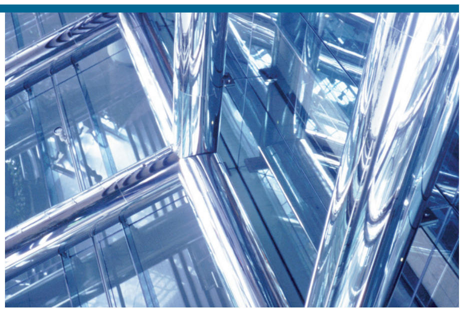
WHITE & CASE

Client**Alert**

Tokyo Financial Services Group

November 2012



FSA's Administrative Sanctions on Investment Managers and a Trust Bank

On October 16, 2012, the Financial Services Agency of Japan (the "**FSA**") announced administrative sanctions against an investment manager (a two month business suspension order and a business improvement order) and a trust bank (a three months business suspension order and a business improvement order). On the same day, the Kanto Local Finance Bureau also announced similar administrative sanctions against another investment manager (a one month business suspension order and a business improvement order).[1]

These companies were all sanctioned in connection with asset management services provided to one particular pension fund client. According to news reports, this pension fund had delegated investment authority with respect to JPY 6.8 billion to the three sanctioned companies, directing them to invest in certain limited partnerships (*toushi jigyou yugen sekinin kumiai*) which would in turn, invest into unlisted shares. Upon such direction from the pension fund and without conducting any substantive review, these companies, each acting as an asset manager, made investments into such limited partnerships. When the investments eventually proved to be unsuccessful, the pension fund incurred losses of JPY 4.6 billion. It should also be noted that this particular pension fund suffered significant losses in the recent AIJ scandal.

While the specific facts that the FSA found and considered differ across the cases (for a summary of the relevant facts, please see the table below), the common findings by the FSA across the cases were the (i) insufficient due diligence of prospective investments prior to the decision to invest in a limited partnership which invests in unlisted shares and (ii) insufficient monitoring of the limited partnership after the initial investment had been made.

The FSA determined that these insufficiencies in each of the three cases were due to a breach by each asset manager of its "duty of care" to its client. Investment managers are subject to the duty of care under the Financial Instruments and Exchanges Law (Law No. 25 of 1948, as amended), while trust banks are subject to the duty of care

1 In connection with these cases, the Kanto Local Finance Bureau also released a written caution to two Article 63 notification filers to stop to providing false statements to clients. One of such filer was cautioned to stop misappropriation of the assets of the fund as well.

If you have questions or comments about this Client Alert, please contact:

Christopher Wells
Partner, Tokyo
+ 81 3 6384 3100
cwells@whitecase.com

Koichiro Ohashi
Partner, Tokyo
+ 81 3 6384 3151
kohashi@whitecase.com

Norifusa Hashimoto
Partner, Tokyo
+ 81 3 6384 3208
nhashimoto@whitecase.com

Tomoko Fuminaga
Partner, Tokyo
+ 81 3 6384 3224
tfuminaga@whitecase.com

Tokyo Financial Services Group

ATTORNEY ADVERTISING. Prior results do not guarantee a similar outcome.

White & Case LLP
White & Case Law Offices
(Registered Association)
Marunouchi Trust Tower Main 26th Floor
1-8-3 Marunouchi
Chiyoda-ku, Tokyo 100-0005
Japan
+ 81 3 6384 3300

under the Act on Engagement in Trust Business by A Financial Institution (Law No. 43 of 1943, as amended). The FSA found that conducting due diligence before an investment is made and continuing to monitor such investments afterwards are both requirements under these duties of care.

Throughout these cases, the FSA emphasized the importance of asset managers and trust banks meeting their respective duties of care. The FSA also expressed its expectation that in managing the assets of clients, assets managers and trust banks are required to continually investigate and assess the appropriateness of target investments, the qualification of the operator of any contemplated investment scheme and all other relevant factors in order to meet their duties of care, regardless of whether their client directs any particular investments.

Prior to Investment	After Investment
Case 1: Investment Manager = > Two months business suspension	
I. Insufficient Due Diligence Conducted on the Target Limited Partnership Prior to Investment (a) No investigation or review was conducted as to whether investing all the delegated funds in the limited partnership that would, in turn, invest in unlisted shares was suitable for the pension fund. (b) Investigations on the appropriateness of selection of the general partner of the limited partnership were insufficient. (c) The understanding of the actual status of the unlisted company in which the limited partnership would invest was completely insufficient.	**I. Insufficient Reporting to the Pension Fund After Investment** (d) Without independently verifying the actual status of the unlisted company with respect to an initial public offering, the investment manager prepared its quarterly investment management report to the pension fund based on the false report from the general partner. **II. Insufficient Monitoring of the Limited Partnership After Investment** (e) The investment manager failed to take appropriate measures when the limited partnership, without reasonable cause, made additional investments in the unlisted company which withdrew its listing plan. (f) The investment manager did not periodically review the appropriateness of the investment in the limited partnership.

Prior to Investment	After Investment
Case 2: Investment Manager = > One month business suspension	
I. Insufficient Due Diligence Conducted on the General Partner (a) The investment manager failed to conduct due diligence of the general partner prior to making an investment into the limited partnership. (b) The investment manager did not investigate the performance of the other limited partnership managed by the general partner. **II. Insufficient Confirmation of the Intent of the Pension Fund** (c) The investment manager made investments in the limited partnership without sufficiently confirming the intent of the pension fund to delegate the authority to manage the fund.	**I. Insufficient Monitoring of the Limited Partnership After Investment** (d) The investment manager was not aware that the general partner failed to prepare an amendment agreement regarding the change of the business year of the limited partnership and that the general partner continued to receive management fees in accordance with the out-of-date business year.
Case 3: Trust Bank = > Three months business suspension	
I. Insufficient Due Diligence Conducted on the Target Limited Partnership and the General Partner (a) The trust bank did not have an appropriate system to review and monitor investments in the limited partnership. Due diligence of the limited partnership and the general partner was conducted only by sales personnel (rather than by the fund managers with review by the compliance department).	**I. Insufficient Monitoring After Investment** (b) The trust bank had not developed systems to perform the continuous monitoring of performance of the general partner and failed to take appropriate actions for a significant time following an adverse opinion being issued against the unlisted company (into which the limited partnership had invested) by an auditing firm.

These cases are the first to explore the scope of the "duty of care" by investment managers and trust banks in the aftermath of the AIJ Scandal. As such, not only do these cases bear on the facts in that scandal, these cases also merit close study by all firms engaged in asset management (and other service providers) in respect of Japanese pension fund monies and investors generally. While the "duty of care" has for a long time been explicitly provided in the law, some observers in the Tokyo financial community view these decisions as having "raised the bar" considerably with respect to the scope of the duty of care applicable to asset managers and trust banks.

This Client Alert is provided for your convenience and does not constitute legal advice. It is prepared for the general information of our clients and other interested persons. This Client Alert should not be acted upon in any specific situation without appropriate legal advice and it may include links to websites other than the White & Case website.

White & Case has no responsibility for any websites other than its own and does not endorse the information, content, presentation or accuracy, or make any warranty, express or implied, regarding any other website.

This Client Alert is protected by copyright. Material appearing herein may be reproduced or translated with appropriate credit.

In this publication, White & Case means the international legal practice comprising White & Case LLP, a New York State registered limited liability partnership, White & Case LLP, a limited liability partnership incorporated under English law and all other affiliated partnerships, companies and entities.
AP1112001_02