The Murakami Fund Incident and Future Fund Regulation

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I. Murakami Fund charged with insider trading

1. Yoshiaki Murakami admits charges

Yoshiaki Murakami, head of the Murakami Fund, which over time had acquired large stock positions in a variety of listed companies and aggressively asserted its "shareholder rights,", suddenly called a press conference at the Tokyo Stock Exchange (TSE) on Monday, 5 June 2006 at 11:00AM.

Initially, the press conference was supposed to be about the tender offer for shares in Hanshin Electric Railway by Hankyu Holdings, but not only did Murakami say he would go along with the tender offer, he also acknowledged having engaged in illegal insider trading related to Livedoor's acquisition in 2005 of a large block of shares in Nippon Broadcasting, an issue that had been taken up by the media the week before.[1]

The website of M&A Consulting, effectively the manager of the fund, also carried a statement from Murakami expressing "profound apology" for the pain inflicted on investors in the fund and the disruption caused for all concerned.

In the afternoon following the press conference, the Tokyo District special prosecutor's office arrested Murakami on suspicion of violating the Securities and Exchange Law and also initiated domiciliary searches of related parties. The incident revealed that people who had made a name for themselves as investor activists and champions of raising shareholder value had, contrary to their purported aim of improving the function of capital markets, been secretly involved in illegal transactions that flaunted market rules.

2. Legal deliberations over the suspected violations

1) Large-scale share acquisitions and insider trading rules

The term "insider trading" refers to corporate executives and other company insiders using their knowledge of material non-public information concerning the company (information unknown to general investors that could have a major impact

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1 One example is the article in the 5 June 2006 issue of Aera (on sale 29 May) written by Yasuaki Oshika, The Truth of the sale of Nippon Broadcasting Stock: Prosecutors vs. the Murakami Fund.

on the company's share price) to trade in the company's stock. The Securities and Exchange Law (SEL) prohibits, and prescribes penalties for, insider trading, since market fairness is compromised when only certain individuals use information inaccessible by normal investors to either make large profits or avoid large losses.

Although a trade using internal information that originates at a listed company is a classic example of such insider trading, this is not the only way that information inaccessible to general investors can have a large impact on a company's share price. The law also prohibits, to the same extent as classic insider trading, cases in which company outsiders are the source of the information, as occurs when a tender offer is initiated (Article 167 of the SEL). This is known as "insider trading by outsiders. "

In this case, the rules apply to insiders of the entity making the tender offer (such as executives or major shareholders), quasi-insiders (persons who have signed an agreement with the offering entity), and persons given direct knowledge of the deal from anyone involved in the tender offer.[2] In other words, it is illegal insider trading when one of the insiders noted above has knowledge of a forthcoming tender offer for a listed company before that information becomes public and uses that information to trade in said company's stock.

The rules apply 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 (Article 31 of the SEL enforcement order). Although in principle the SEL and its enforcement order require the acquisition of more than 5% of shares to be in the form of a tender offer, if the shares are acquired from 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. Furthermore, purchases on the open market are exempt from the tender offer requirement (SEL Article 27-2). 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.

2) Disputes regarding Murakami's trades

As explained by Murakami in his press conference, he learned from Livedoor executives in November 2004 and January 2005 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, it is possible that Murakami could be considered a recipient of information related to actions equivalent to a tender offer, as described above.

Open to debate is whether the Livedoor intentions communicated to Murakami constitute "facts related to the initiation of a tender offer or equivalent action."

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2 See Akio Kondo, Kasushi Yoshihara, and Etsuro Kuronuma, Shoken Torihiki Hou Nyuumon (Introduction to the Securities and Exchange Law), Second revised edition, Shoji Homu, pp 250.

Although Murakami himself admitted at the press conference the possibility that his own actions broke the law, this is clearly not the same as admitting guilt in court. Even if in fact there was a variety of information exchanged between Murakami and Livedoor, no illegal insider trading took place unless there was an actual purchase of Nippon Broadcasting shares following communication of "facts related to the initiation of a tender offer or equivalent action." More information is probably needed concerning this point.

There have been some reports that suggest there are reasons to suspect that when Livedoor purchased a large quantity of Nippon Broadcasting shares in off-hours trading on 8 February 2005, the Murakami Fund may have sold some of its holdings at a substantial gain, but even if the Murakami Fund had knowledge of the non-public fact that Livedoor was planning a large-scale share acquisition and sold stock based on this knowledge, that alone does not necessarily constitute an illegal trade. In fact, it is only natural that a seller would know of a buyer's intentions in the case of a large-scale transaction. And certainly the question of whether such a trade resulted in a large gain is not a problem. The real issue is whether Murakami bought additional shares while knowing the non-public fact that a large buyer was waiting in the wings.

3) An approach based on legal precedent

Under the law, "facts related to the initiation of a tender offer or equivalent action" includes the decision to make a tender offer made by the offering person, or by its governing entity of a corporation (SEL Article 167-2). 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.

An important legal precedent regarding this point is the 1999 Supreme Court decision on the Nippon Orimono Kako case (Supreme Court 10 June 1999, Shoji Homu No. 1529, pp 39). In this case, a listed company under business duress agreed with another company on a merger deal involving a third-party capital increase and including the issuance of new shares, and an auditor (and advising attorney) of the acquiring company was accused of violating insider trading rules.

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 Law, 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."[3]

3 Specifically, the court ruled that when the CEO of the company being acquired, President A, decided as company policy to conduct a third-party capital increase, and conveyed that to Managing Director B of the company that is effectively the parent company and the company that originally employed president A, that such constituted a "decision" by a "governing entity" of the company.

Applying the same logic to the case at hand, if the intentions of Livedoor conveyed to Murakami were not a resolution of Livedoor's board of directors, but instead only the intentions of several of Livedoor's executives, including its president Horie, and if furthermore the allocation for the necessary funds and other steps necessary for the acquisition were not yet complete at that time, this could still easily be interpreted as a "decision" by the "governing entity." In his statement, Murakami noted that "when taking into consideration Livedoor's financial position at the time, acquisition of a 5% or greater stake in Nippon Broadcasting would be impossible, and thus said intentions should be construed as nothing more than wishful thinking on the part of Livedoor." In light of the Supreme Court decision, however, it does not logically follow that being merely wishful thinking immediately rules out the possibility of it also being a critical fact.

Of course, some of the factual relationships in this case are unclear, making it difficult to render a definitive judgment at this point.[4] On 23 June, the Tokyo district prosecutor indicted Murakami as an individual and also indicted MAC Asset Management, the key company involved with the fund. The court's discovery process will continue.

4) How important is criminal intent?

Although Murakami acknowledged the possibility that his actions may have violated insider trading laws, in interviews he made references to "mistakes" and to "unknowingly entering a one-way street and only later noticing the "do not enter" sign," suggesting that because of the technical complexity of insider trading laws, the violations were "accidental," and thus possibly only a "violation of adjective law." Such a legal argument will not necessarily hold sway, however.

For example, when Murakami says he "wound up hearing" of Livedoor's intentions, it appears that he is trying to argue that there was no criminal intent at insider trading. That said, insider trading is trading based on material non-public information, and in cases like Murakami's where it is trading by the recipient of information that is at issue, whether the recipient aggressively pressed an insider in order to obtain that material information or just obtained the information by chance is not the fundamental question.

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4 In his article in the 19 June 2006 issue of Aera (on sale 12 June), Surprise scenario: A not-guilty verdict for Murakami, writer Yasuaki Oshika, noting that in November 2004, Ryoji Miyauchi, Livedoor's CFO at the time, took responsibility for the scandal and was stripped of his corporate officer status, argues that the court will rule that critical facts were not conveyed.

Insider trading laws in the US emphasize the obligation of insiders with knowledge of material non-public information and recipients of that knowledge to either disclose the information or abstain from trading.[5] Market participants must at a minimum understand that, even with information obtained by chance, if it contains material non-public facts and disclosure is not an option, trading based on that information is not allowed.

Murakami has argued that he "did not try to profit" from the information obtained from Livedoor, but a fund representative explaining their motivation for acquiring stock on the fund's account as anything other than an attempt to profit is a far-fetched rationalization, and nothing more. Even if that were subjectively true from Murakami's perspective, it would still be hard to deny any motivation to use that information to at least try to avoid a loss.

3. Structural problems with the Murakami Fund

The investment approach of the Murakami Fund is 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 carries with it two major risks. The first concerns whether such pressure can succeed in boosting the share price. Murakami has always seen his mission as making proactive proposals aimed at increasing shareholder value, but whether his methods lead to a better performance of the fund's investments depends on two unknowns: (1) whether management accepts the proposals and (2) whether the proposals really lead to greater shareholder value.

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

In the trades that have come under suspicion, Murakami was able to add to his holdings without worrying about the risk of not being able to exist 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

5 In the 1980 Chiarella case, the US Supreme Court ruled that trading by an employee of the printing company that printed documents related to a tender offer, based on the material non-public fact learned in the course of doing business that a tender offer was planned, was not illegal insider trading, and thus the process by which the information is obtained is not completely irrelevant. In any case, under Japanese law whether the recipient of information obtained the information accidentally or intentionally has no bearing on whether the trade is considered illegal. If the information were overheard in a train from the conversation of a person connected with the company, the rules would not apply, based on the logic that the information was not obtained directly from the person connected with the company.

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 the answer becomes obvious 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. Murakami's decision to hold his own press conference at the TSE and come clean upon hearing that he could be arrested that day may be evidence that he is a man of high principles, but it does not at all lessen the seriousness of his crime.

It always come 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 there is a motivation to improve the fund's investment performance, there will be a substantial risk of involvement in illegal insider trading. It is important not to overlook the fact that this structural problem is inherent in the investment philosophy of the Murakami Fund.

II. Fund rules in the FIEL

1. Tighter regulations called for

The Murakami Fund incident emboldened those demanding greater regulation of funds. One of the focal points of the argument for tightening regulations is the mandating of information disclosures related to a fund's investors. For example, a 6 June editorial in the Asahi Shimbun, entitled "Murakami's arrest spells the end of fund growth," says it would be a good idea to require disclosure of who the investors in a fund are, while an 8 June Yomiuri Shimbun editorial, "The FIEL: An ongoing checklist need to eliminate unfairness," argues that consideration must given to expanding investment fund disclosure requirements to include information on investors.

It has been noted that fund rules have always been inadequate in many respects, and important revisions to these rules are included in the FIEL (Law #65, 2006), which was passed by the Diet on 7 June and promulgated on 14 June. The FIEL is meant to replace, and provide broader coverage than, the SEL, the core law governing Japan's post-war capital markets, and the primary components of the FIEL are expected to go into force in July 2007.[6] The question of whether fund rules need to be tightened further is one that should be addressed after reviewing the new law just passed.

6 For more details on the new law, see my book Kaisetsu: Kin'yu Shohin Torihiki Hou (The Financial Instruments Exchange Law Explained), published in July 2006 by Koubundou.

2. Fund rules in detail

1) Rules to protect fund investors

(1) 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 (Article 2-2-5 of the 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 broadly defines these as any scheme that collects funds from investors and invests those funds, irrespective of their name or legal structure. This broadens rules for protecting investors beyond investment business limited liability partnerships and limited liability partnerships, both of which were already subject to the SEL, to funds in general, including funds that manage investments through the use of civil law-based partnerships and commercial code-based secret partnerships.

Nevertheless, businesses in which all the investors are directly involved are exempt from the FIEL, even when the above rights apply (Article 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 is a financial product. Based on such thinking, a production committee formed by people in that business to procure funds to produce a movie or animated TV program would probably not be viewed as a collective investment scheme subject to the FIEL.[7]

(2) Disclosure rules

The term "fund rules" refers to a wide range of content. To begin with, certain disclosure rules are necessary from the perspective of protecting fund investors. Of those collective investment schemes that are primarily involved in the business of

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7 Under US legal precedent, as well, the basic thinking is that an investment contract subject to the Securities Act is formed when there is a solicitation to invest funds in a joint business with the expectation of obtaining profits from the efforts of others (under the Howey standard).

investing in securities, the ones that make an offering to a substantial number of investors (we expect the law to define this as 500 persons) will be required to make initial securities filings as well as ongoing disclosures subsequent to filing (Article 2-3-2, Article 4, and Article 24-1-3 and -4).

Disclosure to fund investors is of course only an issue when there are multiple general investors involved. There is no disclosure requirement when the only investors are qualified institutional investors with a wealth of expertise and experience in investing and the ability to request directly from the founder of the fund the information that they need; that is, in a private placement with professionals.

In contrast, funds that are exempt from disclosure rules, primarily funds that invest in businesses that make investments other than in securities, are still required to provide prospective clients with advance notification of the content of the documents to be handed over, when the offering conditions noted above apply (Article 37-3-3). If the content of the documents so notified is deemed inappropriate, even though the documents are not made available to the public as when the disclosure rules apply, it is likely that the supervising authorities will devise some measures aimed at protecting investors.

(3) Application of industry regulations

Regulating to a certain degree the solicitation of investments can be an effective way to protect fund investors.

The handling of fund offerings and private placements as a business, as well as the offering and private placement of funds as a business, is regulated as a secondary financial instruments business (a business that handles securities of lower liquidity than stocks and bonds) under the FIEL (Article 28-2-1). That is, when the founder of a fund solicits its own investors, the act of solicitation itself is subject to regulation.

The FIEL considers the business of managing collective investment schemes as the investment management business (Article 28-4-3), requires registration of that business with the FSA, and establishes as a prerequisite to registration that the business be a joint stock company with a minimum amount of capital (Article 29-4-1 and -5).

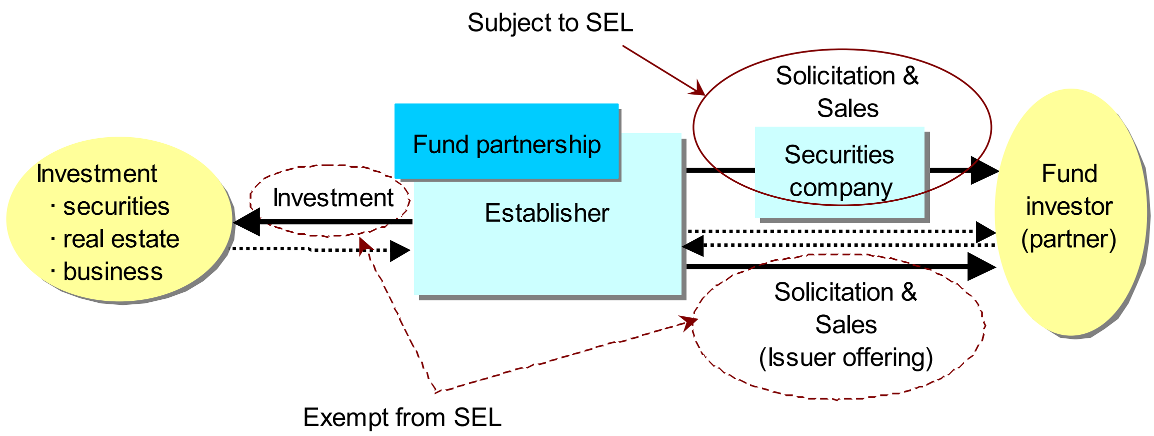
If the founder or manager of a fund is subject to industry regulations, they must strictly adhere to rules related to the duty to explain when soliciting, principles of suitability, and prohibitions on compensating for client losses. There is also a requirement to submit business reports to the FSA and 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 industry regulations. A classic example of this would be when a listed company directly approaches business contacts and requests investment in a third-party capital increase involving its own shares.

When a corporation offers its own shares, it is not only to profit from the issuance and sale of stock, but also to procure funds for some other separate business. There is no need for investors who purchase the shares to pay any sort of compensation to the issuing company outside of the cost of buying the shares. 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 that such activity is subject to industry regulation therefore makes sense.

Figure 1 Current fund rules under the SEL



Source: Nomura Institute of Capital Markets Research

(4) Qualms over industry regulation

Nevertheless, the reaction of those affected to the extension of industry regulation under the FIEL to venture capital and other fund businesses, which had thus far not been subject to industry regulation per se, appears to be quite strong. This resistance to tighter regulations is understandable, considering that various types of funds, largely using private placements targeted at professional investors to obtain funds, have thus far operated without being subject to disclosure requirements or industry regulations, and have done so without causing any major problems. 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 small number of unqualified institutional investors, the registration required of regular secondary financial instrument businesses and investment management business is waived, and prior notification alone is sufficient (Article 63). In this case, even when managing a fund, there is no need to meet the registration requirement for investment management businesses of being a joint stock company. 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 only prior notification, but these are rules that should be tolerated at a minimum.

The new law also requires those funds allowed only prior notification to submit reports and documentation, as well as submit to no-notice inspections, in order to confirm the condition of their businesses (Article 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 those funds are managed.

Figure 2 Fund rules under the FIEL

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 after that.
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 place 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

Source: Nomura Institute of Capital Markets Research

2) Disclosures related to fund activity

Fund activity can have an impact other than that on fund investors. Therefore, fund activity is monitored through supervisory rules, and there is also a large shareholdings reporting (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 had come under fire because the Murakami Fund did not reveal the status of its shareholdings.

Specifically, it changed the exception, previously limited 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 are having a critical impact on, the business activities of the issuer (omitted) without the objective of ownership." This change was aimed at keeping those funds trying to assert themselves in the management of the invested company from relying on the reporting exceptions (Article 27-26-1). Additionally, the ownership status for these reporting exceptions is as of "the base day," but this was changed from "the last day of the month every three months" to "the day, chosen from at least two designated days every month (omitted), that notification is given." The reporting deadline was also changed from the 15th day of the month following the base day to "within five days of the base day." (Article 27-1 and -3).

3) Application of rules requiring return of short-term trading profits

The FIEL also includes provisions to prevent unfair trading by funds. 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, which is the same as required of the listed company's executives and of major shareholders who individually own a 10% or higher stake (Article 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 multiplying the funds percentage ownership by that member's percentage share of the fund.[8] 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.

3. Assessing fund rules

As described above, the FIEL includes numerous provisions that tighten the regulation of funds in various aspects. Many of these provisions must go into effect within 18 months of the new law's promulgation date, and the expectation at this point is that they will become effective from July 2007. Additionally, the increased

8 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.

frequency of large shareholding reporting and the tighter reporting deadlines become effective as established by administrative order, which must be no later than one year from the promulgation date. System revisions will not be made immediately, since it takes some time to prepare the administrative orders and Cabinet Office Directives that establish the detailed rules, but the regulation of funds will be tightened to a substantial degree in the near future.

Furthermore, even the provisions within the FIEL are fairly strict in comparison with rules in other countries. Taking the example of industry regulations affecting funds, it is said that in the US, the regulation of hedge funds was tightened in December 2004 through Securities and Exchange Commission (SEC) rule 203(b)(3)-2. That rule expanded the registration requirement for fund managers in the 1940 Investment Advisor Act, from those that manage 15 or more domestic US funds to those with 15 or more clients in the US.[9]

In Japan, by contrast, under the current Investment Advisory Law, (leaving aside the question of whether it is actually enforced), in principle a fund manager with even one domestic client must register as an investment advisory business and be approved for making discretionary investments.[10] Add to this the new industry regulations affecting issuer-managed offerings, and it may be the case that Japan's fund industry regulation is the strictest in the world. The large shareholding reporting rules, which are strengthened notably under the new law, were already quite strict relative to other countries even before the revisions.[11]

4. Additional regulations are unnecessary

But is there a need to tighten the regulation of funds any further? As already noted, those arguing for tighter regulations are mostly calling for disclosure of information on fund investors. Although it is not that clear why such disclosure is necessary, it may be that a fund's support of a listed company is grounds for requiring the disclosure of information on that fund just as disclosure of information on the unlisted parent company of a listed company is requested. This would include information on that fund's investors, which equates to information on the parent company's shareholders.

It has also been noted in this regard, while keeping in mind how the Murakami Fund hit the companies it invested in with various demands, that management is

9 These rules do not apply to funds that have not established a redemption period of 2 years or less, and thus venture capital investors are not required to register. Also, on 23 June the Washington D.C. Circuit Court of Appeal ruled the SEC rules invalid.

10 With no exceptions based on the number of clients as under US law, a foreign investment advisor seeking to operate an investment advisory business domestically is required to register, except when they do business with an approved investment advisor or an investment trust management company (Article 4 of the Investment Advisory Law and Article 2 of the enforcement ordinance for said law). These rules will continue to hold under the new law (Article 61 of the FIEL).

11 See my article entitled Disclosure of Large Shareholdings in the Winter 2006 edition of the Nomura Capital Market Review, from pp 21.

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 at participating in management by, major shareholders.[12] That is, because there is a possibility that a fund's actions are going to reflect the intentions of its investors, it should be known who those investors are.

Nevertheless, the whole purpose of a fund is to entrust the selection of investments to a fund manager, 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.

III. Conclusion

With Murakami having admitted the charges, we expect the court case to unfold relatively smoothly. Murakami's press conference and statements he has made suggest that he has admitted guilt in order to put this case to rest and allow the fund business to survive. It may be difficult, however, for the institutional investors who have invested money in the Murakami Fund to maintain those investments at the same level as before in a fund that has violated a central tenet of fiduciary duty, which is to not use unfair trading methods; this is also true in light of the fiduciary duty that funds have to their beneficiaries.

It is also true that this case should not lead us to reject all of the Murakami Fund's previous actions. 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, Murakami's success in this regard should be remembered. At the same time, there is no denying that Murakami's unique character and way of speaking tends

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[12] From my informal interview with former bank employee Tsuyoshi Egami on page 10 of the 14 June 2006 edition of the Hokkaido Shimbun.

to leave the impression that he is somewhat selfish and high-handed, despite what he says having a certain rationality and logic to it, and this will probably hinder the development of reasoned and constructive dialogue with the management of listed companies.[13]

It may 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 of 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.

13 Although I have never been confronted by 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 [comment] of the Osaka Stock Exchange. My experience at that time lent further credence to the negative opinion of Murakami's words and conduct that many have expressed.