

## ASSET MANAGEMENT BULLETIN

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## New Exemptions to Attract Foreign Investment Managers

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### I. Introduction

The Japanese Government has been committed to expanding Japan's role as an international finance hub. As a part of this commitment, the Japanese Financial Services Agency (the "**FSA**") submitted a bill to the Diet on March 5, 2021 for the amendment of the Financial Instruments and Exchange Act (the "**Amendment**"), introducing exemptions for (i) special business activities during a certain transition period (the "**Transition Period Exemption**") and (ii) special business activities for overseas qualified investors (the "**Overseas Investors Exemption**"). The bill was passed by the Diet on May 19, 2021 and promulgated on May 26, 2021.

These exemptions aim to promote the operation by foreign investment managers of an investment management business in Japan through notification procedures instead of the registration process under the current Financial Instruments and Exchange Act (the "**FIEA**"<sup>1</sup>). This newsletter outlines these exemptions and their effect on foreign investment managers.

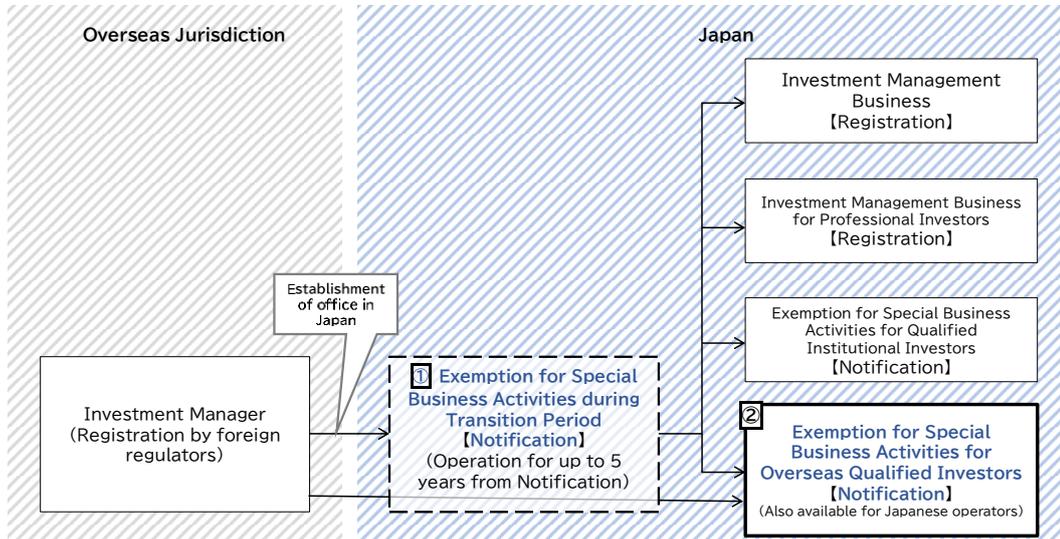
Foreign investment managers may also take advantage of the services of the Financial Market Entry Office, which facilitates the regular registration process and ongoing monitoring obligations of foreign investment managers in English. For more information, please see our newsletter "[Lowering the Entry Barrier for Foreign Asset Management Firms: Introduction of the "Financial Market Entry Office" \(May 2021 \(E Vol. 1\)\)](#)" for an overview of the Financial Market Entry

<sup>1</sup> In this letter, the "Amended FIEA" means the FIEA as amended by the Amendment.

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Office.

## &lt; Diagram of Exemptions to be Introduced &gt;



(Extract from FSA's explanatory materials regarding the bill for the Amendment dated March 2021<sup>2</sup>)

(Note): You may rely on the exemption for special business activities for qualified institutional investors without opening an office in Japan.

## II. Exemption for Special Business Activities during Transition Period (“Transition Period Exemption”)

### 1. What is the Transition Period Exemption?

The Transition Period Exemption is an exemption that allows investment managers conducting investment management business activities outside Japan under foreign laws (the “**Foreign Investment Managers**”) to conduct certain investment management business and related business activities (the “**Special Business Activities during Transition Period**”) in Japan by filing a notification with Japanese regulatory authorities in lieu of registration. The Foreign Investment Managers may rely on the Transition Period Exemption for five years from the date of the notification if they satisfy certain statutory requirements during that period (Article 3-3 of the Supplementary Provisions of the Amended FIEA).

<sup>2</sup> <https://www.fsa.go.jp/common/diet/204/01/setsume.pdf>

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### 2. What is the purpose of the Transition Period Exemption?

Under the FIEA, in principle, registration is required for an investment manager to conduct investment management business activities in Japan. While there are several exemptions, including the exemption for Special Business Activities for Qualified Institutional Investors (the “**QII-Targeted Fund Exemption**”), which provides for notification rather than registration (Article 63 of the FIEA), the current regime does not take into account the previous or current activities of the foreign financial managers (e.g., track record and foreign financial regulatory supervision) when they file an application to operate an investment management business in Japan.

The Transition Period Exemption aims to lower the hurdle for foreign investment managers managing assets of foreign investors (including foreign funds) under foreign regulations to operate an investment management business in Japan, by taking into account past activities (i.e., track record) and the fact of being under foreign financial regulatory supervision.

### 3. What are the Special Business Activities during Transition Period?

Special Business Activities during Transition Period include the following business activities, which are conducted by Foreign Investment Managers and may be carried out at their offices in Japan (Article 3-3, Paragraph 5 of the Supplementary Provisions of the Amended FIEA)<sup>3</sup>:

**(1) Investment management activities that Foreign Investment Managers conduct in foreign countries under foreign laws and regulations:**

- (i) Investment management services provided only to certain Foreign Investors, etc. (as defined below) under investment management agreements<sup>4</sup>;
- (ii) Investment management services provided to foreign investment trusts with Foreign Investors, etc. only; and
- (iii) Fund management services for foreign collective investment schemes (e.g., limited partnership) with Foreign Investors, etc. only.

<sup>3</sup> Details of permitted business activities will be stipulated in a cabinet office ordinance.

<sup>4</sup> It is also possible for a subsidiary of a Foreign Investment Manager to conduct investment management business activities at its offices in Japan under an investment management agreement with (but only with) the Foreign Investment Manager (Article 3-3, Paragraph 7 of the Supplementary Provisions of the Amended FIEA).

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### (2) Activities related to the activities listed in (1) above:

- (i) In connection with the investment management services to certain Foreign Investors, etc., offering or private placement of foreign investment trust units, shares of foreign investment companies, or interests of foreign collective investment schemes to Foreign Investors, etc.;
- (ii) In connection with the investment management services to foreign investment trusts with Foreign Investors, etc., offering or private placement of foreign investment trust units to Foreign Investors, etc.; and
- (iii) In connection with fund management services for foreign collective investment schemes with Foreign Investors, etc., offering or private placement of interests of foreign collective investment schemes to Foreign Investors, etc.

“**Foreign Investors, etc.**” means (i) foreign corporations<sup>5</sup> and individuals having residence outside Japan, (ii) those who are closely related to a Foreign Investment Manager, and (iii) those equivalent to (i) and (ii) (Article 3-3, Paragraph 6 of the Supplementary Provisions of the Amended FIEA). Details regarding (ii) and (iii) will be stipulated under a cabinet order and cabinet office ordinance.

### 4. What are the requirements to utilize the exemption for Special Business Activities during Transition Period?

While the Transition Period Exemption involves notification, not registration, a Foreign Investment Manager will be disqualified and cannot perform any Special Business Activities during Transition Period if any of the following apply (Article 3-3, Paragraph 3 of the Supplementary Provisions of the Amended FIEA):

#### (1) General matters:

- (i) The Foreign Investment Manager is not registered as a business operator of the same type as an investment management business operator under the FIEA in certain foreign countries (each a

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<sup>5</sup> Given the interpretation of the current FIEA, foreign corporations would include management companies and trustees of foreign investment trusts, foreign investment companies, and general partners of foreign limited partnerships.

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“**Foreign Country**” and, collectively, the “**Foreign Countries**”)<sup>6</sup> under the laws thereof;

- (ii) The Foreign Investment Manager has not operated its investment management business in any Foreign Country under the laws thereof for the statutory period<sup>7</sup>;
- (iii) The Foreign Investment Manager was previously subject to a certain penalty, punishment, or other sanction within the last five years;
- (iv) The Foreign Investment Manager does not have sufficient personnel to properly conduct the Special Business Activities during Transition Period<sup>8</sup>;
- (v) The Foreign Investment Manager does not have a sufficient organizational structure to properly conduct the Special Business Activities during Transition Period<sup>9</sup>; and
- (vi) The Foreign Investment Manager manages its clients’ assets primarily by investing in the stocks or stock options set out in Article 2, Paragraph 1, Item 9 of the FIEA and other certain securities.

### (2) Matters for corporate Foreign Investment Managers:

- (i) Officers or key employees of the Foreign Investment Manager cannot properly perform their duties in relation to the Special Business Activities during Transition Period due to physical or mental disability, continuing loss of rights after receiving an order for the commencement of bankruptcy or other similar proceedings, or the imposition of any specified penalty, punishment, or other sanction within the last five years etc.;
- (ii) The Foreign Investment Manager does not have offices in Japan (i.e., the Foreign Investment Manager must establish and maintain its office in Japan to rely on the Transition Period Exemption.);
- (iii) The Foreign Investment Manager fails to appoint a representative in Japan;
- (iv) The Foreign Investment Manager is not guaranteed by each of the foreign financial regulators set out in Article 189, Paragraph 1 of the FIEA in the jurisdictions where its offices are located; and
- (v) The major individual and corporate shareholders of the Foreign

<sup>6</sup> Details regarding the Foreign Countries will be set forth in a cabinet office ordinance.

<sup>7</sup> The statutory period will be set forth in a cabinet order.

<sup>8</sup> Details of this requirement will be set forth in a cabinet office ordinance.

<sup>9</sup> Details of this requirement will be set forth in a cabinet office ordinance.

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Investment Manager do not satisfy statutory eligibility requirements.

### (3) Matters for individual Foreign Investment Managers:

- (i) The individual who is a Foreign Investment Manager or such individual's key employees cannot properly perform their duties in relation to the Special Business Activities during Transition Period due to physical or mental disability, continuing loss of rights after receiving an order for the commencement of bankruptcy or other similar proceedings, or the imposition of any specified penalty, punishment, or other sanction within the last five years etc.; and
- (ii) The individual who is a Foreign Investment Manager has residence outside Japan.

In practice, it would be ideal for the Foreign Investment Manager to consult with the FSA prior to filing the notification in order to confirm whether it satisfies the necessary requirements.

### 5. When is the deadline of the notification?

The Transition Period Exemption is introduced as a temporary exemption. The notification under the Transition Period Exemption must be filed with the regulatory authority within five years from the effective date of the Amendment (Article 3-3, Paragraph 2 of the Supplementary Provisions of the Amended FIEA).

### 6. Until when can a Foreign Investment Manager rely on the Transition Period Exemption?

The Foreign Investment Manager can rely on the Transition Period Exemption to operate an investment management business in Japan for five years from the date of the notification, until or unless (Article 3-3, Paragraph 1 of the Supplementary Provisions of the Amended FIEA):

- (i) The Foreign Investment Manager becomes a registered investment manager under the FIEA or submits a notification for a QII-Targeted Fund Exemption or Overseas Investors Exemption; or
- (ii) The Foreign Investment Manager ceases to engage in Special Business Activities during Transition Period.

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Given the five-year validity period for the Transition Period Exemption, the Foreign Investment Managers must (i) be registered as an investment manager, (ii) utilize other exemptions, such as the QII-Targeted Fund Exemption or the Overseas Investors Exemption, or (iii) close its Japan office by the end of that period.

### III. Exemption for Special Business Activities for Overseas Qualified Investors (“Overseas Investor Exemption”)

#### 1. What is the Overseas Investor Exemption?

In order for general partners who mainly manage funds for non-Japanese investors to operate an investment management business in Japan under a simplified procedure, the Amendment introduced a new exemption, i.e. the Overseas Investor Exemption.<sup>10</sup>

The current FIEA and regulations thereunder provide as follows:

- As a general rule, a general partner of a private equity/venture capital fund structured as a partnership-type fund that issues interests of a collective investment scheme (Article 2, Paragraph 2, Item 5 or 6 of the FIEA) is required to be registered with the authority, both in respect of its offering activities and the investment management activities of the fund in Japan or to Japan-resident investors. However, such registration is a document-intensive and time-consuming process, and thus registration is not a practicable option for most general partners.
- Usually, general partners rely on the QII-Targeted Fund Exemption in respect of its offering activities and the investment management activities of a fund; however, this exemption requires in particular that (i) at least one of the fund investors is a “Qualified Institutional Investor” (“QII”); (ii) the number of non-QII Japanese investors<sup>11</sup> is no more than 49; and (iii) each non-QII Japanese investor is an “Eligible Non-QII”<sup>12</sup> at the time of the solicitation of the subscription. If QIIs are not expected to invest in a

<sup>10</sup> Article 63-8 of the Amended FIEA.

<sup>11</sup> An investor who is a Japanese resident, as defined in the first sentence of Article 6, Paragraph 1, Item 5 of the Foreign Exchange and Foreign Trade Act of Japan, or who was solicited in Japan in connection with the subscription of interests.

<sup>12</sup> Under the FIEA, in order for a fund to qualify for the QII-Targeted Fund Exemption, non-QII Japanese investors need to fulfill certain minimum economic criteria or qualify as a person closely related to the fund. Specifically, each non-QII Japanese investor that subscribes for interests in such fund must fall under any of the categories under Article 17-12, Paragraph 4, Item 2 of the Cabinet Order for Enforcement of the Financial Instruments and Exchange Act of Japan (“Eligible Non-QII”). Individuals will be categorized as Eligible Non-QIIs if the value of their financial assets is no less than JPY 100 million, and they opened a securities account more than 1 year ago.

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fund or the number of non-QII Japanese investors would be more than 49, it has been difficult for general partners to continue their operations in Japan in the same manner as they would overseas because they cannot meet these requirements under the QII-Targeted Fund Exemption.

In order to improve the situation and lower the barriers for general partners who manage funds mainly for foreign investors, the Overseas Investor Exemption was introduced to allow general partners who meet certain requirements (which are different from the requirements for the QII-Targeted Fund Exemption) to provide their products from Japan by filing a notification in respect of their offering activities and investment management activities, as further described below. In particular, it is noteworthy that QII investments are not required and there is no limit on the number of investors that are not QIIs.

### 2. What are the requirements for utilizing the Overseas Investor Exemption?

The main requirements to rely on the Overseas Investor Exemption are as follows:

- (1) Investors must be “Overseas Investors, etc.”

“**Overseas Investors, etc.**” are investors who fall under any one of the following categories (Article 63-8, Paragraph 2 of the Amended FIEA):

- (i) Foreign corporations, or individuals domiciled in a foreign country who meet the requirements specified under a cabinet office ordinance, in light of their knowledge, experience, and assets;
- (ii) QIIs (including those specified under a cabinet office ordinance as being equivalent thereto, other than those listed in the preceding item); or
- (iii) Any other persons specified under a cabinet office order as having a close relationship with the person conducting the activities relying on the Overseas Investor Exemption.

Compared with the QII-Targeted Fund Exemption, the Overseas Investor Exemption does not require that any QII invest in the fund and

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the general partner may accept more than 49 Japanese investors who are not QIIs. However, please note that the scope of “Overseas Investors, etc.” differs from the scope of “Foreign Investors, etc.” – this is one of the key elements of the Transition Period Exemption. Also, if the investor is an Eligible Non-QII who can invest in the fund under the QII-Targeted Fund Exemption, such investor cannot invest in the fund under the Overseas Investor Exemption unless that investor falls under the definition of “Overseas Investors, etc.” as well.

- (2) Money invested or contributed must be mainly invested or contributed by “**Non-Japan Residents**” as defined in Article 6, Paragraph 1, Item 6 of the Foreign Exchange and Foreign Trade Law of Japan (Article 63-8, Paragraph 1, Item 1 of the Amended FIEA)

A majority of the contributions to the fund must be made by Non-Japan Residents. Although this is not specified in the Amended FIEA, taking the first report of the working group on market systems of the FSA dated December 23, 2020 into consideration, the percentage of contributions by Non-Japan Residents should be more than 50%.

- (3) The general partner will be disqualified if it falls within any of the following categories:
  - (i) Any person specified under a cabinet office order as not having sufficient personnel to properly conduct the Special Business Activities for Overseas Qualified Investors (Article 63-9, Paragraph 6, Item 1 (ii) of the Amended FIEA)
  - (ii) Any person specified under a cabinet office order as not having a sufficient organizational structure to properly conduct the Special Business Activities for Overseas Qualified Investors (Article 63-9, Paragraph 6, Item 1 (iii) of the Amended FIEA)
  - (iii) Any person who does not have any business office in Japan (i.e., the general partner must establish and maintain its office in Japan to rely on the Overseas Investor Exemption.) (Article 63-9, Paragraph 6, Item 2 (ii) of the Amended FIEA)
  - (iv) Any foreign corporation that does not appoint a representative in Japan for its Special Business Activities for Overseas Qualified Investors (Article 63-9, Paragraph 6, Item 2 (iii) of the Amended

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FIEA)

Items (i) and (ii) above are not required under the QII-Targeted Fund Exemption. In foreign jurisdictions, such as the Cayman Islands and the State of Delaware in the United States, general partners are usually established for each fund, and many of their functions may be outsourced to an investment manager and administrator. For this reason, a general partner might not have sufficient personnel to meet these requirements unless those delegates are considered to be part of the general partner's personnel. It remains to be seen if a cabinet office ordinance will address this point in the future.

Item (iii) above is not required under the QII-Targeted Fund Exemption.

As for item (iv), although the same requirement is imposed, under the QII-Targeted Fund Exemption, a foreign general partner may delegate the representative function to an accounting firm or any juridical or natural person in Japan. On the other hand, the Overseas Investor Exemption requires that the foreign general partner have a business office in Japan and thus the cost of opening a business office in Japan must be incurred. In addition, because they must have a business office in Japan, foreign general partners under the Overseas Investor Exemption would need to analyze tax and other considerations if they had previously relied on the QII-Targeted Fund Exemption.

- (4) Only general partners of a collective investment scheme may rely on the Overseas Investor Exemption. Thus, if the fund is established as an investment trust (e.g., unit trust) or an investment company, the Overseas Investor Exemption is not available.

### 3. Possible usage scenarios

As explained above, the Overseas Investor Exemption was introduced as a simplified entry program for general partners who mainly manage funds for non-Japanese investors. Although it looks similar to the QII-Targeted Fund Exemption to some extent, it is actually quite different from the QII-Targeted Fund Exemption, as can be seen from the fact that a general partner is required to have a business office in Japan. The following are some cases

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where the Overseas Investor Exemption may be useful:

- (1) Where a general partner's offering activities and investment management activities of a fund for Non-Japan Residents would be subject to the FIEA because those activities are conducted in Japan

If a solicitation for a subscription of interests in a foreign collective investment scheme or an investment management of assets of a foreign collective investment scheme is conducted outside Japan for Non-Japan Residents, it is considered that those activities are not subject to the FIEA in principle<sup>13</sup>.

However, if a general partner has a business office in Japan and such solicitation for a subscription of interests and investment management is conducted in Japan, those activities would be subject to the FIEA even if those activities are conducted for Non-Japan Residents.<sup>14</sup> Therefore, if a general partner having an office in Japan and subject to the FIEA wishes to rely on the QII-Targeted Fund Exemption, investors, including those who are Non-Japan Residents, must be QIIs or Eligible Non-QIIs and the number of Eligible Non-QIIs cannot exceed 49.

In this regard, if the general partner can rely on the Overseas Investor Exemption, it is possible to provide services regardless of whether they are rendered to QIIs or Eligible Non-QIIs, and regardless of the number of investors who are not QIIs, as long as they are Overseas Investors, etc. This makes it easier for general partners with offices in Japan and whose main investors are Non-Japan Residents.

- (2) Where QIIs are not expected to be limited partners, e.g., cases where the manager intends to establish funds for its officers and employees

To provide incentives to the officers and employees of the general partner or the manager of the fund; in practice, some general partners or managers establish a parallel fund or feeder fund for its officers and employees and provide investment opportunities to become limited partners of such funds.

<sup>13</sup> See No. 17 of page 541 and No. 22 of page 542 of the FSA's responses to the public comments made public in July 2007.

<sup>14</sup> See No. 20 of page 541 and No. 23 of page 542 of the FSA's responses to the public comments made public in July 2007.

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However, if the general partner has a business office in Japan, the solicitation for subscriptions of interests and investment management for domestic and overseas officers and employees are subject to the FIEA. In addition, if there are no QIIs among such officers and employees, it is not possible to rely on the QII-Targeted Fund Exemption. Even if they can rely on the QII-Targeted Fund Exemption, the number of Eligible Non-QIIs (i.e., officers and employees who are not QIIs) cannot exceed 49.

In this regard, if the general partner can rely on the Overseas Investor Exemption, it is possible to provide such investment opportunities to the Overseas Investors, etc. even if there are no QIIs among the limited partners or the number of officers and employees who are not QIIs exceed 49. As for officers and employees in Japan, although an exact definition has yet to be provided in a cabinet office ordinance, it is expected that they would fall under the category of Overseas Investors, etc. due to their close relationship with the person conducting the Special Business Activities for Overseas Qualified Investors. Therefore, it would be possible to provide officers and employees with opportunities to participate in funds for officers and employees even if the solicitation for subscriptions of interests and investment management are subject to the FIEA.

### IV. Conclusion

The Amendment will be enforced within six months after the date of promulgation. As many aspects of the new exceptions will be provided for in detail under a cabinet order and cabinet office ordinance, the contents of these regulations are important.

The FSA recognizes that it is important to make the Japanese market more attractive, not only through introducing the above simplified entry programs, but also by promoting the supply of growth capital, in order to promote the entry of foreign investment managers into Japan. They also recognize the importance of having a favorable environment for foreign investment managers and their personnel to operate their businesses in Japan by removing tax disincentives, allowing registration and supervision procedures to be carried out in English,

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and the relaxation of residence requirements<sup>15</sup>.

Given the active commitment of the FSA, we can expect that the Japanese financial market will become more attractive for foreign investment managers through a number of measures, including the Transition Period Exemption and the Overseas Investors Exemption.

### PUBLICATIONS

- Article " Chambers Global Practice Guide - Investment Funds - Japan Law and Practice"
- Publication Chambers Global Practice Guides Investment Funds 2020
- Author Yasuzo Takeno, Ken Miura and Nobuharu Onishi (co-author)

### NEWS

- **Lawyers from Mori Hamada & Matsumoto were included in the 12th edition of The Best Lawyers™ in Japan**
- 120 lawyers from our firm were included in the 12th edition of The Best Lawyers™ in Japan by Best Lawyers® survey. 4 lawyers were selected as "Lawyers of the Year" in the area of below.
- "Lawyers of the Year"
- Yasuzo Takeno - Investment and Investment Funds
  - Fintech Practice  
Yasuzo Takeno
  - Investment and Investment Funds  
Yasuzo Takeno  
Ken Miura  
Nobuharu Onishi
  - Private Equity, Private Funds and Venture Capital Law  
Yasuzo Takeno  
Ken Miura
- **Top Ranking Received From The Legal 500 Asia Pacific 2021**
- Mori Hamada & Matsumoto has been ranked in the top tier of recommended law firms in Japan, Myanmar and Thailand for several areas of practice in The Legal

<sup>15</sup> The first report of the working group on market systems of the FSA dated December 23, 2020.

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500 Asia Pacific 2021 and the following lawyers have been recommended as "Leading individuals".

Leading individuals – JAPAN

- Investment funds: Ken Miura, Nobuharu Onishi, Yasuzo Takeno

➤ **Top Ranking Received From Chambers Asia-Pacific 2021**

Mori Hamada & Matsumoto and our lawyers are recognized in the practice areas named below in Chambers Asia-Pacific 2021.

Lawyers

JAPAN

Investment Funds

Leading Individual: Yasuzo Takeno, Ken Miura, Nobuharu Onishi

➤ **Top rankings received from IFLR1000's thirtieth edition**

Mori Hamada & Matsumoto has been ranked in the top tier of recommended law firms in following category in Japan by IFLR1000's thirtieth edition. Thirty-one of the firm's lawyers have received prestigious rankings.

- Banking

Notable Practitioner: Yasuzo Takeno

- Investment funds

Notable Practitioner: Ken Miura

➤ **35 lawyers were selected as leading lawyers in asialaw Profiles "asia law Leading Lawyers 2021"**

35 lawyers were selected as leading lawyers in asialaw Profiles "asia law Leading Lawyers 2021". (29 lawyers from our Japan Office, 6 lawyers from our Bangkok Office.)

- Banking & Finance

Elite practitioner: Ken Miura

- Investment funds

Elite practitioner: Ken Miura

Distinguished practitioner: Yasuzo Takeno, Nobuharu Onishi

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