



Japan establishes new exempted structures for investment management businesses

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February 2022

In brief

As outlined in our Newsletter in July 2021 (hereinafter, the 2021 Newsletter), the Financial Services Agency of Japan introduced new business structures to attract foreign investment management businesses, where they may enjoy exemption from registration as financial instruments business operators. The new exemption structures came into force on 22 November 2021. In this Newsletter, which serves to update the 2021 Newsletter, we will provide an overview and describe the key requirements of these exemptions.

In detail

1. Background

The Financial Services Agency of Japan (JFSA) has been eager to remove regulatory bottlenecks and enhance the attractiveness of financial and capital markets in Japan, by making it easier for foreign asset management business providers and professionals to enter the market. In order to make the Japanese market an international financial hub, the JFSA introduced new exempted business structures to attract foreign investment management businesses. The new structures came into force on 22 November 2022, by amendment to the Financial Instrument and Exchange Act (FIEA), the Order for Enforcement of the Financial Instruments and Exchange Act (hereinafter, the Enforcement Order), the Cabinet Office Order on Financial Instruments Business (hereinafter, the FIB Cabinet Office Order) and the Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc.

2. Registration requirements under the FIEA for self-offering of interests in and management of partnership-type funds

Under the FIEA, the self-offering of interests in collective investment schemes, including interests in partnership-type funds, falls under the category of a type II financial instruments business. Similarly, fund management of assets by investing over 50% of the cash contributed by the investors in securities or rights in derivatives transactions falls under the category of an investment management business.

In order to attempt self-offering or fund management of the interests in a collective investment scheme, it is necessary for a business to register as a financial instruments business (a type II financial instruments business and/or an investment management business) or entrust the handling

of private placement and fund management authority to registered financial instruments business operators.

As an exception under the FIEA, private placement and fund management of funds for professionals may be carried out without registration as a financial instruments business by submitting prior notification as a 'Special Business Notifier' to the competent authority (Article 63 of the FIEA, 'Specially Permitted Businesses for Qualified Institutional Investors').

In order to enjoy the exemption as Specially Permitted Businesses for Qualified Institutional Investors, domestic investors in the fund must include at least one Qualified Institutional Investor¹ (QII), and the other domestic investors are limited to 49 or fewer investors who fall under the category of 'Eligible Investors'². A prior notification to the JFSA or to the competent Local Finance Bureau must be made with the other requirements under the FIEA (including, but not limited to, the non-existence of disqualified investors) being met.

Businesses are also exempt from the need to register as an investment management business in the following cases:

- When a partnership-type fund is managed by a foreign investment management company and accepts investments in Japan only from investment management business operators and trust banks (Article 61(3) of FIEA); and
- When a partnership-type fund is a foreign-based fund and its Japanese investors are fewer than 10 QIIs or Special Business Notifiers of Specially Permitted Businesses for Qualified Institutional Investors, and the amount of investment by Japanese investors does not exceed one-third of the total amount invested in the fund (Article 16(1)(xiii) of the Cabinet Office Order on Definitions under Article 2 of the Financial Instruments and Exchange Act).

3. Overview of the requirements for the new exemptions

(1) Specially Permitted Businesses for Foreign Investors

The recent amendment to the FIEA introduced a new exemption from the requirement to register as a financial instruments business operator (i.e. a type II financial instruments business operator and investment management business operator) (Article 63-8 of the FIEA, 'Specially Permitted Businesses for Foreign Investors'), in addition to the exemption schemes referred to in section 2 above. The general partners of partnership-type funds and other fund managers can enjoy the new exemption when they make a prior notification to the JFSA with the following requirements³ being met:

- (a) The investors in the fund shall fall under the following categories ('Foreign Investors');
- Investors who are non-resident⁴ in Japan and who meet the specific requirements to be provided in the Enforcement Order;

¹ 'Qualified Institutional Investors' are persons specified by the Cabinet Office Order on Definitions under Article 2 of the Financial Instruments and Exchange Act as 'persons who have professional knowledge and experience in investment in securities'. They mainly include financial instruments business operators that engage in type I financial instruments businesses that fall under the category of securities-related businesses or investment management businesses, investment corporations, banks and other financial institutions that receive deposits or savings, insurance companies and pension fund associations.

² 'Eligible Investors' are certain investors with investment decision-making capabilities and persons with close relationships with Special Business Notifiers. This category mainly includes financial instruments business operators, listed companies, corporations with stated capital or net assets of 50 million yen or more, individuals with assets of 100 million yen or more who opened an account for trading of securities at least one year ago, and corporations with assets of 100 million yen or more.

³ The requirements mentioned here are key requirements only.

⁴ 'Non-resident' means a natural person or corporation other than a resident (Article 63-8(1)(i) of the FIEA, Article 6(1)(vi) of the Foreign Exchange and Foreign Trade Act (FEFTA)). 'Resident' means a natural person

- Qualified Institutional Investors and equivalent persons to be provided in the Enforcement Order; or
- Investors with a close relationship with those set out in the above categories.

For the detailed scope of the Foreign Investors, please see the table below.

- (b) More than 50% of the fund assets are invested by investors who are not resident in Japan;
- (c) The fund manager has a personnel structure and an internal system sufficient for conducting a financial instruments business in an appropriate manner;
- (d) The fund manager has a business office in Japan; and
- (e) The fund manager has appointed a local representative in Japan.

Unlike Specially Permitted Businesses for Qualified Institutional Investors, there is no requirement for Specially Permitted Businesses for Foreign Investors to have at least one QII as an investor in the fund, and no limitation on the number of investors. Public offering of a partnership-type fund (i.e. solicitation for the acquisition of 500 or more investors) is also permitted under this exemption, in addition to private placement (i.e. solicitation for the acquisition of less than 500 investors). While this exemption assumes that primarily non-resident investors will invest in the fund, domestic QIIs and domestic investors with a close relationship with QIIs are also permitted to make investments into the exempted fund, as long as 50% or more of the fund assets are invested by non-resident investors.

Please be advised, however, that some of the requirements for Specially Permitted Businesses for Foreign Investors seem stricter than those for Specially Permitted Businesses for Qualified Institutional Investors. Businesses which wish to enjoy this exemption are required to have a sufficient personnel structure and have in place the necessary system for performing Specially Permitted Businesses for Foreign Investors in an appropriate manner⁵ (Articles 63-9(6)(i)), while the equivalent requirements are not provided for Specially Permitted Businesses for Qualified Institutional Investors. In addition, Specially Permitted Businesses for Foreign Investors are also required to have a business office in Japan and to appoint a local representative in Japan. We therefore recommend that businesses considering this exemption consult with tax counsels regarding the tax implications of these requirements.

(2) Specially Permitted Businesses for Transition Periods

The amendment to FIEA also introduces a new temporary exemption (Article 3-3 of the supplemental provisions of the FIEA, 'Specially Permitted Businesses for Transition Periods'), where a foreign investment management company is permitted to engage in certain investment management business without registering as type-I financial instruments business operator, type-II financial instruments business operator or investment management business operator, for up to five years from the time the relevant notification is submitted to the JFSA⁶.

Under the provisions for Specially Permitted Businesses for Transition Periods, a foreign investment management company may enjoy exemption from the registration requirement if the company makes a prior notification to the JFSA with the following requirements⁷ being met:

having a domicile or residence in Japan, or a corporation having its principal office in Japan; whereas a non-resident's office in Japan, such as a branch office and local office, is deemed to be a resident even if the non-resident's principal office is located in a foreign country, regardless of whether the office in Japan has the legal authority to represent the non-resident (Article 6(1)(v) of the FEFTA).

⁵ Businesses are required to have relevant corporate policies in place and to establish a framework to comply with such policies (FIB Cabinet Office Order 246-19).

⁶ A subsidiary of a foreign investment management company may also enjoy the exemption (Article 3-3 (7) and (1) of supplemental provisions of the FIEA).

⁷ The requirements mentioned here are key requirements only.

(a) The investors shall fall under the following categories ('Foreign Investors');

- Investors who are non-resident in Japan; or
- Investors with a close relationship with a foreign investment management company.

For the detailed scope of Foreign Investors, please see the table below.

- (b) The foreign investment management company holds a license which is equivalent to an investment management business operator license under FIEA in another jurisdiction with a legal framework providing an equivalent level of investor protection to FIEA⁸;
- (c) The foreign investment management company has a certain track record of managing funds (i.e., a business track record of three years or more);
- (d) Less than 50% of the fund assets managed by the foreign investment management company are invested into voting securities issued by Japanese issuers;
- (e) The foreign investment management company has a personnel structure and an internal system sufficient for conducting the financial instruments business in an appropriate manner;
- (f) The foreign investment management company has a business office in Japan; and
- (g) The foreign investment management company has appointed a local representative in Japan.

The scope of businesses for which a foreign investment management company may enjoy this exemption are as follows:

- (a) Any of the following acts performed in a foreign country in accordance with the laws and regulations of that country
 - discretionary investment management business for Foreign Investors.
 - investment trust management business for foreign investment trusts with Foreign Investors as investors
 - fund management business for foreign partnership-type funds with Foreign Investors as investors
- (b) Offering or private placement of beneficiary securities of foreign investment trusts, foreign investment securities or interests in foreign partnership-type funds and/or handling thereof in connection with the investment management activities described in (a) above.

Please be advised that the Specially Permitted Businesses for Transition Periods exemption is a temporary exemption which will last until 21 November 2026. Notification regarding this exemption must be submitted to JFSA by that date. Also, a foreign investment management company may enjoy this exemption for a maximum of five years from the date of notification.

Table: Scope of Foreign Investors

Please be advised that the scope of 'Foreign Investors' as pertaining to Specially Permitted Businesses for Foreign Investors and Specially Permitted Businesses for Transition Periods differ as follows.

<u>Specially Permitted Businesses for Foreign Investors</u>	<u>Specially Permitted Businesses for Transition Period</u>
A foreign corporation or an individual domiciled in a foreign state, which satisfies the	A foreign corporation or an individual domiciled in a foreign state.

⁸ The JFSA's regulatory notice No.101 designates the following jurisdictions: The US, the UK, Australia, Singapore, Switzerland, Germany, France and Hong Kong.

requirements specified by a Cabinet Office Order in consideration of such individual's knowledge, experience and the state of its assets.	
(FIB Cabinet Office Order) (i) A foreign corporation (ii) An individual domiciled in a foreign state, who falls under any of the following (A) A person who falls under all of the following (a) Net assets of 300 million yen or more (b) Investable financial assets of 300 million yen or more (c) One year has passed since the opening of a securities or derivatives account (B) A person who is equivalent to a professional investor under the applicable laws and regulations of a foreign country	
Qualified Institutional Investors (including persons specified by a Enforcement Order as being equivalent thereto, but excluding persons set forth in the preceding item).	Other than those listed in the preceding item, persons specified by a Enforcement Order as having a close relationship with a foreign investment manager.
(FIB Cabinet Office Order) (i) Professional investors (ii) Employees' pension funds or corporate pension funds under applicable foreign laws (mainly for the purpose of retirement pension management and benefits)	(Enforcement Order) (i) Officers and employees of foreign investment managers (ii) Parent company, etc. of foreign investment manager (iii) Person(s) specified by a Cabinet Office Order
	(FIB Cabinet Office Order) (i) Subsidiaries of the foreign investment manager (ii) A person/entity entrusted with the investment management or investment advice by the foreign investment manager (iii) Officers or employees of a parent company, subsidiary, etc., or of a person/entity entrusted with investment management or investment advice by the foreign investment manager (iv) Relative(s) within the third degree of kinship of the foreign investment manager, etc.
Other than those listed in the preceding two items, person(s) specified by a Enforcement Order as having a close relationship with the Notifier.	Persons specified by Cabinet Office Order as being equivalent to those listed in the preceding two items
(Enforcement Order) (i) Officers and employees of the Notifier (ii) Parent company, etc. of the Notifier (iii) Persons specified by a Cabinet Office Order	(FIB Cabinet Office Order) (i) Financial instruments business operators, etc. conducting investment management business
(FIB Cabinet Office Order) (i) Subsidiaries of a foreign investment manager (ii) A person/entity entrusted with investment management or investment advice by the Notifier (iii) Officers or employees of a parent company, subsidiary, etc., or of a person entrusted with investment management or investment advice by the notifier (iv) A relative within the third degree of kinship of the notifier," etc.	

The takeaway

It is still unclear whether the new exemption structures will be widely embraced by foreign investment management businesses, as the amended FIEA requires them to hold a business office with a local representative in Japan, which might be a burden on them. In addition, the Specially Permitted Businesses for Foreign Investors exemption does not seem to be designed to promote fund-raising in Japan, considering its requirements on investors. Apart from the regulations under the FIEA, tax issues should also be considered. On the other hand, the amendment to the FIEA provides businesses with a certain flexibility in structuring their funds in some cases. PwC Legal Japan can assist foreign businesses hoping to enter the Japanese market, in close collaboration with the PwC global network.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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