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New Exemptions for Foreign Investment Managers¹

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On May 19, 2021, the Diet enacted amendments to the Financial Instruments and Exchange Act (the “**FIEA**”) that introduce new exemptions for foreign investment managers. In this connection, the Financial Services Agency (the “**FSA**”) has released draft regulations implementing the amended FIEA on August 6 and is soliciting public comments thereto until September 6. The amended FIEA will be put into effect later this year, within six months after its promulgation. This newsletter outlines the new exemptions based on the draft regulations.

1. Foreign Investors Exemption

As a general rule, a general partner which manages partnership assets contributed by limited partner(s) residing in Japan by investing more than 50% of such assets in securities and derivatives is required to be registered as an investment manager under the FIEA. A general partner is also required to be registered as a Type 2 financial instruments business operator if it offers the limited partnership interests to investors in Japan.

However, it is burdensome, especially for foreign investment managers, to undergo the above registration procedures. While the current FIEA allows for an exemption from this general rule called the “Specially Permitted Business for Qualified Institutional Investors”² (also known as the “QII Exemption” or “Article 63 Exemption”), the amended FIEA additionally introduces a similar new exemption called the “Specially Permitted Business for Foreign Investors”, or “Foreign Investors Exemption”.

Pursuant to the Foreign Investors Exemption, a general partner may offer the limited partnership interests to investors in Japan and manage the partnership assets by investing more than 50% of such

¹ For details on the background of the amendments to the FIEA, please see: https://www.amt-law.com/asset/pdf/bulletins2_pdf/210405.pdf

² For details, please see: https://www.amt-law.com/asset/pdf/bulletins2_pdf/160229.pdf

assets in securities and derivatives without any registration or license under the FIEA by simply filing a notification with the regulator (*i.e.*, the Kanto Local Finance Bureau, in the case of a foreign general partner) and by satisfying certain requirements.

As one of the requirements, a general partner must limit all the investors in the partnership to “foreign investors”, which are defined as below. The number of the foreign investors does not matter: as shown below, “foreign investors” may include residents of Japan, however, in order for a general partner to be able to manage the partnership assets without an investment manager registration, more than 50% of such assets must be sourced from the following categories of persons who are non-residents of Japan:

- (1) foreign corporations;
- (2) individuals who have addresses in foreign jurisdictions and:
 - (a) are expected to have at least JPY300 million of net assets and at least JPY300 million of investment-like financial assets, and maintain securities or derivative accounts for over one year; or
 - (b) are treated as persons similar to professional investors as specified by the FIEA (*tokutei toushika*) under the laws of foreign jurisdictions;
- (3) qualified institutional investors;
- (4) professional investors as specified by the FIEA (*tokutei toushika*);
- (5) foreign pension funds similar to Japanese welfare pension funds or corporate pension funds;
- (6) directors, officers and employees of the general partner;
- (7) parent entities, subsidiaries and parent entities’ subsidiaries of the general partner;
- (8) investment managers and investment advisers to the general partner;
- (9) directors, officers and employees of the entities listed in (7) and (8) above; and
- (10) if the general partner is an individual, certain relatives of the general partner or the persons listed in (6), (8) and (9).

Similarly to the QII Exemption, a general partner is generally prohibited from having another investment vehicle invest in the partnership where such investment vehicle contains investments made by an investor who is not a foreign investor. A general partner must stipulate a transfer restriction in the limited partnership agreement or side letter thereto that prohibits any limited partner from transferring its interests to any person who is not a foreign investor. A general partner must also comply with certain rules under the FIEA. Such rules include, among others, a disclosure requirement to those who are not professional investors as specified by the FIEA (*tokutei toushika*); a reporting requirement to the regulator; and a record-keeping requirement.

Unlike the QII Exemption, on the other hand, a general partner must have sufficient staff and an appropriate organizational structure to rely on this exemption. A general partner may not rely on this exemption if any of its major shareholders (typically holding 20% or more) falls under any of the disqualification criteria prescribed under the FIEA. In this connection, a general partner must attach to the notification, among others, a document describing its organizational structure, a document describing its major shareholders, and the internal rules governing its specially permitted business for

foreign investors. It should be noted that, most importantly, in order to rely on this exemption, a general partner must have a physical office in Japan.

2. Foreign Investment Manager Temporary Exemption

As a general rule, a person who manages the assets of its client in Japan by investing more than 50% of such assets in securities and derivatives is required to be registered as an investment manager under the FIEA.

However, it takes some time (normally six months or more) to complete the investment manager registration procedure even if an applicant is duly licensed to engage in an investment management business and has a track record in a foreign jurisdiction. The applicant may not engage in the same business in Japan before completing this registration procedure, which is inconvenient for applicants who wish to commence their operations in Japan as soon as possible. In order to eliminate such inconvenience, the amended FIEA introduces a new exemption, called the “Foreign Investment Manager Temporary Exemption”.

The Foreign Investment Manager Temporary Exemption is designed for foreign investment managers who wish to commence their operations in Japan by completing the investment manager registration process or by applying for the QII Exemption or the Foreign Investor Exemption within five years. A foreign investment manager may engage in any of the following “specially permitted businesses for a transition period” through its local office in Japan for up to five years by filing a notification with the regulator (*i.e.*, the Kanto Local Finance Bureau):

- (1) The following investment management businesses, as permitted in the prescribed foreign jurisdictions (*i.e.*, the United States, the United Kingdom, Australia, Singapore, Swiss, Germany, France or Hong Kong):
 - (a) Managing the assets of the foreign clients by investing more than 50% thereof in securities and derivatives pursuant to a discretionary investment management agreement with such foreign clients;
 - (b) Managing the assets of the foreign investment trusts (limited to those all of their unitholders are foreign clients) by investing more than 50% thereof in securities and derivatives; and
 - (c) Managing the assets of the foreign collective investment schemes (typically foreign limited partnerships; limited to those where all of their limited partners are foreign clients) by investing more than 50% thereof in securities and derivatives; and
- (2) The following offering businesses:
 - (a) Offering units of foreign investment trusts, shares of foreign investment corporations and interests in foreign collective investment schemes to foreign clients which are undertaken in connection with the foreign investment manager’s business listed in (1)(a) above;
 - (b) Offering units of foreign investment trusts which are undertaken in connection with the foreign investment manager’s business listed in (1)(b) above; and

- (c) Offering interests in foreign collective investment schemes to foreign clients which are undertaken in connection with the foreign investment manager's business listed in (1)(c) above.

In the above context, "foreign clients" are defined as below. Similarly to the QII Exemption, a foreign investment manager may not rely on the Foreign Investment Manager Temporary Exemption if any of the foreign clients described above falls under the category of an investment vehicle that is invested in by any investor who is not a foreign client:

- (1) foreign corporations;
- (2) individuals who have addresses in foreign jurisdictions;
- (3) directors, officers and employees of the foreign investment manager;
- (4) parent entities, subsidiaries and parent entities' subsidiaries of the foreign investment manager;
- (5) investment sub-managers and investment sub-advisers to the foreign investment manager;
- (6) directors, officers and employees of the entities listed in (4) and (5) above; and
- (7) if the foreign investment manager is an individual, certain relatives of the foreign investment manager or the persons listed in (3), (5) and (6).

A foreign investment manager must satisfy, among others, the following conditions in order to rely on the Foreign Investment Manager Temporary Exemption:

- (1) It is duly registered or licensed to engage in the investment management business in any of the prescribed foreign jurisdictions (*i.e.*, the United States, the United Kingdom, Australia, Singapore, Swiss, Germany, France or Hong Kong);
- (2) It commences and maintains its operation in any of the above foreign jurisdictions for over three years; and
- (3) It manages the assets of the foreign clients by investing more than 50% thereof in securities other than Japanese equity-like instruments with voting rights.

Similarly to the QII Exemption, a foreign investment manager is generally prohibited from having another investment vehicle invest in a foreign investment trust, foreign investment corporation or foreign collective investment scheme, as the case may be, where that vehicle is invested in by an investor who is not a foreign client. A foreign investment manager must ensure to prohibit any investor in the foreign investment trust, foreign investment corporation or foreign collective investment scheme, as the case may be, from transferring its units, shares or interests, as the case may be, to any person who is not a foreign client. For such purpose, a foreign investment manager must, depending on the type of vehicle, stipulate a transfer restriction language in the partnership agreement or its side letter, or enter into a transfer restriction agreement between the offeror and the offeree and, in certain cases, between the issuer and the offeree. A foreign investment manager must also comply with certain rules under the FIEA. Such rules include, among others, a disclosure requirement to those who are not professional investors as specified by the FIEA (*tokutei toushika*); a reporting requirement to the regulator; and a record-keeping requirement.

Unlike the QII Exemption but similarly to the Foreign Investor Exemption, on the other hand, a foreign investment manager must have sufficient staff and an appropriate organizational structure to rely on this exemption. A foreign investment manager may not rely on this exemption if any of its major shareholders (typically holding 20% or more) falls under any of the disqualification criteria prescribed under the FIEA. In this connection, a foreign investment manager must attach to the notification, among others, a document describing its organizational structure, a document describing its major shareholder, and the internal rules governing its specially permitted business for a transition period. It should be noted that, most importantly, in order to rely on this exemption, a foreign investment manager must have a physical office in Japan.

3. Summary Chart

The following chart illustrates, by way of comparison with the QII Exemption, the key elements of the newly introduced “Foreign Investors Exemption” and “Foreign Investment Manager Temporary Exemption”.

	QII Exemption	Foreign Investor Exemption	Foreign Investment Manager Temporary Exemption
Available by:	Issuers of collective investment schemes (typically, general partners of limited partnerships) * Investment managers to the general partners may not rely on the exemptions.		Foreign investment managers duly licensed in certain jurisdictions to manage foreign investment funds or managed accounts and having over 3 years track record
License exemption	Permitted to engage in investment management and distribution businesses without license (registration) under the FIEA		
Duration	Unlimited		Up to 5 years
Investment restriction	Not applicable		Investment mainly in Japanese equity-like instruments is prohibited
Eligible investors	At least one QII and Up to 49 Eligible Non-QIIs	Foreign investors (number unlimited)	Foreign clients (number unlimited)
	* Investment vehicles containing non-eligible investors are not permitted. * Transfer restriction is necessary.		
Staff requirement	Not applicable	Applicable	
Organizational requirement	Not applicable	Applicable (organizational structure chart and internal rules are required)	
Major shareholder requirement	Not applicable	Applicable (capital relationship diagram/document is required)	

Physical office in Japan	Unnecessary	Necessary
Representative in Japan	Necessary	
Major ongoing requirements	<ul style="list-style-type: none"> ● Disclosure to those who are not professional investors (<i>tokutei toushika</i>) ● Reporting to the regulator ● Record-keeping 	

4. Japan as an International Financial Center

As published on the FSA's website, the government of Japan is committed to expanding Japan's role as an international financial hub.³ The introduction of the aforementioned two new exemptions is regarded as part and parcel of the government's commitments to attract foreign investment managers to Japanese markets.

³ For details, please see: <https://www.fsa.go.jp/en/financialcenter/financialcenter.html>

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