



November 22, 2017

Via Electronic Submission

Mr. Takuo Komori
Director of the Markets Division

Mr. Shigeki Mitomo
Head of the Market Function Enhancement Office

Financial Services Agency
General Affairs Planning Bureau
Market Division, Market Function Enhancement Office
〒 100-8967
Chiyoda-ku, Tokyo 3-2-1 Kasumigaseki
No. 7 Building

Re: Consultation regarding Order for Enforcement of The Financial Instruments and Exchange Act and Cabinet Office Ordinance regarding Financial Instruments Business (together, “Enforcement Order”)

Dear Messrs. Komori and Mitomo:

Managed Funds Association (“MFA”) appreciates the opportunity to provide comments to the Financial Services Agency (“FSA”) on its Enforcement Order regarding registration and regulation of persons/entities engaged in high speed trading (“HST”).

By way of introduction, MFA represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns.¹

MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, and the Americas to help develop regulations that address important policy objectives in an effective manner that is also feasible for investment managers, big and small and with various types of businesses. Over the past 40 years, as financial markets have

¹ For further information, please visit our website at www.managedfunds.org.

employed ever more advanced technology, investors too have come to rely heavily on technology and computers. In our members' experience, investors have benefited from these developments as transaction costs have fallen and market liquidity has improved. However, as markets and trading evolve, we believe it is important for regulators to modernize regulation to accommodate and regulate these changes. Accordingly, in the past few years we have discussed automated trading with regulators in the U.S., Europe, and China.

In light of MFA's wish to serve as a constructive policy resource on issues related to automated trading, we write to FSA with some questions and comments for consideration on the Enforcement Order. We observe that the FSA's definition of HST focuses on the technology used for accessing markets, rather than on the type or role of the market participant; and as a result, the Enforcement Order may affect a large number of market participants, including many foreign investment managers. The registration and regulatory requirements for HST operators appear quite burdensome. Accordingly, many foreign investment managers will reevaluate how they invest in Japanese markets and weigh the cost and burden of registration. We thank the FSA for allowing HST operators to submit registration and compliance materials in English as this will reduce burden and assist foreign HST operators with compliance. Nevertheless, we would greatly appreciate further efforts of the FSA to adopt a level of flexibility and proportionality in the application and implementation of the HST registration requirements to recognize more fully the variety of scale and scope of applicants' business. We discuss our concerns in more detail below.

I. Registration Application

A. Confidentiality

We understand that Form 29 is to be made available in a public registry, but respectfully urge that certain information included on that form not be included in the public registry. Specifically, the amount of capital and names of officers should not be made publicly available. Public disclosure of such information (as distinguished from privately reporting this information to regulators) seems to achieve no public purpose and may expose the named individuals to unnecessary harm. Investment managers, commonly organized as limited liability companies or limited partnerships, are generally not required to disclose their capital levels. Investment managers maintain this information in the strictest confidence given the sensitive business implications of disclosure to competitors and to the public. If capital information is necessary on Form 29, we recommend that FSA amend Form 29 to allow HST operators to indicate the range of capital they have as opposed to the specific amount of capital that they maintain. For example, Form 29 could request that an HST operator indicate whether they have: (1) ¥10 million - ¥50 million; (2) ¥50 million - ¥100 million; or (3) over ¥100 million.

In addition, our members would appreciate if the FSA could confirm that it will grant confidential treatment to other materials required as part of an HST operator's registration application package, such as the business method manual, business execution system, resumes of executives and other personnel, certifications/oaths with individual signatures, financial statements and net asset information. As a general matter, MFA and its members have strong

concerns with data security and the confidentiality of registrant information and have written to U.S. and European policy makers and regulators on this subject on numerous occasions.²

We are concerned that public disclosure of registration application materials will increase the cybersecurity threats of applicants by raising their public profiles. MFA member firms and their employees are regularly targeted in phishing and other cyberattacks and face a high risk of theft and economic espionage. Separately, our members are concerned that many of the required documents concerning an applicant's business contain proprietary information and trade secrets, and disclosure of such information would harm their investors, businesses and employees. Accordingly, we respectfully urge the FSA to confirm that, with the exception of certain general information on Form 29, all HST operator registration application materials will be maintained confidential by regulators.

B. Financial Information

We appreciate that the FSA has an interest in the solvency of HST operators. We do not believe, however, that profit and loss (“**P&L**”) statements and salary and wage information is necessary or relevant for understanding an HST operator's solvency. For our members, financial information is very sensitive and confidential information (*e.g.*, for a small firm with only a few employees, divulging total salary and wages would be nearly equivalent to sharing individual employee salary information). As such, we respectfully urge the FSA to balance its need to understand the financial solvency of an HST operator with the need of HST operators to protect the confidentiality of such information. We recommend that the FSA require that HST operators submit a high-level balance sheet for purposes of showing solvency, and not require a P&L statement, nor information regarding wages and salary (*e.g.*, allow HST operators to provide total expenses, rather than categorizing specific line items).

To the extent the FSA determines that P&L information is necessary, we recommend that the FSA provide investment managers with the flexibility of providing the P&L information of the investment funds that are engaged in HST. The financial information of the investment funds would be a better gauge of the solvency of the entity engaged in HST. May the FSA confirm that an investment manager may provide the P&L information of the investment fund engaged in HST?

In addition, we have a few other suggestions if the FSA determines that an HST operator must provide financial statements. First, we suggest that the FSA allow an HST operator to provide unaudited financial statements, rather than audited financial statements. Second, we suggest that the FSA require that HST operators submit annual reports within 8 months from year-end. Third, if the FSA determines that HST operators must provide audited financial statements, we suggest

² See, *e.g.*, letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to the Honorable Jay Clayton, Chairman, SEC, on October 17, 2017, regarding the Protection of Confidential Registrant Information, available at: https://www.managedfunds.org/wp-content/uploads/2017/10/MFA.RIA-data-security.final_10.17.17-1.pdf; and letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to the Honorable Chris Giancarlo, Chairman, CFTC, on November 17, 2017, regarding the Protection of Confidential Registrant Information, available at: https://www.managedfunds.org/wp-content/uploads/2017/11/MFA.CFTC-data-security.final_11.17.17.pdf.

that the FSA allow HST operators to produce financial statements prepared in accordance with the generally acceptable accounting principles used in such entity's relevant home jurisdiction.

Many investment managers do not have their financial statements audited, and those that choose to have their financial statements audited receive them at the earliest 6 months after the year-end. While U.S. regulation does not require investment managers to have their financial statements audited, it does require them to have the financial statements of the investment funds they advise audited annually and provided to investors within 120 days from year end. In order to audit the financial statement of an investment manager, the financial statements of the funds that the investment manager advises must first be audited. As such, it would be very difficult to provide audited financials to the FSA in an annual report within 3 months from year-end. Finally, to the extent the FSA requires audited financials, it would be extremely burdensome for an HST operator to produce audited financial statements in accordance with Japanese Accounting Standards.

C. Business Methods Description

We understand that the FSA requires an HST operator to include in its registration materials, a Business Method Description or Manual. Would the FSA confirm that it is looking for a high-level summary of business operations and methods as opposed to the submission of detailed policies and procedures? We believe submitting summaries would be more helpful for regulators to understand the general nature of an HST's operations. By comparison, HST operators may include sensitive business information in their policies and procedures and regularly make minor changes to policies and procedures. Such information may be too detailed to be of value to regulators but may reveal confidential information to competitors, if the information became public.

II. Notifications & Annual Reports

A. Notification Requirements

The Enforcement Order requires HST operators immediately to notify regulators of changes related to the business method description and to notify regulators within two weeks of changes related to the registration application. To achieve the FSA's regulatory interest in registration and to decrease regulatory burden, we believe the FSA should only require notifications of material changes.

Many of our members operate global investment management businesses and are constantly adjusting their processes and business methods. For example, it is not uncommon for an investment manager to frequently make minor adjustments to certain parameters embedded in its trading software, including administrative changes, or enhancements for risk management purposes. In addition, as global firms, many of our members make business changes that only impact certain geographies and would not be material to their operation as an HST operator in Japan. We are concerned that information regarding each and every change in business methods or trading strategies will be little use to Japanese regulators, but will impose a very significant ongoing burden on HST operators.

Accordingly, we recommend that the FSA adopt a materiality standard in the requirement for HST operators to report changes to trading strategies and business methods. In addition, we respectfully urge the FSA to confirm that an HST operator must only notify regulators of material changes related to the HST operator's activities in Japan.

B. Annual Reports

The Enforcement Order requires HST operators to file Form 30, the Annual Business Report. One of the requirements of Form 30 is for HST operators to provide an outline of their business in the current term, outline of business activities in the current fiscal year, general outlook on business results, summary of important matters that affected operating results, and matters resolved at the shareholders meeting. We believe this request is more appropriate of an operating company, rather than of an investment manager and/or its fund. An investment manager can report on the performance of its funds, but it is not possible to provide a general outlook of results nor to hold a shareholders meeting. Can the FSA confirm that this type of information in Form 30 should be provided only to the extent applicable?

Form 30 requests for information on the status of trading securities. Investment managers do not maintain records of stock and bond information as categorized by Form 30 (differentiated by listed and unlisted stocks, and traded during or after market hours), so completing the request will be very burdensome and time-consuming. Instead, since the exchanges on which HST operators trade will tag HST strategies and maintain detailed trade information, we believe it would be more efficient for the FSA to request for such information from exchanges. This approach would ensure the FSA receives data efficiently and in a manner that it can reliably analyze.

With respect to accounting information, we repeat our request above in section I.B that the FSA only require a high-level report of financial information and not require a full P&L statement with each annual report. To the extent the FSA requires audited financial information, as discussed above, 3 months would not be enough time as it takes accounting firms at least 3 months to audit the financial statements of investment funds and at least 6 months to audit the financial statements of investment managers.

Finally, we are concerned that 3 months from the end of the fiscal year is not enough time for investment managers to complete and file the annual business report given the materials requested in Form 30. We recommend that the FSA allow HST operators to submit the annual report within 8 months from the end of the fiscal year.

III. Compliance Requirements

A. Internal Audit Function

The Enforcement Order indicates that an HST operator should have staff to conduct internal audits. Investment managers registered with the U.S. Securities and Exchange Commission or U.S. Commodity Futures Trading Commission are required to have compliance

programs and to conduct regular assessments of internal procedures. To accommodate for HST operators of varying size and businesses, we would like the FSA to confirm that it would be acceptable for an investment manager's compliance or risk department to perform the internal audit function.

In addition, we respectfully request that the FSA allow an HST operator to satisfy the internal audit requirement by: (1) allowing the HST operator's governance committee or senior management to hire a third party to conduct an internal audit of the HST operator; or (2) allowing the HST operator's agent in Japan to conduct the internal audit of the HST operator. In addition, we respectfully urge the FSA to confirm that such audit need only cover the HST operator's activities in Japan.

B. Recordkeeping

The Enforcement Order requires HST operators to maintain records of order tickets for a period of 7 years, and transaction blotters and ledgers for a period of 10 years. We believe 10 years is inconsistent with regulatory requirements in other jurisdictions, such as the U.S., EU, and other parts of the Asia-Pacific region, and greatly increases the burden and cost on registrants. For regulatory simplification and consistency, we respectfully urge the FSA to require that all records be maintained for a period of no more than 7 years. We do not believe that a longer period of time will serve any meaningful regulatory purpose and will simply raise costs. Moreover, we believe that as cyberattacks become more pervasive and sophisticated, it is preferable to save only that information that regulators reasonably foresee to be necessary.

C. Supervisory Guidelines

The Enforcement Order requires HST operators to have measures to prevent unfair trading activity. We appreciate that the Enforcement Order provides examples of how an HST operator might comply with the requirement, such as surveillance factors. However, the factors the FSA has identified may not be appropriate or relevant for all investment strategies. For example, the FSA provides as a sample surveillance metric that an HST operator develop standards for identifying trades that take into account the magnitude of individual issue price movements and the HST operator's share of participation in such individual issue. If a manager is executing trades using HST techniques, but the manager's underlying investment objective is to acquire a sizable position over the long-term, we would expect the manager's trading to have an effect on the price of the security and potentially have a high participation rate. Having a market impact is not in and of itself problematic; it is only problematic if the trading is done for the purpose of causing the market impact (with the intent of taking advantage of that market impact). We submit that registrants should have the flexibility to develop the surveillance they deem most effective to prevent unfair behavior and not be required to apply all of the factors provided as examples in the Enforcement Order in order to comply with the requirement to have mechanisms to prevent unfair trading activity. Would the FSA confirm that an HST operator may satisfy its obligations to prevent unfair trading, provided that its surveillance takes into consideration factors that are appropriate for the trading strategy being operated?

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MFA thanks the FSA for the opportunity to provide comments and recommendations with respect to the Enforcement Order. If the staff has any questions, please do not hesitate to contact Jennifer Han or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel

/s/ Michael Pedroni

Michael Pedroni
Executive Vice President & Managing
Director, International Affairs