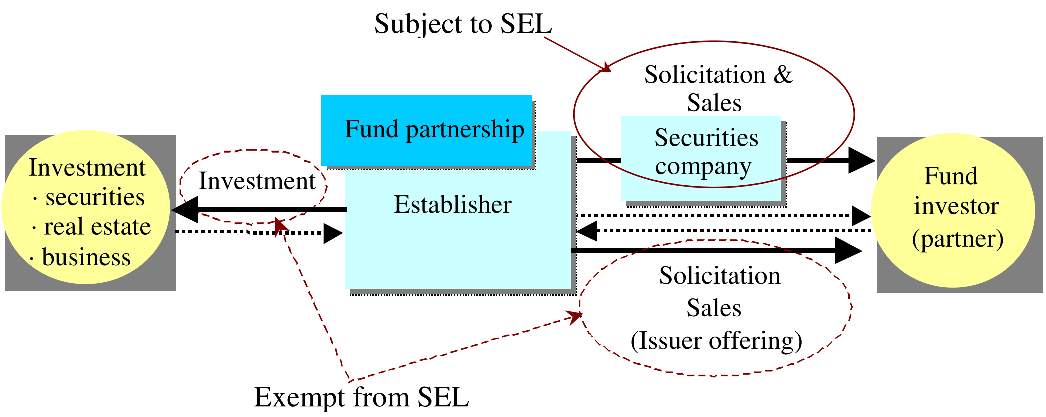
Under the SEL, offerings conducted by the issuer of securities were not subject to a registration requirement. A classic example of this would be when a joint stock company that wants to increase its capital directly approaches business contacts and requests their investment in new shares.

When a corporation offers its own shares, its objective is not to profit from the issuance and sale of stock, but to procure funds for its business. There is no need for investors who purchase the shares to pay any sort of compensation (e.g. fees or commissions) to the issuing company other than the payment for buying the shares themselves. In this case, as long as information related to the stock and its issuer is fairly disclosed, there should not be any major problem relative to investor protection resulting from not regulating the issuer as a financial business.

This is in contrast with a fund, wherein the primary objective of the fund founder is to solicit investors, collect funds, and then earn profits by managing those funds. The investor bears the cost of the compensation paid to the fund manager by investing in the fund, although often indirectly. Whereas a stock offering is aimed at no more than procuring funds to operate a business, the offering of a fund is itself the business. The FIEL's basic approach of subjecting such activity to a registration requirement therefore makes sense.

*Figure 1*

**Fund Rules under the SEL (before 2007)**




## d) *Exemption for Institutional Business*

The main objective of subjecting the founders and managers of collective investment schemes to a registration requirement is to expand the scope of regulation to such funds as hedge funds, buyout funds and activist funds. However, the new regulations also cover venture capital and other fund businesses, which had thus far not been regulated under the SEL. Since the original draft of the FIEL was made public, there has been considerable resentment among fund managers, in particular venture capitalists, toward the idea of their being subject to the regulations.

This resistance to tighter regulations is understandable, considering that various types of funds that largely obtain funds through private placements with professional investors have thus far operated without causing any major problems from the regulatory point of view. It seems likely that the excess regulatory burden placed on these sound funds by the new law will put a damper on market growth.

In deference to these concerns, the new law provides that for private placements of funds targeted only at qualified institutional investors and a limited number (up to 49 by Art. 17-12-2 of the FIEL Order) of unqualified investors, the registration required of the regular "financial instruments business, category 2" and "investment management business" is waived, and prior notification to the FSA alone is sufficient (Art. 63). Naturally, in this case, even when managing a fund, there is no need to meet the registration requirement that investment management businesses be joint stock companies. The basic business conduct rules for financial instrument businesses, including prohibitions against making false statements when soliciting clients and against compensating for client losses, also apply to businesses allowed on a prior notification basis only, but these are rules that should be tolerated at a minimum.

The new law also requires those funds allowed on a prior notification basis to submit reports and documentation, as well as submit to no-notice inspections, in order to confirm the condition of their businesses (Art 63-7-8). Although we think that at least this level of regulation should be tolerated, we do not rule out the possibility that such rules risk placing an excessive regulatory burden on funds, depending on how inspections and enforcement actions are carried out.

*Figure 2*

**Fund Rules under the FIEL**

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| Industry regulations | ○ | Registration as a financial instruments business is required. |
| | • | When managers of collective investment schemes run their own offerings, they are treated as secondary financial instruments businesses. |
| | • | Management of a collective investment scheme is treated as an investment management business (required to be a joint stock corporation). |
| | ⇒ | The conduct rules for a financial instruments business apply (including the suitability principle and the requirement to provide written documentation). |
| Disclosure regulations | ○ | Collective investment schemes that primarily invest in securities are required to submit securities filing at the time of offering and make ongoing disclosures thereafter. |
| Exceptional provisions (Specially-designated services of qualified institutional investors) | ○ | Nevertheless, managers of the following types of collective investment schemes are exempt from registration requirements, and prior notification alone is sufficient (in this case, there is no requirement to be a joint stock corporation, even if the applicable type of investment management business would be). |
| | • | When the collective investment scheme is primarily offered and placed privately with qualified institutional investors. |
| | • | When managing a collective investment scheme that is primarily invested in and subscribed to by qualified institutional investors. |
| | ⇒ | The only conduct rules that apply are the prohibitions against false statements and compensation for client losses. |

### 2. *Disclosures Related to Fund Activity*

When a collective investment scheme invests in a listed company, said investment activity can have an impact other than that on fund investors. This is why fund activity is monitored through supervisory rules, and why there is also a large shareholdings reporting rule (the 5% rule) that requires disclosure when a fund becomes a major shareholder of a listed company. In this area, as well, the FIEL strengthened disclosure rules, including through major revisions to the special reporting requirements for institutional investors, which provided for exceptions to the normal reporting requirements.

Specifically, it changed the exception, previously granted to "entities supporting the business activity of the issuing company without the objective of ownership," to "entities deemed by administrative order as materially changing, or having a critical impact on, the business activities of the issuer … without the objective of ownership." This change was aimed at preventing those funds trying to assert themselves in the management of the invested company from relying on the reporting exceptions (Art. 27-26-1).

Under the exception, institutional investors have to report their major shareholdings as of "the reporting day (*kijun-bi*)". The reporting day was to be set every three months under the previous regulation, but under the FIEL institutional investors relying on the exception have to report twice each month. The reporting deadline was also changed from the $15^{th}$ day of the month following the reporting day to "within five days of the base day." (Art. 27-1 and 27-3). The amendment adds a substantial compliance burden for institutional investors, although advocates of the revision argue that it will increase market transparency.[8]

### 3. *Application of Rules Requiring the Return of Short-term Trading Profits*

The FIEL also includes provisions to prevent unfair trading by funds (or collective investment schemes). Specifically, it revised the rules, established to prevent insider trading, related to the return of short-term (six months or less) trading profits by major shareholders, requiring that, when the shares of a particular company belonging to a partnership's assets reaches 10% or more of the outstanding shares, the partnership's members report their trades and return short-term trading profits. This is the same that is required of the listed company's executives and of major shareholders who individually own a 10% or higher stake (Art. 165-2).

Under the previous rules on the return of short-term trading profits, the 10% ownership hurdle was based not on the shared holdings of the entire partnership, but only the actual holdings of each member of the partnership (fund), which was figured by multi-

8 About the incidents and discussions that led to the amendment, see SADAKAZU OSAKI, Disclosure of Large Shareholdings, in: Nomura Capital Market Review, Vol. 8 No. 4, 2005.

plying the funds percentage ownership by that member's percentage share of the fund.[9] This can become a problem for the company, however, when a fund, behaving as a major shareholder and in a position to easily access non-public information, is able to profit from short-term trades with impunity. This explains why the revised law includes the provisions noted above.

## III. ASSESSING THE NEW FUND RULES

As described above, the FIEL includes numerous provisions that tighten the regulation of funds in various aspects. It could be argued that those provisions within the FIEL are fairly strict in comparison with rules in other countries.

Taking the example of registration requirements affecting funds, in the US, The Investment Advisers Act of 1940 provides that "any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients" need not be registered with the Securities and Exchange Commission (SEC). In contrast, Japan's FIEL exempts an investment management business from the registration requirement only when the fund manager manages the assets of less than ten clients, all of whom must be qualified institutional investors.

The large shareholding reporting rules, which are strengthened notably under the new law, were already quite strict compared with other countries even before the revisions.[10]

When Mr. Murakami was arrested and indicted, however, there were calls for a further tightening of fund rules in Japan. Those who argue for tighter regulations are mostly calling for disclosure of information on fund investments and fund investors. Although it is not that clear why such disclosure should be necessary, it may be that a fund having to disclose further information about itself when it owns controlling shares in a listed company is viewed as the same as when the unlisted parent company of a listed company is required to disclose information. This would include information on that fund's investors, which equates to information on the parent company's shareholders.

In this regard, it has also been noted, in view of how the Murakami Fund peppered the companies it invested in with various demands, that management is bound to make mistakes in deciding how to respond to demands from a fund if it does not know who the fund's investors are, and also that disclosure of who the major investors are is necessary when there are proposals from, or attempts to participate in management by, major shareholders. In other words, because of the possibility that a fund's actions are going to reflect the intentions of its investors, it should be known who those investors are.

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9 This interpretation was also confirmed by the FSA in its no action letter dated 6 September 2002 in response to the Murakami Fund's request for a legal opinion in July of that year.

10 See my article cited at footnote 8.

Nevertheless, the whole purpose of a fund is to entrust the selection of investments to a fund manager, who is a specialist in asset management. Normally, fund investors do not get involved in the investment decisions made by fund managers. When an investor has an opinion that is at odds with the fund manager's judgment, the only real option is to withdraw from the fund, since firing the fund manager is not an option. This is different from a corporate shareholder, who can have a director removed. Taking this aspect of funds in isolation, it seems unlikely that it would be possible to forecast a fund's actions based on knowing who its investors are.

In fact, disclosure of information concerning a fund's investors would merely have the negative impact of encouraging investors who value secrecy to withdraw the investment they made in the fund. Funds play an important role for the community at large in making asset management more efficient and enabling the effective use of financial assets. Any strengthening of regulations that would be likely to stifle Japan's nascent fund business should be avoided at all costs, in our opinion.

## IV. CONCLUDING REMARKS

Although the legal battle between Mr. Murakami and government prosecutors still continues, his reputation as a champion of exercising shareholder's rights to improve the corporate governance of Japan's listed companies has been seriously injured. However, it is also true that this case should not lead us to view all of the Murakami Fund's previous actions in a negative light. By initiating what was said to be Japan's first hostile tender offer for *Shoei* in January 2000, and then by its acquisition of a large block of shares in Tokyo Style from February 2002 and the various demands it placed on management of that company, the Murakami Fund has done much to impress upon the management of Japanese corporations the need to raise shareholder value, an area that had received very little attention until then, and to encourage a change in management's attitude. At the very least, Mr. Murakami's success in this regard should be remembered.

At the same time, there is no denying that Mr. Murakami's unique character and way of speaking tends to leave the impression that he is somewhat selfish and high-handed, despite his statements having a certain rationality and logic to them, and this has probably hindered the development of reasoned and constructive dialogue with the management of listed companies.[11]

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11 Although I have never been confronted by Mr. Murakami and been subject to his demands like the executives of many listed companies, I did have the opportunity to hear his opinions as a member of the Cash Management Committee of the Osaka Securities Exchange. My experience at that time lent further credence to the negative opinion of Mr. Murakami's words and conduct that many have expressed.

It may be necessary to reemphasize that this latest incident is no more than a problem with a specific trade made by a specific fund. When something like this occurs, there is a tendency to engage in sweeping criticism of all similar entities, in this case by lumping together all funds that pursue a similar investor activist philosophy, characterized by their voicing strong opinions on the management and corporate governance of the companies they invest in. We should think twice, however, before taking such a short-term view.

ZUSAMMENFASSUNG

*Im Juni des Jahres 2006 wurde* Yoshiaki Murakami*, der Manager des Murakami-Fonds und bekannt für sein aktives Eintreten für die Rechte der Aktionäre in Japan ist, verhaftet. Ihm wurde vorgeworfen, im Zusammenhang mit der Übernahme eines großen Aktienpakets an der Firma* Nippon Broadcasting Co. Ltd. *durch die* Livedoor Co. Ltd. *verbotenen Insiderhandel betrieben zu haben. Im Juli 2007 verurteilte ihn das Distriktgericht Tokyo zu zwei Jahren Gefängnis ohne Bewährung. Damit folgte das Gericht der flexiblen Gesetzesauslegung des Obersten Gerichtshofs im Falle* Nippon Orimono Kako.

*Murakami hatte die Unternehmensleitungen verschiedener börsennotierter Aktiengesellschaften unter Druck gesetzt, wobei er die Bestimmungen des japanischen Wertpapierhandels- und Börsengesetzes zu Übernahmeangeboten und Berichtspflichten zu seinem Vorteil ausgelegt hatte. Das neue „Finanzprodukte- und Börsengesetz (FBG)“, welches das Wertpapierhandels- und Börsengesetz abgelöst hat und im September 2007 in Kraft getreten ist, enthält eine Reihe neuer Bestimmungen zur Regulierung von Investmentfonds. Tatsächlich hat die Diskussion über den Fall Murakami die neuen Gesetzesregelungen entscheidend beeinflußt. Im Vergleich zu entsprechenden Gesetzesregelungen anderer Ländern sind die Bestimmungen in dem neuen japanischen Gesetz ziemlich restriktiv ausgefallen.*

*Es gibt jedoch Stimmen, die eine noch restriktivere Regelung in Form von Offenlegungspflichten von Anlagen von Investment4fonds und deren Akteuren fordern. Solch kurzsichtige Reaktionen würden jedoch eine kräftige weitere Entwicklung der Fondsanlagen verhindern, die ihrerseits zur Erholung des japanischen Wirtschaft beiträgt.*

*(Zusammenfassung durch die Red.)*