

UNLOCKING FLEXIBILITY IN INVESTMENT MANAGEMENT IN JAPAN

Effective 1 May 2025, regulatory reforms will lower barriers for investment managers in Japan and support the country's ambition to become a leading global investment management centre. This update highlights key changes, including easing outsourcing restrictions, that aim to modernise and diversify investment management practices in Japan.

FIEA AMENDMENT

Under the Financial Instruments and Exchange Act (Act No. 25 of 1948, as amended, the **FIEA**), entities conducting asset management or investment management activities in Japan must register as an Investment Management Business (*tōshi unyō gyō*) operator. Historically, this registration process has been burdensome, with stringent personnel and operational requirements, even for Japanese subsidiaries of global firms.

With effect from 1 May 2025, an amendment has been passed to the FIEA (the **Amendment**) which reduces entry barriers by easing personnel requirements. In particular, it allows investment managers to:

- Delegate middle-office operations (e.g., legal, compliance, accounting) to group companies or third parties, including newly established Approved Middle-Office Service Providers.
- Delegate full authority for investment decision-making and execution to another registered domestic Investment Management Business operator or an overseas investment manager, including affiliated entities.

Delegation of Middle-Office Operations

The Amendment explicitly permits the outsourcing of ancillary functions, such as:

- Asset valuation and calculation of assets under management.
- Compliance operations (collectively, **Middle-Office Operations**).

This initiative aims to reduce the operational burden on investment managers by allowing these non-core functions to be outsourced, thereby facilitating leaner internal personnel structures that comply with regulatory expectations.

Key issues

- **Historical high entry barriers** – Japan's Investment Management Business registration has historically been stringent and resource-intensive.
- **Regulatory reform** – The May 2025 FIEA Amendment permits firms to delegate middle-office operations and even full investment authority to third parties.
- **New service providers** – A new regime of Approved Middle-Office Service Providers eases personnel requirements. Leaner personnel structures are allowed, but a minimum governance framework is still required.
- **Ongoing oversight** – Delegation is permitted, but firms must retain supervisory responsibility and proper internal controls. Supervision from offshore may be possible.

Applicants seeking registration as an Investment Management Business operator who intend to outsource functions must disclose in their application (i) the name of the service provider and (ii) the scope of the functions to be delegated. Investment Management Business operators with *de facto* outsourcing arrangements established before the Amendment must submit a change notification that includes this information.

The Amendment also introduces a new voluntary registration framework for Approved Middle-Office Service Providers (*tōshi unyō kankei gyōmu jutaku gyōsha*), who may receive delegated responsibilities from Investment Management Business operators.

A key benefit of using Approved Middle-Office Service Providers is the ability to appoint a single individual to act as supervisor who is capable of giving appropriate instructions, rather than needing to maintain a larger in-house team. Notably, under the amended supervisory guidelines, this supervisor:

- Is not required to possess direct expertise in the delegated Middle-Office Operations.
- Need not have prior experience in investment management.
- May be based outside Japan.

This addresses a long-standing challenge for foreign investment managers: the scarcity of bilingual compliance professionals in the Japanese market.

Delegation of investment management

The Amendment also permits full delegation of investment management authority, enabling Investment Management Business operators to focus solely on strategic oversight. Previously, such delegation was prohibited. This is a significant change which aligns Japanese practice with global trends observed in Europe and the U.S., where delegation structures are more common.

Under the new framework, investment managers may delegate all investment execution responsibilities to a regulated investment management entity, either in Japan or abroad. The delegating entity remains responsible for:

- Defining investment targets and policies.
- Monitoring and overseeing delegates through:
 - Criteria for delegatee selection and communication systems.
 - Systems for continuous performance monitoring and compliance checks.
 - Remedial measures, including guidance or termination, if the delegatee fails to perform appropriately.

PERSONNEL REQUIREMENTS FOR OFFSHORE INVESTMENT MANAGERS OPERATING IN JAPAN

With middle-office and investment management functions now delegable, foreign managers may consider entering the Japanese market with leaner staffing structures. However, minimum personnel requirements will still apply depending on the circumstances, including whether retail investors are included in the target customer base, the specifics of the proposed business plan, and the extent to which key functions are outsourced.

Japan subsidiary or Japan branch

Incorporating a Japan subsidiary is the most common structure for foreign managers to commence operation in Japan. Such an entity applying for Investment Management Business registration must be organised as a stock company (*kabushiki kaisha*) (**KK**) and must:

- Maintain a board of directors with at least three directors, two of whom may be part-time and seconded from affiliated companies.
- Appoint a full-time representative director residing in Japan to oversee local operations.
- Appoint a statutory auditor (not required to be full-time).

Alternatively, a Japanese branch of a foreign entity may apply for registration, provided it:

- Appoints a local representative.
- Maintains a personnel structure functionally equivalent to a KK.

To date, few Investment Management Business registrations have been obtained by foreign entities without establishing a Japan subsidiary, and it remains to be seen whether the Amendment will encourage broader uptake of the Japan branch option.

Key Considerations for the Required Three-Tier Operational Structure

Regardless of structure, offshore managers must establish a three-tier operational framework comprising: (i) investment management, (ii) compliance and (iii) internal control functions. A key consideration for offshore investment managers, in order to reduce staffing for the operation in Japan, is whether these functions can be outsourced to other entities, conducted from offshore, and/or covered by a small number of multi-functional personnel.

Outsourcing - as outlined above, a significant portion of the investment management operation can now be outsourced; i.e. authority of investment management can be delegated to a foreign regulated investment manager within the group; and Middle-Office Operations, including compliance and a part of the internal control functions, can be outsourced to Approved Middle-Office Service Providers. However, this does not mean that there can be no personnel responsible for these functions at all for the operation in Japan. The outsourced functions must still be supervised, and final decisions must still be made by the registered entity. Therefore, while the personnel do not need to be capable of directly performing the outsourced functions, such personnel still need to have ability to supervise and control the outsourced functions.

Operation from offshore - Although the guidelines are not explicit, they emphasise functional capacity over physical presence. Therefore, supervision of outsourced operations may be performed from offshore locations, provided the personnel have the necessary competence and appropriate systems are in place.

Double hatting – while the compliance function must be independent from investment management, it may be permissible for personnel undertaking those activities to also undertake part of the internal control function duties, provided this does not lead to potential conflicts of interest.

CONCLUSION

The Amendment offers new operational flexibility for investment management firms operating in Japan, particularly those leveraging third-party service providers. These changes open up practical pathways for foreign and domestic managers to streamline operations, reducing entry barriers while maintaining regulatory integrity. However, regulatory scrutiny of internal structures will remain. Existing and new market entrants should therefore carefully navigate this evolving regulatory landscape, and seek the advice of experienced advisers with a deep understanding of Japanese financial regulations and extensive experience in assisting global investment managers.

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