

Alert | Investment Management



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Amendment of Investment Management Business Regulations for Foreign Fund Managers Doing Business in Japan

The proposed amendment of Japan's Financial Instruments and Exchange Act (Act No. 25 of 1948, the FIEA) passed the Diet and was enacted May 19, 2021. The amendment creates an exemption from investment management business registration requirements for fund managers who mainly manage funds contributed by foreign professional investors. The amendment also creates a temporary exemption for managers with track records of conducting an investment management business in their home jurisdiction who intend to test the Japanese business environment for a certain period before they proceed to obtain a full-scale registration or exemption to do business in Japan.

Background

The Japanese government has several campaigns and initiatives to attract foreign investment to Japan in order to make Japan a major international financial center once again.

Under the FIEA, a person who wants to conduct an investment management business in Japan is required to be registered as an Investment Management Business (IMB), which requires a robust operational structure and financial strength such as minimum capital and net asset requirements. The generally lengthy and onerous registration process has deterred foreign managers from entering the Japanese market. Also, the existing regime does not have an appropriate registration process for foreign investment managers who mainly manage foreign funds, and does not take into account the track record and the foreign authority's supervision of such foreign investment managers in the review process.

To address these issues and encourage foreign investment managers to come to Japan as one of their global business hubs, the amendment introduces temporary and permanent exemptions from IMB regulations to accommodate foreign investment managers with a more practical regulatory environment to do business in Japan.

Transition Period Exemption

The Specially Permitted Business for Transition Period (“Transition Period Exemption”) enables a foreign investment manager licensed and regulated by a foreign regulator in its home jurisdiction (“Foreign Investment Manager”) to, upon a summary notification, conduct certain investment management businesses in Japan for up to five years from the date of the notification without obtaining the IMB registration under the FIEA. Because of the time-limited nature of this exemption, by the end of the five-year transition period, the Foreign Investment Manager enjoying the Transition Period Exemption must be registered as an IMB or exempted from the IMB registration by the Article 63 Exemption or the Foreign Investor Exemption, each as discussed below (otherwise, the manager needs to give up their business in Japan and leave).

Temporary Relief

The Transition Period Exemption is a temporary relaxation of the regulations to encourage Foreign Investment Managers to consider opening an office in Japan by reducing initial cost, i.e., applying for onerous IMB registration, in the early stage of business in Japan. This exemption is available only for those who made the necessary notification within five years after the amendment goes into effect. Therefore, if a manager wishes to test the business environment in Japan under this exemption, it must make the necessary notification within this five-year window to be eligible for the five-year exemption from the IMB registration requirements.

Permitted Businesses: Type of Investors

A Foreign Investment Manager¹ is permitted to conduct certain activities in Japan in connection with its investment management business in its home jurisdiction. Such activities include the following:

- Investment management services, such as discretionary investment management for Foreign Investors, investment management of foreign investment trusts or management of a limited partnership for Foreign Investors as a general partner; and
- Marketing and Distribution of interests of funds that such Foreign Investment Manager manages for Foreign Investors.

For purposes of the Transition Period Exemption, “Foreign Investors” include foreign corporations, individuals who have home addresses outside Japan, and closely affiliated persons of the Foreign Investment Manager designated by any related cabinet order or cabinet ordinance (collectively, “Related Orders or Ordinances”). Japanese Qualified Institutional Investors (QIIs²) are not covered by the forgoing definition of Foreign Investors; therefore, the Foreign Investment Manager may not provide its services

¹ A subsidiary of a Foreign Investment Manager may also rely on the Transition Period Exemption, but the scope of service it can conduct in Japan is limited, i.e., it can provide only discretionary investment management services for its parent Foreign Investment Manager.

² There are two types of QIIs: i) statutory QIIs, which are licensed financial institutions such as securities brokers, insurance companies, banks, and IMBs; and ii) registered QIIs who are not statutory QIIs but hold 1 billion yen (approx. USD 9 million) financial portfolios and are registered as QIIs with the KLPB.

for QIIs under the Transition Period Exemption, as opposed to the Foreign Investor Exemption (to be discussed below).

Notification and Qualifications

A Foreign Investment Manager is required to file a notification with the Kanto Local Finance Bureau (KLFB) which states, among other things, the stated capital amount; name of directors, executive officers and the representative in Japan; name of important employees (i.e., a compliance officer and an employee who supervises the investment management division); address of the main office and the office in Japan; type of exempted businesses to be conducted; and other businesses conducted by the Foreign Investment Manager.

The Foreign Investment Manager is permitted to start its business in Japan if the above-described notification is accepted by the KLFB and if the Foreign Investment Manager meets the following qualifications:

- Hold an investment management license granted by its home regulators similar to IMB license granted by the KLFB;
- Have a track record of conducting an investment management business for a certain number of years (to be specified by the Related Orders or Ordinances) after receiving its license in its home jurisdiction;
- Have sufficient human resources and governance structure to conduct the investment management business properly;
- Mainly invest in non-Japanese securities as specified by the Related Orders or Ordinances;
- Have an office in Japan;
- Appoint a representative in Japan.
- Neither the Foreign Investment Manager nor any major shareholder of it is subject to any disqualifiers, e.g., a person who has violated financial regulations or other regulations within the preceding five years, a person who lacks the capacity of recognition, decision making or communication due to a mental disorder, etc.

Ongoing Reporting Obligations.

Foreign Investment Managers are required to prepare and keep books and records specified by the Related Orders or Ordinances. They also need to file an annual business report with the KLFB within three months of the end of each business year. Certain items of the business report must be made public at its offices or on its website.

The Related Orders or Ordinances are yet to be published, but the notifications and annual business reports can likely be made in English for the Transition Period Exemption and the Foreign Investor Exemption, discussed below.

Foreign Investor Exemption

Permitted Businesses: Type of Investors

The Specially Permitted Business for Foreign Investors (“Foreign Investor Exemption”) allows an investment manager (“Exempted Manager”) to conduct management of collective investment schemes, e.g., limited partnerships, with funds mainly contributed by non-Japanese investors, without the IMB registration under the FIEA. The Exempted Manager may also distribute the interests of a partnership, etc., managed by such Exempted Manager, to Foreign Investors. This exemption does not require an investment manager to hold a license granted by a foreign authority and may be relied upon by domestic managers as well. The Foreign Investor Exemption is a permanent amendment of the FIEA regulations.

For purposes of the Foreign Investor Exemption, “Foreign Investors” means professional investors outside Japan, such as foreign corporations and individuals who have a home address outside Japan and who have sufficient knowledge, experience, and assets to be specified by the Related Orders or Ordinances; QIIs; and closely affiliated persons of the Exempted Manager designated by the Related Orders or Ordinances.

Unlike the Transition Period Exemption, the Foreign Investor Exemption covers only partnership-type funds. Thus, a manager of investment trusts or mutual funds may not rely on the Foreign Investor Exemption. In addition, the Exempted Manager may provide its services for QIIs, but the majority of the funds must be contributed by non-Japanese residents. Further, eligible non-QII investors are limited to those who have sufficient knowledge, experience, and assets under the Foreign Investor Exemption.

Notification and Qualifications

An Exempted Manager is required to file a notification with the KLFB. The notification must include, but is not limited to, the following information: stated capital amount; names of directors, executive officers and representatives in Japan (in case of foreign Exempted Managers); names of key employees; addresses of the main office and the office in Japan (in case of foreign Exempted Managers); types of exempted businesses to be conducted; and other businesses conducted by the Exempted Manager.

To be qualified for the Foreign Investor Exemption, the Exempted Manager must meet the following qualifications:

- Have sufficient human resources and governance structure to conduct the exempted business properly;
- Have an office in Japan;
- Appoint a representative in Japan (in case of foreign Exempted Managers).
- Neither the Exempted Manager nor any major shareholder of it is subject to any of the disqualifiers discussed above.

Ongoing Reporting Obligations

Exempted Managers are required to prepare and keep books and records specified by the Related Orders or Ordinances. They must also file an annual business report with the KLFB within three months of the end of each business year. Certain items of the business report must be made public at its offices or on its website.

Comparison with Article 63 Exemption

There is a similar exemption from the IMB registration, which is applicable to managers of partnership-type funds, i.e., Specially Permitted Businesses for Qualified Institutional Investors, Etc. (so-called “Article 63 Exemption”), which is basically a professional investor exemption. Thus, it exempts managers from the IMB registration and the distribution license requirements if the prospective investors include at least one QII with up to 49 eligible non-QII investors. Indeed, the Article 63 Exemption has been widely used for private fund distribution in Japan.

The Foreign Investor Exemption is useful for those managers who do not have a prospective QII for their partnership and the investors are eligible foreign corporations or individuals only. Even if the partnership has a QII on board, a manager can rely on the Foreign Investor Exemption when the manager intends to market its partnership to more than 50 eligible non-QIIs.

The business conduct of Exempted Managers is subject to the FIEA regulations, just like under the Article 63 Exemption. However, the Foreign Investor Exemption has additional staffing and governance structure requirements including having internal policies in place regarding the investment management business and the training of officers and employees to comply with the internal policies. The regulations related to the Foreign Investor Exemption are less burdensome than those related to the IMB registration, but they are a little heavier than those related to the Article 63 Exemption in such respects. This level of regulation may impact the notification process for the Foreign Investor Exemption, i.e., the manager may need to provide a copy of internal policies and a description of its staffing and governance structure³.

Thus, a manager who wants to manage a partnership fund in Japan should carefully choose which exemption the manager should rely on for its contemplated business in Japan to take advantage of those exemptions.

Schedule

The Related Orders or Ordinances that set forth the details of the regulations to enforce the amendment are expected to be published in summer 2021 and will be subject to a public comment process for a few months. The amendment of the FIEA will become effective after this public comment process, which is currently expected to close by the end of 2021.

** This GT Alert is limited to non-U.S. law.*

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³ Such details should be made clear by the Related Orders or Ordinances and their public comment process.

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