NEW SCHEMES TO FACILITATE THE ENTRY OF OVERSEAS INVESTMENT MANAGERS INTO JAPAN

To make Japan an international financial hub, the Japanese government has established a new system to attract overseas investment managers by reducing some of the barriers to entering the Japan market.

STREAMLINING OVERSEAS ASSET MANAGERS' ENTRY INTO THE JAPANESE MARKET

An amendment to the Financial Instruments and Exchange Act (FIEA) (Amendment to the FIEA) was enacted on 19 May 2021 to facilitate the entry of overseas investment managers (OIMs) into Japan's financial market. The Amendment to the FIEA was made based on the Japanese Financial Services Agency's (Japan FSA) "First Report — Regulatory Policy: Toward an International Financial Hub" published by the Working Group on Capital Market Regulations of the Financial System Council on 23 December 2020, with the aim of, among others, expanding and deepening the Japanese market by welcoming OIMs to Japan. See our previous Alerter, including a link to an English summary of the report.

Under the Amendment to the FIEA, two new schemes have been established to allow the following two types of OIMs to conduct business in Japan:

- investment managers operating under the supervision of overseas regulatory authorities and having a proven track record; and
- general partners (GPs) of limited partnerships with overseas qualified investors.

INVESTMENT MANAGERS UNDER SUPERVISION OF OVERSEAS REGULATORY AUTHORITIES AND HAVING A PROVEN TRACK RECORD

The first scheme is intended to encourage OIMs to establish operations in Japan, by instituting a transitional period of up to five years during which OIMs will be permitted to engage in investment management business without needing to obtain a formal licence (Special Transition Period Business). The key conditions that must be satisfied to conduct such Special Transition Period Business are as follows:

- services in respect of the Special Transition Period Business must be provided only to overseas investors;
NEW SCHEMES TO FACILITATE THE ENTRY OF OVERSEAS INVESTMENT MANAGERS INTO JAPAN

prior notification must be filed with the Japan FSA;

the OIM must have obtained approval or a licence equivalent to the investment manager licence under the FIEA in an overseas jurisdiction with a legal framework providing an equivalent level of investor protection to that under the FIEA;

the OIM must have the human resources and internal control systems required to conduct the Special Transition Period Business appropriately;

the OIM must have a track record of managing funds from overseas investors;

the OIM must not invest primarily in Japanese companies' shares; and

the OIM must establish a business office or representative office in Japan.

Prior to the Amendment to the FIEA, the Japan FSA introduced a temporary licence permit system for OIMs facing difficulties in continuing to operate from their home jurisdiction, for example due to pandemics, natural disasters or political unrest, entitling the OIM to operate from Japan for up to three months. Under the Special Transition Period Business scheme, there is no requirement for the OIM to be facing difficulties in its home jurisdiction.

As this new scheme requires prior notification to be filed within a five-year period after the implementation of the Amendment to the FIEA and only entitles OIMs to operate from Japan for up to five years from the submission of the prior notification, it is temporary and transitional in nature. However, it is a significant change in that it allows OIMs to operate from Japan without the need to obtain a formal licence for a substantially longer period than under the temporary licence permit system. It is also likely to improve the prospects for OIMs of applying successfully for a formal licence to establish a more permanent base of business operations in Japan.

GP OF LIMITED PARTNERSHIPS WITH OVERSEAS QUALIFIED INVESTORS

The second scheme provides a GP of a limited partnership investing in securities (whichever listed or private), who is ordinarily required by the FIEA to obtain an investment management licence in order to act as a GP in Japan, with an exemption from the licensing requirement when all the limited partners are Overseas Qualified Investors (Overseas Qualified Investor Exemption).

"Overseas Qualified Investors" means:

- any offshore corporate entity or any individual who resides outside Japan and meets the criteria for a professional investor;
- any qualified institutional investor (QII) under the FIEA (which may include residents of Japan); and
- any person who is closely related to either of these types of persons (which may include residents of Japan).

Pending implementation of the Amendment to the FIEA, a GP is, in principle, required to be licensed as an investment manager under the FIEA if any of the limited partners is a resident of Japan or the GP operates in Japan, subject to

Useful for business continuity planning

The new schemes provide OIMs with an opportunity to continue operating their business from Japan much as they would in their home jurisdiction, subject to the restrictions on providing services to Japanese residents. It is therefore envisaged that they could be attractive to OIMs looking to bolster their business continuity planning by establishing bases of operations in multiple countries and mitigating concentration risk.
being able to rely on the Article 63 Notification Exemption\(^1\) or the Foreign Fund Exemption\(^2\) to avoid the licensing requirement.

As the Article 63 Notification Exemption and the Foreign Fund Exemption remain in place, this new scheme offers an additional exemption to GPs.

The key conditions that must be satisfied to take advantage of the Overseas Qualified Investor Exemption are as follows:

- all the limited partners must be Overseas Qualified Investors;
- the majority of the funds contributed to the GP must be from non-residents of Japan;
- prior notification must be filed with the Japan FSA;
- the GP must have the human resources and internal control systems required to conduct business appropriately under the Overseas Qualified Investor Exemption; and
- the GP must establish a business office or representative office in Japan.

When the above conditions are satisfied, the GP can act in Japan as the GP of a partnership investing in securities.

The main differences from the Article 63 Notification Exemption, which has been most heavily relied upon to date, are that, under this scheme, a place of business in Japan is required, and there is no requirement for at least one limited partner in the limited partnership to be a QII. The removal of the QII requirement is based on the condition that the investors are limited to Overseas Qualified Investors and the majority of the funds contributed to the GP are from non-residents of Japan.

OTHER AREAS THE GOVERNMENT IS ADDRESSING

In addition to the abovementioned regulatory schemes, the Japanese government is addressing several other areas with a view to making Japan an international financial hub.

For example, in order to remove taxation bottlenecks, certain favourable tax treatments will be applicable to OIMs and their officers and employees.

Also, as mentioned in our previous Alerter, the Japan FSA has established a “Financial Market Entry Support Office” which provides foreign asset management companies newly entering the Japan market with services in English for pre-application consultation, registration and supervision.

TIMING OF IMPLEMENTATION

For further details of the new schemes and in order to assess how user-friendly and beneficial they might be in practice, we need to await publication of the implementing regulations for the Amendment to the FIEA. These are

---

\(^1\) The Article 63 Notification Exemption has been widely used by GPs to conduct investment management business for the funds they manage without registering as an investment manager. To rely on the Exemption, an Article 63 Notification must be filed, and the investors must be limited to the investor group comprised of at least one QII and fewer than 50 certain experienced investors.

\(^2\) The Foreign Fund Exemption has also been used when the Japanese investors are limited to 9 or fewer QIIs and their total contribution is one third or less of the total contributions of the partnership.
expected to be published in draft and undergo a public consultation process prior to implementation, which is scheduled to take place by November 2021.

CONCLUSION

It remains to be seen whether OIMs will be sufficiently incentivised to operate within the parameters set by the schemes, in particular the restriction to conducting business for overseas clients only (although limited residents of Japan may be targeted), and to what extent these schemes will be successful in attracting OIMs to establish in Japan. Related to this, we note that there has been no specific move to encourage onshoring of fund vehicles in Japan unlike in Hong Kong and Singapore where onshore vehicle options to the toolbox of available fund vehicles have been added in recent years.

While deregulation of the kind envisaged by the Amendment to the FIEA is welcome and necessary, it seems clear that the process of reform should not end here. Wider and, in some cases, more radical reforms may be required in order to firmly establish Japan’s credentials as an international financial hub.
NEW SCHEMES TO FACILITATE THE ENTRY OF OVERSEAS INVESTMENT MANAGERS INTO JAPAN

CONTACTS

Eiichi Kanda
Partner
Tokyo
T +81 3 6632 6643
E eiichi.kanda@cliffordchance.com

Leng-Fong Lai
Partner
Tokyo
T +81 3 6632 6625
E leng-fong.lai@cliffordchance.com

Chihiro Ashizawa
Counsel – Head of Capital Markets (Japanese Law)
Tokyo
T +81 3 6632 6414
E chihiro.ashizawa@cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

Clifford Chance (Gaikokuho Kyodo Jigyo)
Palace Building, 3rd floor
1-1, Marunouchi 1-chome, Chiyoda-ku, Tokyo 100-0005, Japan
© Clifford Chance 2021

Clifford Chance has a co-operation agreement with Abuhamed Alsheikh Alhagbani Law Firm in Riyadh.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.