



EBC Position on Dealing for Related Parties

European Business Community in Japan (EBC)¹ Asset Management Committee

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1. Aims of this viewpoint

At present, Investment Advisor (IA) companies are not permitted to execute transactions on behalf of the clients of other wholly-owned investment management companies within their own Groups. In particular, IAs cannot place orders for Japanese securities together with similar orders generated by other companies in their own Group. This leads to duplication of dealing functions, reduces market efficiency, increases client transaction costs and creates a compliance risk of front-running for one group of clients over the interests of others. Fund managers believe that best execution is obtained for all clients, wherever domiciled, when orders are placed within the business hours of the Japanese market.

The practice of executing transactions on behalf of affiliates is allowed in most jurisdictions.² However, the FSA have indicated VERBALLY that an IA would require a securities licence to execute such orders. We believe this is an inappropriate policy: the IA's aim is to merge the orders to ensure fairness and best execution, whereas we believe that if an IA held a securities licence, we understand that it would be required to keep those functions separate.

2. Detailed Comments

Our primary aim in wishing to be able to place orders on behalf of affiliated investment management companies directly with securities companies in Japan is to ensure equal treatment in Japanese securities for all clients of global fund management groups. We consider that ensuring equal treatment between all clients is a very important way of fulfilling our fiduciary responsibilities as investment managers. In particular, we seek with this viewpoint to ensure that we do not let Japanese clients be disadvantaged by other affiliated companies' clients.

¹ The European Business Community is the trade policy arm of the combined European national Chambers of Commerce in Japan.

² For example: US, UK, Australia, Hong Kong, Singapore, Switzerland, and Germany

Our present understanding is that, without a securities licence, there is only one way in which this goal could be achieved:

Through full delegation of all affiliated companies' investment decisions to the Japanese affiliate (as stipulated in Article 2 Section 4-2 of the Law Concerning Restrictions, etc., on an Investment Advisory Business Related to Securities).

This is impractical for most companies since many global investment decisions for global mandates are taken by investment staff located in other countries. Clients will reject the concept of delegating all assets in a global portfolio country by country. We believe that a simpler and fairer treatment can be obtained if all IA licence holders are permitted to execute trades for affiliated companies.

3. Issues of Controls

We accept that IA companies would need to put in place certain controls to ensure that investors are fully protected from potential conflicts of interest. We believe that the following conditions would achieve this:

- a) The affiliated companies from whom IAs would receive order placements for Japanese assets would be limited to those investment management companies that will be designated in a list submitted to FSA annually or at any such time as an IA needs to make amendments to the list of names. [Such amendments could occur when affiliates change names, when new affiliates are acquired etc.];
- b) The orders received by the IA in Japan will be strictly limited to those on behalf of clients' accounts of the listed affiliated companies. In every case, the client will have a duly executed signed investment management agreement with the Group company which has discretion to make and execute investment decisions. The IA will make a copy of that agreement available at the regulators' request.
- c) The fees for placing orders as a service to our affiliated companies will be charged to those companies at a reasonable level. (*We believe it is appropriate to charge our affiliated companies for our expenses incurred.*)

As well as ensuring equal treatment of all customers globally in Japanese assets we believe that our proposal has a number of other significant advantages:

1. Ability to "work" orders in live market hours for all clients.

When, as at present, orders in Japanese assets are placed separately by different affiliates around the world, there is a risk that, acting independently, the various affiliated companies place competing orders in the same stocks inadvertently, which would be against the interests of all our clients.

For active managers, this is a very real risk, since affiliated companies will base their investment decisions upon common research information, typically provided by the local IA in Japan. We believe that the risk of unintentional conflicts of interest between those clients would be manageable if the local IA in Japan could execute all orders for Japanese securities.

2. Accessing large volumes – a problem faced by all large global firms.

One of the hardest issues facing global firms is the ability to access large volumes of stock. In many instances, it can take many days' trading volume to meet our total Group client needs in some stocks. Accordingly, it is vital to be able to respond immediately on a global basis to large block offers from brokers or other market participants. For Japanese assets, these offers will take place in this time zone during market hours in Tokyo. Under current separate dealing arrangements for affiliates in other time zones, it is impossible for them to participate in or even see those offers of blocks which could achieve our order size in one trade. Clients whose trading progress is slower would often risk a price disadvantage.

3. Obtaining better commission terms for all our clients.

By executing all orders in Japanese assets, the IA in Japan is likely to be placing larger orders on average and this could lead to an improvement in commission terms for our clients through lower costs. This will be of benefit to all the affiliates' clients, including the Japanese IA's clients.

4. Execution Skill Base in Japan

We believe that it is in Japan's interests to have a significant depth of investment skills present and operating in the market place. Part of the added value for fund management companies lies in their ability to add value through the execution of investment decisions efficiently and quickly. Our proposal will lead to an increase in the pool of dealing/trading executives in Japan as volumes rise to accommodate the orders of affiliated companies. We would also make the point that the present ruling by the FSA is likely to encourage global IAs to re-locate their execution resources to other locations in the Asian time zone to achieve the same objectives. We think this would be detrimental to Japan's credibility as a global financial centre.

4. Recommendation

The EBC urges the FSA to issue a **No Action Letter** to all IA licence holders specifically allowing them to execute transactions on behalf of clients of affiliated companies in the Japanese securities markets in such a manner that allows maximum efficiency and fairness to all clients of the IA and its affiliated group companies.