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Investment Funds 2023

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Japan: Law & Practice

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JAPAN

Law and Practice

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1. Market Overview

1.1 State of the Market

Financial assets held by Japanese households have been increasing steadily for years, reaching JPY2,000 trillion in 2021. Building on this, a number of various types of investment funds are being marketed, offered and distributed in the Japanese market. The most widely used form of investment fund in Japan is an investment trust (*toushi shintaku*), created pursuant to the Act on Investment Trusts and Investment Corporations of Japan (the Investment Trust Act), which is offered on both retail markets (through public offerings) and institutional (mostly through private placements) markets.

The Investment Trust Act also provides for an investment corporation (*toushi houjin*), which is typically used for real estate investments and is popularly known as a Japanese Real Estate Investment Trust (J-REIT), which is something of a misnomer given that all existing J-REITs use the form of an investment corporation rather than being structured as trusts.

In addition, offshore investment funds domiciled in jurisdictions such as the Cayman Islands, Luxembourg and Ireland and qualified as foreign investment trusts/corporations under the Investment Trust Act have long been used to provide access to the global market for Japanese investors.

Lastly, collective investment schemes such as investment limited partnerships under the Limited Partnership Act for Investment of Japan (LPAI) and silent partnerships under the Commercial Code also account for a substantial portion of investment funds in certain areas, such as private equity funds, as do leasing funds such as aircraft leasing funds, because those are generally treated as pass-through entities for Japanese taxation purposes. Furthermore, offshore collective investment schemes such as Cayman limited partnerships and Luxembourg common and special limited partnerships are preferred in cross-border transactions because of their flexibility and global recognition.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

While there is no specific category analogous to alternative investment funds under Japanese law, privately placed investment funds are used in practice to provide alternate investment opportunities to Japanese investors.

With respect to publicly offered investment trusts/corporations, the Investment Trusts Association, Japan (ITAJ – a self-regulatory organisation of investment trust managers and asset management companies for investment corporations) provides detailed requirements on the management and administration of portfolio assets of publicly offered investment trusts/corporations. Please see **3.3.1 Regulatory Regime** for more details on the rules of the ITAJ.

On the other hand, privately placed investment trusts/corporations are often created and tailored to meet specific investment purposes, strategies and risk allowances of potential investors.

In addition, collective investment schemes are, in general, offered by way of private placement because of their nature and their high flexibility in terms of their organisation, capital structure, types of underlying assets, dividend policies and fee schedules.

Therefore, for the purpose of this article, privately placed investment funds are treated as alternative investment funds.

2.1.2 Common Process for Setting Up Investment Funds

Investment Trusts

An investment trust is generally established by a trust agreement between an investment trust manager and a trustee. An investment trust manager must be a person registered as an investment management business under the Financial Instruments and Exchange Act of Japan (FIEA) ("Registered Investment Manager"), and a trustee must be a trust company licensed under the Trust Business Act or a financial institution authorised under the Act on Engagement in Trust Business by Financial Institutions.

An investment trust must invest more than half of its assets in securities, derivatives, real estate, commodities and other assets specified by the regulation under the Investment Trusts Act ("Specified Assets").

An investment trust manager intending to enter into a trust agreement has to notify the regulator of the terms and conditions thereof in advance, and these must contain items such as the investment objective, policy, restrictions, dividend policy, method of calculation of net asset value and procedures of issuance and redemption of units.

Investment Corporations

In order to incorporate an investment corporation, promoters must prepare a certificate of incorporation, which must be executed by all of the promoters; the promoters must notify the regulator of their intention to that effect. At least one promoter must be a Registered Investment Manager or must have the experience and knowledge specified by the Investment Trust Act.

A certificate of incorporation must include the investment corporation's purpose, investment policy and types of assets, dividend policy, valuation method of assets, and fees and charges. As with an investment trust, an investment corporation must invest more than half of its assets in the Specified Assets.

Subscribers for shares must contribute capital in cash into an investment corporation at the time of incorporation in exchange for an issuance of new shares. The minimum contributed capital and the net asset value at the incorporation are JPY100 million and JPY50 million, respectively.

An investment corporation is established upon the registration of its incorporation.

In order to ensure that an investment corporation functions solely as an investment vehicle, the Investment Trusts Act prohibits it from engaging in business other than asset management and the hiring of employees. As such, an investment corporation must retain an asset management company, a custody company and an administrative agent, and must delegate the relevant functions to them. An investment corporation must be registered by the regulator with the basic terms of its certificate of incorporation, names of executive and supervisory directors, and the name of an asset management company before commencement of its operations.

Foreign Investment Trust/Corporations

The Investment Trusts Act defines a foreign investment trust/corporation as an investment fund established or incorporated outside Japan under the laws and regulations of a foreign jurisdiction, which is similar to an investment trust/

corporation. Therefore, a close review of whether an offshore investment fund is treated as a foreign investment trust/corporation under the Investment Trusts Act is required before introducing it into Japan.

A foreign investment trust/corporation must file a "Notification" with the regulator, before conducting an offering (whether private placement or public offering) in Japan under the Investment Trusts Act, containing basic terms such as its investment objective, restrictions, dividend policy, procedures of subscription and redemptions, and costs and expenses.

No regulatory requirement is imposed on a manager, investment manager, asset management company or trustee in respect of a foreign investment trust/corporation.

Collective Investment Schemes

The establishment process and notification requirements of collective investment schemes are prescribed by the relevant laws governing such collective investment schemes. For example, an investment limited partnership formed pursuant to the LPAI becomes effective upon the execution of a partnership agreement by at least one general partner and one limited partner. When a partnership agreement takes effect, its business, duration and the name of its general partner must be registered within two weeks.

The general partner of an investment limited partnership under the LPAI must be a Registered Investment Manager under the FIEA, unless an exemption from registration requirements is available.

An offshore partnership established under a foreign law can also be offered for private placement in Japan, although a general partner is required to be a Registered Investment Manager if any Japanese investor acquires and holds an interest in it, unless an exemption from registration requirements is available.

2.1.3 Limited Liability

Holders of units/shares in an investment trust/corporation are liable only to the extent of the amount contributed by them.

Liabilities of investors in collective investment schemes are determined by the relevant governing law. For example, a general partner of an investment limited partnership formed pursuant to the LPAI is jointly and severally liable for the obligations of the partnership, while a limited partner thereof is liable for the partnership's obligations only to the extent of its contribution.

2.1.4 Disclosure Requirements

In contrast to publicly offered investment funds (please see **3.1.4 Disclosure Requirements**), the disclosure requirements for privately placed investment funds are limited.

An investment trust manager must provide a document detailing the trust agreement to investors seeking a subscription of units of an investment trust, except where the units are offered by way of a QII Placement (please see **2.3.6 Rules Concerning Marketing of Alternative Funds**).

An investment trust manager must prepare and deliver a management report containing performance results, market conditions and its financial statements for the relevant fiscal year to known unitholders, and must also send this report to the regulator after the end of the fiscal year without delay, unless the units of the investment trust are offered by way of a QII Placement and the terms and conditions of the trust agree-

ment provide that a management report will not be delivered.

A management report is comprised of two types of reports: a summary management report, which contains material information, and a full management report. In addition, the ITAJ provides detailed rules on matters to be included in a management report, and the forms necessary for drafting one. A full management report may be delivered to known unitholders through electronic means, including by posting the report on an issuer's website, as long as the terms and conditions of the trust agreement so allow.

An investment corporation must notify investors seeking a subscription of shares of the basic terms of a certificate of incorporation, such as its investment objective and its dividend policy, as well as its subscription requirements.

An investment corporation must prepare financial statements, an asset investment report and a statement on the distribution of funds for each fiscal period, and must send them to the shareholders once approved by a board of directors. An asset investment report must include material issues on the situation of the investment corporation and other matters relating to the current situation, on the directors and on its shares.

The rules of the ITAJ also prescribe specific matters to be included in an asset investment report of investment corporations, and the necessary forms for the drafting thereof.

A foreign investment trust must deliver a document containing a constitutional document, such as the trust deed of a unit trust or a management regulation for a fonds communs de placement (FCP), to a prospective investor, and must prepare a management report and deliver it to known unitholders. A foreign investment corporation is not required to prepare an asset investment report.

With respect to a collective investment scheme, there is no general obligation of disclosure to a prospective investor, but a prospective investor is normally provided with a partnership agreement to review before executing it.

Ongoing disclosure obligations applicable to a collective investment scheme depend on the relevant governing law. For example, a general partner of an investment limited partnership formed pursuant to the LPAI must prepare a balance sheet, profit and loss statement and business report, and must maintain these at its principal office; a limited partner may inspect or request their own copies at any time during normal business hours.

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

In the case of a private placement for qualified institution investors only, permitted investors are limited to certain qualified institutional investors (QIIs) as defined in the FIEA. Please see **2.3.6 Rules Concerning Marketing of Alternative Funds** regarding the requirements of private placement and **2.3.7 Marketing of Alternative Funds** for the scope of the QIIs.

With respect to privately placed investment funds, most investors are persons who have knowledge and experience of investment in investment funds, such as banks, insurance companies, trust companies, Registered Financial Instruments Business Operators (as defined in **2.3.2 Requirements for Non-local Service Providers**), wealthy individuals and general business companies with sufficient cash supplies.

2.2.2 Legal Structures Used by Fund Managers

Please see **2.1.2 Common Process for Setting Up Investment Funds**.

2.2.3 Restrictions on Investors

Please see **2.3.7 Marketing of Alternative Funds**.

2.3 Regulatory Environment

2.3.1 Regulatory Regime

Most investment trusts are established as securities investment trusts for Japanese taxation purposes. In order to be qualified as a securities investment trust, a trust must invest more than half of its assets in securities (excluding certain "deemed securities" such as trust beneficiary interests in a trust and interests in a collective investment scheme such as an investment limited partnership) and in securities-related derivatives.

In addition, the rules of the ITAJ prohibit a securities investment trust/corporation from investing in fund-of-funds type investment funds.

The rules of the ITAJ require that a real estate investment corporation prescribes in its certificate of incorporation that its purpose is to invest more than half of its assets in real estate, lease rights and other real estate-related assets such as asset-backed securities, more than half of the underlying assets of which are real estate and lease rights.

An investment limited partnership may acquire and hold stocks in joint stock companies (*kabushiki kaisha*), bonds issued by or loans to business entities, and other properties that facilitate the business of the entities. However, it may acquire and hold shares or convertible bonds in foreign companies only up to half of its assets under the LPAI.

2.3.2 Requirements for Non-local Service Providers

The FIEA provides four categories of financial instruments businesses:

- type I financial instruments business;
- type II financial instruments business;
- investment management business; and
- investment advisory business.

It requires a person intending to be engaged in any such business to be registered under the FIEA as a Registered Financial Instruments Business Operator. Type I and II financial instruments businesses are involved in the services of brokerage, intermediary activity and the trading of liquid and illiquid securities (as the case may be), and their derivatives.

The Trust Business Act requires a trust company to be licensed thereunder in order to conduct a trust business.

Accordingly, if a non-local service provider wants to carry out any such business in Japan or to provide the services of such business to clients resident in Japan, it must be registered under the FIEA or licensed under the Trust Business Act.

2.3.3 Local Regulatory Requirements for Non-local Managers

As mentioned in **2.3.2 Requirements for Non-local Service Providers**, registration is necessary in order to conduct an investment management business under the FIEA. Therefore, if a non-local manager intends to act as an investment trust manager of an investment trust, an asset management company of an investment corporation or a general partner of an invest-

ment limited partnership, it must generally be a Registered Investment Manager under the FIEA.

On the other hand, acting as a manager or investment manager of a foreign investment trust or an asset management company of a foreign investment corporation does not require registration as an investment management business under the FIEA.

2.3.4 Regulatory Approval Process

Generally speaking, the establishment processes for an investment trust and an investment corporation take one to two months and three to six months, respectively.

For a foreign investment trust/corporation, it usually takes one to two months to prepare and file a Notification.

The length of time for the creation of a collective investment scheme depends on its type, its complexity and the number of investors involved, among other factors.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

Assuming that pre-marketing activities are those which do not constitute solicitation of securities and, therefore, are not subject to regulations applicable to public offerings or private placements, there is no such notion under the governing Japanese law.

The solicitation of securities is not expressly defined in the FIEA or in any related law or guidelines. Nonetheless, under current practice, the solicitation of securities is generally understood to mean any act carried out with a view to inducing or pressuring a targeted person to purchase a specific product or to agree to enter into a transaction. Accordingly, activities that do not amount to such conduct would be regarded as pre-marketing under Japanese law.

In practice, however, it is difficult to draw a clear line between the solicitation of securities and pre-marketing activities, and this should be determined on a substantive basis considering all of the facts of the circumstances, including the wording used, the addressee of the information provided, and the reasons for the provision of the information.

In light of the above, activities such as simply answering questions posed by a potential investor (at the instigation of such potential investor) would be treated as pre-marketing. On the other hand, delivering a prospectus or sending marketing material containing past performance details of a specific investment fund is likely to be treated as solicitation of securities and must follow the requirements of the relevant private placement.

In the case of a foreign investment trust/corporation, advance Notification must be filed before conducting a private placement in Japan under the Investment Trust Act (please see **2.1.2 Common Process for Setting Up Investment Funds**).

2.3.6 Rules Concerning Marketing of Alternative Funds

With respect to investment trusts/corporations, the FIEA principally provides for the following two methods of private placements:

- private placements for qualified institutional investors only (“QII Placements”); and
- private placements of small numbers of investors (“Small Number Placements”).

It should be noted that any solicitation of securities that does not meet the requirements for

private placements will generally be treated as public offerings under the FIEA.

Pursuant to a QII Placement, an issuer of an investment trust/corporation may offer its units/shares to an unlimited number of QIIs. An investor acquiring units/shares under the QII Placement is subject to a transfer restriction prohibiting any sale or transfer of units/shares to any person who is not a QII.

Pursuant to a Small Number Placement, an issuer may offer its units/shares to fewer than 50 offerees. This limitation is based on the number of offerees but not acquirers, and the number of QIIs can be excluded in calculating the number of offerees if they are subject to the requirements specified for a QII Placement (including transfer restriction). In addition, if units/shares of the same kind as the units/shares to be offered were issued during the three-month period preceding the scheduled issue date of the relevant private placement, the number of offerees of such preceding issue will be aggregated in calculating the number of offerees, which must be fewer than 50.

An investor acquiring units of an investment trust under a Small Number Placement is subject to a transfer restriction prohibiting any sale or transfer of units, unless it transfers all of its units as a whole, or unless certificates of units are unable to be divided. No transfer restriction is imposed on shares of an investment corporation issued pursuant to a Small Number Placement.

A foreign investment trust/corporation follows the same requirements as stated above.

With respect to collective investment schemes, only Small Number Placements are available, pursuant to which an issuer may offer interests in a collective investment scheme to up to 500 investors acquiring the interests therein.

In the case of a private placement, a written notification stating that a securities registration statement has not been made because the offering is being made by way of a private placement must be delivered to an investor; said notification must include the applicable transfer restrictions.

2.3.7 Marketing of Alternative Funds

Under a QII placement, units/shares can only be offered to QIIs, which include the following persons or institutions:

- Registered Financial Instruments Business Operators with registrations of type I financial instruments businesses and investment management businesses;
- investment corporations and foreign investment corporations;
- banks;
- insurance companies and foreign insurance companies;
- credit associations and labour credit associations;
- credit co-operative associations and agricultural co-operative associations;
- the Government Pension Investment Fund;
- the Japan Bank for International Cooperation;
- Development Bank of Japan Inc.;
- investment limited partnerships;
- certain employee and corporate pension funds that have submitted a notification to the regulator;
- certain corporations that have submitted a notification to the regulator; and
- certain individuals that have submitted a notification to the regulator.

2.3.8 Marketing Authorisation/Notification Process

In the case of a foreign investment trust/corporation, a Notification is required to be filed with the regulator before conducting an offering (please see **2.1.2 Common Process for Setting Up Investment Funds**).

2.3.9 Post-marketing Ongoing Requirements

If an investment trust manager intends to change the terms and conditions of a trust agreement or implement a consolidation of investment trusts, the trustees of which are the same, it has to notify the regulator of its intention and the contents of the change or consolidation in advance. If such changes to the terms and conditions are material, an investment trust manager has to give at least two weeks' prior written notice to known unitholders and hold a vote on a written resolution on such change or consolidation, unless such consolidation has only a minor influence on the unitholders' interests.

If an investment trust manager intends to terminate a trust agreement, it has to notify the regulator of this intention in advance. An investment trust manager has to give at least two weeks' prior written notice to known unitholders and hold a vote on a written resolution on such termination, except in cases where it is truly unavoidable to terminate a trust agreement without sending a notice or except when otherwise the conditions prescribed in advance by the terms and conditions of the trust agreement are met.

If any change is made to items that have been registered with the regulator, an investment corporation has to notify these to the regulator within two weeks of said change.

If an investment corporation is extinguished as a result of a merger or is dissolved, it must notify the regulator to that effect within 30 days after this takes place.

If any change is intended to be made to a constitutional document of a foreign investment trust, the issuer must notify these to the regulator in advance. If such change to a constitutional document is material, an issuer has to give at least two weeks' prior written notice to known unitholders. If an issuer intends to terminate a constitutional document, it has to notify the regulator of its intention in advance and give at least two weeks' prior written notice to known unitholders.

If any change is intended to be made to the items included in a Notification in respect of a foreign investment corporation having been filed with the regulator, an issuer must notify the regulator of its intention in advance. If a foreign investment corporation is dissolved as a result of bankruptcy or similar proceedings, or will be dissolved for another reason, it has to notify this to the regulator.

Collective investment schemes must follow the ongoing requirements as prescribed by the relevant governing law. For example, in the case of an investment limited partnership formed under the LPAI, if any change is made to items that have been registered with the regulator, the investment limited partnership must apply for registration of such change within two weeks of such change.

2.3.10 Investor Protection Rules

There is no regulation that sets a specific limitation on investors for a certain investment fund.

However, a Registered Financial Instruments Business Operator has to comply with the general principle of suitability in the marketing and

selling of financial instruments to investors under the FIEA. Pursuant to this, it must determine whether it is acceptable to market and sell a particular financial instrument to targeted investors, considering their knowledge and experience of investing in financial instruments, their asset situation and their purpose of investment, and provide an explanation to the investors in a manner and to the extent necessary for them to understand it.

Prior to entering into a contract with an investor, a Registered Financial Instruments Business Operator must, in general, deliver a document to the investor containing an outline of such contract, charges and fees, and major risk factors associated with the contract.

Upon concluding a contract, a Registered Financial Instruments Business Operator must, in general, deliver a document containing an outline of such contract, charges and fees, and provide a method for allowing communications between the operator and the investor.

2.3.11 Approach of the Regulator

The Financial Services Agency of Japan (FSA) has authority over the administration of the FIEA, and responsibility for regulating the financial markets and financial institutions. The FSA delegates certain authorities to a local finance bureau of the Ministry of Finance, such as that of regulating Registered Financial Instruments Business Operators and disclosure obligations in respect of financial instruments.

There is no general limitation on access to the regulator. It may take time to obtain their conclusions on matters that are innovative or unprecedented. In some cases, the regulator prefers to hold preliminary consultations prior to an official filing or application.

2.4 Operational Requirements

A Registered Investment Manager owes a general duty of sincerity and fairness to its clients and must work faithfully on behalf of its investors and carry out its investment management business with the due care of a prudent manager under the FIEA.

As part of this, the FIEA specifically prohibits a Registered Investment Manager from:

- conducting a transaction with itself or its offices;
- conducting a transaction between investment funds both of which are managed by it;
- conducting a transaction with the aim of benefitting itself or a third party;
- conducting a transaction that is detrimental to investors;
- purchasing or selling securities on its own account using information about a transaction that it has conducted as an investment;
- providing, or promising to provide, loss compensation or additional benefits to investors; or
- taking any other act deemed to be insufficient as a form of investor protection, harming the fairness of transactions, or causing a loss of confidence in the financial instruments business.

In addition, a Registered Investment Manager of collective investment schemes must manage invested assets separately from its own assets and other invested assets in the manner prescribed by the FIEA.

2.5 Fund Finance

While there is no restriction on borrowing in respect of an investment trust/corporation under the Investment Trusts Act, the rules of the ITAJ provide that a securities investment trust/cor-

poration may borrow funds only to the extent doing so is necessary for the purpose of providing funds for payment of redemption and distribution.

Collective investment schemes have no restriction on borrowing.

2.6 Tax Regime

Taxation on Investment Funds

Investment trusts are generally exempted from Japanese taxation.

Investment corporations are subject to income tax, but distributions payable to investors can be included in tax deductible expenses if certain conditions are met, such as distributing an amount equal to more than 90% of profit available for dividend to investors.

Collective investment schemes are pass-through entities and are non-taxable at the investment fund level.

Taxation on Investors

For Japanese tax purposes, investment trusts are classified into public and corporate bond investment trusts and stock investment trusts. The former invest in public and corporate bonds, but may not invest in any stocks, shares or equities, while the latter comprise investment trusts other than public and corporate bond investment trusts.

There is no such classification for investment corporations, which are generally treated in the same way as stock investment trusts for tax purposes.

For individual investors, investment in a stock investment trust is treated the same as a direct investment in unlisted stocks for tax purposes. Ordinary distributions are subject to withholding taxes at the rate of 20.42% and, thereafter, to an aggregate taxation whereby tax is calculated in combination with other types of income by a final return. Special distributions are exempted from taxes because they are in substance a refund of capital.

Capital gains are subject to separate self-assessed taxation at the rate of 20.315%, whereby tax is calculated separately from other types of income by a final return.

Investment in a public and corporate bond investment trust is treated the same as a direct investment in public and corporate bonds for tax purposes. Ordinary distributions are subject to a withholding tax at a rate of 20.315%. Capital gains are subject to a separate self-assessed taxation at the rate of 20.315%.

For corporate investors, ordinary distributions and capital gains arising from an investment trust are subject to a withholding tax at a rate of 15.315%.

Collective investment schemes are transparent for Japanese tax purposes. Profits or losses of collective investment schemes are attributed directly to investors and recognised as their own profits or losses by them.

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

Traditionally, most publicly offered investment funds in Japan are securities investment trusts, while investment corporations are predominantly used as J-REITs. Many foreign investment trusts are also publicly offered in Japan, while foreign

investment corporations such as SICAVs domiciled in Luxembourg are sometimes used.

Collective investment schemes are seldom publicly offered in Japan.

3.1.2 Common Process for Setting Up Investment Funds

The statutory establishment processes for publicly offered investment funds are the same as those for privately placed investment funds; please see **2.1.2 Common Process for Setting Up Investment Funds**. However, due to the rules of the ITAJ and the Japan Securities Dealers Association (JSDA), the self-regulatory organisation of securities firms, banks and other financial institutions operating in the securities business apply to investment trusts/corporations and foreign investment trusts/corporations, respectively, and they have to satisfy the detailed requirements provided for by them; please see **3.3.1 Regulatory Regime**.

3.1.3 Limited Liability

Please see **2.1.3 Limited Liability**.

3.1.4 Disclosure Requirements

In addition to the general disclosure requirements applicable to investment funds (please see **2.1.4 Disclosure Requirements**), an issuer of an investment fund who intends to conduct a public offering in Japan must file a securities registration statement (SRS) in the form prescribed based on the types of securities enumerated by the FIEA prior to conducting solicitation in Japan. The SRS generally becomes effective 15 days after the filing, and thereafter an issuer can accept subscription orders placed by investors.

However, for an investment fund that is offered on a continuous basis, the SRS becomes effective on the day following the filing, on the condition that one year has elapsed since the previous SRS was filed. Accordingly, an investment fund can continue its public offering by filing of a new SRS annually.

The SRS requires full disclosure of publicly offered investment funds, enabling investors to make reasonable investment decisions. For example, the SRS with respect to an investment trust must contain the following information:

- the terms and conditions of the public offering;
- investment objective, fund structure, types of assets, management system, dividend policy, investment restrictions, risk factors, charges and costs, taxation, performance results, procedures of subscription and redemption, valuation of assets, term, and description of an investment trust manager, a trustee and related parties; and
- audited financial statements of an investment trust as well as an investment trust manager.

The SRS is filed through an electronic filing system, the Electronic Disclosure for Investors' NETwork (EDINET), and is made available for public inspection via the internet.

If there is a change to material facts that must be stated on the SRS after it has been filed (including cases where new financial statements are prepared and an important lawsuit has been resolved), or if an issuer recognises there is an item on the SRS that needs amending, an amendment to the SRS must be filed.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

There is no restriction on types of investors in respect of public offered investment funds. General investors may apply for subscription, includ-

ing a wide range of individual investors and institutional investors.

3.2.2 Legal Structures Used by Fund Managers

Please see **3.1.1 Fund Structures**.

3.2.3 Restrictions on Investors

Please see **3.2.1 Types of Investors in Retail Funds**.

3.3 Regulatory Environment

3.3.1 Regulatory Regime

In general, a publicly offered securities investment trust must comply with the following requirements provided by the rules of the ITAJ.

- It may invest only in shares listed on a stock exchange and registered on an over-the-counter market established in a foreign country, and in unlisted shares or unregistered shares whose issuer is subject to ongoing disclosure obligations to file annual securities reports in accordance with the EIEA (please see **3.3.9 Post-marketing Ongoing Requirements**) or those issued in foreign countries that are deemed similar to these.
- It may invest in an aggregate amount of units/shares of investment funds up to 5% of its net assets. This limitation does not apply to fund-of-funds type securities investment trusts, but they must invest in multiple investment funds and comply with the credit risk limitations stated below.
- The amount of risk arising from derivative transactions calculated in a reasonable manner may not exceed its net asset value (the "derivative transaction limitation").
- Ratios of the exposure to a single entity to the total amount of net assets may not exceed 10% for each of the following categories, or 20% in total (the "credit risk limitation"):
  - (a) shares and units/shares of investment trusts/corporations;
  - (b) other securities and liabilities; and
  - (c) derivative transactions.

A publicly offered foreign investment trust/corporation must comply with the following requirements provided by the rules of the JSDA:

- the total value of securities sold short shall not at any time exceed its net asset value;
- no more than 15% of the net assets may be invested in illiquid assets such as privately placed equity securities or unlisted securities, unless appropriate measures have been taken to ensure price transparency;
- any transactions that are contrary to the protection of unitholders or prejudicial to the proper management of assets, such as transactions made for the benefit of a manager or any third party, shall be prohibited;
- a manager shall not acquire shares of any one company if doing so would result in the total number of shares of such company held by all funds managed by a manager exceeding 50% of the total number of all issued and outstanding shares of such company;
- derivative transaction limitations; and
- credit risk limitations.

In addition, if an issuer of an investment trust/corporation intends to list their units/shares on a stock exchange (eg, ETF or J-REIT), they must apply for a listing examination from the relevant stock exchange. To be qualified as listed units/shares, they have to meet criteria for the listing examination provided by the securities listing regulations and related rules issued by the relevant stock exchange.

3.3.2 Requirements for Non-local Service Providers

Please see **2.3.2 Requirements for Non-local Service Providers**.

3.3.3 Local Regulatory Requirements for Non-local Managers

Please see **2.3.3 Local Regulatory Requirements for Non-local Managers**.

3.3.4 Regulatory Approval Process

Please see **2.3.4 Regulatory Approval Process**. An additional one to three months are required to prepare the SRS and a prospectus, depending on the complexity and risk character of an investment fund.

3.3.5 Rules Concerning Pre-Marketing of Retail Funds

The solicitation of securities before the filing of the SRS is strictly prohibited under the FIEA. While some safe harbour rules on pre-marketing have been provided, there is no specific safe harbour rule applicable to the pre-marketing of investment funds in Japan.

3.3.6 Rules Concerning Marketing of Retail Funds

An issuer must prepare a prospectus in connection with a public offering of an investment fund.

A prospectus in respect of an investment fund is comprised of two types of prospectus: a summary prospectus and a full prospectus. A summary prospectus must contain substantially material information, such as an outline of investment objectives and features, selected information on the investment trust manager, material risk factors, selected performance results and charges and costs in the case of an investment trust.

An issuer or distributor must deliver a summary prospectus to prospective investors before or at the same time as the sale. A full prospectus must contain almost the same information as the SRS, and an issuer or distributor must, upon request, deliver this to a prospective investor immediately.

3.3.7 Marketing of Retail Funds

Please see **3.3.3 Local Regulatory Requirements for Non-local Managers**.

3.3.8 Marketing Authorisation/Notification Process

Please see **3.1.4 Disclosure Requirements**.

3.3.9 Post-marketing Ongoing Requirements

An issuer of investment funds for which the SRS has been filed is subject to as ongoing disclosure obligation to file the annual securities report and semi-annual report every year within three months (or six months for an offshore investment funds) after the fiscal year end and the interim fiscal year end, respectively (where the fiscal period is six months or less, an issuer must file an annual securities report every six months).

An annual securities report with respect to an investment trust must contain the following information:

- investment objective, fund structure, types of assets, management system, dividend policy, investment restrictions, risk factors, charges and costs, taxation, performance results, procedures of subscription and redemption, valuation of assets, term, and description of the investment trust manager, the trustee and related parties; and
- audited financial statements of the investment trust as well as the investment trust manager.

A semi-annual report with respect to an investment trust must contain the following information:

- performance results for a six-month period;
- a description of the investment trust manager; and
- unaudited interim financial statements of the investment trust and the latest financial statements of the investment trust manager.

The annual securities report and semi-annual report are filed through EDINET and made available for public inspection via the internet.

In addition, an issuer must file an extraordinary report if a certain event occurs as prescribed by the law, including a change to a major investment fund-related corporation, a material change to basic policies, restrictions or dividend policies, a dissolution of the investment corporation or termination of the investment trust.

Furthermore, if units/shares of an investment trust/corporation are listed on a stock exchange, they are subject to timely disclosure obligations provided by the securities listing regulations and related rules issued by the relevant stock exchange. For example, an issuer of an exchange traded fund (ETF) listed on the Tokyo stock exchange must disclose details of secondary offerings, borrowing of funds, revision of terms and conditions of a trust agreement, cancellation of a trust agreement, or the merger or dissolution of an issuer immediately after the occurrence thereof.

3.3.10 Investor Protection Rules

If the SRS or a prospectus contains a false statement regarding a material fact, or omits a statement regarding a material fact that is required to be stated or is necessary to prevent the SRS or prospectus from being misleading, an issuer is liable for damages suffered by an investor, whether or not there is an absence of intent or negligence on the part of the issuer, unless it can be shown that the investor was aware of such false statement or such omission at the time of purchase. Furthermore, the directors of the issuer filing such SRS, or the distributors using such prospectus, are liable for damages suffered by an investor, except in cases where such directors or distributors can prove that they did not know or could not have known of such false statement or such omission had they exercised reasonable care.

In addition, it is prohibited for any person to make a false or misleading representation in documents, drawings, via audio media, or by means other than the prospectus used for the public offering.

Apart from this, an issuer that has filed an SRS containing a false statement or misleading omission would be subject to criminal penalties and administrative fines.

3.3.11 Approach of the Regulator

Please see **2.3.11 Approach of the Regulator**.

3.4 Operational Requirements

Please see **2.4 Operational Requirements**.

3.5 Fund Finance

Please see **2.5 Fund Finance**.

A publicly offered foreign investment trust may borrow up to 10% of the net asset value.

3.6 Tax Regime

The taxation of publicly offered investment funds is basically the same as for privately placed investment funds.

Nonetheless, for individual investors, in respect of stock investment trusts, ordinary distributions are subject to a withholding tax at the rate of 20.315% and, thereafter, the taxpayer may select an aggregate taxation, a separate self-assessed taxation, or a separate taxation at source. If separate taxation at source is selected, the taxpayer's tax obligations are thereby fulfilled.

Capital gains are subject to a separate self-assessed taxation at the rate of 20.315%. In respect of public and corporate bond investment trusts, ordinary distributions are subject to a withholding tax at the rate of 20.315% and, thereafter, the taxpayer may select a separate self-assessed taxation or a separate taxation at source. Capital gains are subject to a separate self-assessed taxation at the rate of 20.315%.

In respect of investment corporations, ordinary distributions are subject to a withholding tax at the rate of 20.315% and, thereafter, the taxpayer may select an aggregate taxation, a separate self-assessed taxation or a separate taxation at source. Capital gains are subject to a separate self-assessed taxation at the rate of 20.315%.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

ESG Investment Trusts

In response to the rapid increase in ESG investment funds and growing concerns over "greenwashing" issues, the FSA published a draft of revised "Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc" on 19 December 2022.

Accordingly, ESG investment trusts are defined as publicly offered investment trusts that consider ESG as a key factor in the selection of assets and that describe said assets in their summary prospectus.

ESG investment trusts must state how key ESG factors are taken into account during the investment process, and must include an assessment of risks and limitations in their consideration of key ESG factors during the investment process in a prospectus. They must also periodically disclose the actual ratio of investments selected with ESG in mind as a major factor, and the achievement status of their goals in a management report.

Accordingly, the regulator will check whether an investment trust manager has adequate resources to implement operations in line with the investment strategy of the ESG investment trust and to monitor their implementation status on an ongoing basis.

After completion of the public comments phase, the FSA will issue the final version of the revised "Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc".

Anderson Mori & Tomotsune is one of the largest and most international Japanese law firms, with a long history of advising overseas companies that conduct business in Japan and in cross-border transactions. The main office in Tokyo is supported by two regional offices, in Osaka and Nagoya, and eight overseas offices. AMT has considerable experience and expertise in investment funds and trusts, including investment corporations such as J-REITs, infrastructure funds, ETFs, partnerships and other forms of collective investment schemes. The firm works with increasingly diversified international and Japanese-based investment funds, comprising private equity funds, venture capital funds, hedge funds, funds of funds and commodity funds. Consisting of 15 partners and 45 associates, the team provides comprehensive advice at all stages of the procedures to which investment funds are subject, and supports clients in navigating a broad range of regulatory matters concerning asset management.

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