JAPAN'S INTERNATIONAL FINANCIAL CITY INITIATIVE CONTINUES IN FULL FORCE, AIMING TO ATTRACT FOREIGN MANAGERS WITH LICENSING EXEMPTIONS AND FINANCIAL INCENTIVES

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Asset Management and Investment Funds Alert

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In November of 2021, Japan adopted two licensing exemptions aimed at assisting foreign asset managers who intend to open offices in Japan. This is another important step forward for Japan's International Financial City Initiative policy (IFC Initiative Policy), which we discussed in our previous alert accessible here. By way of background, the IFC Initiative Policy includes:

1. Key regulatory reforms such as regulatory (licensing) and immigration reforms, and tax reforms, all of which are intended to make it easier for foreign managers to open Japan offices and register with the Japanese regulator; and
2. Direct support to these managers through (i) the English-language support and supervisory desk within the Japanese regulator called Financial Market Entry Office, and (ii) an office set-up support program called Financial Start-Up Support Program that includes monetary incentives up to JPY 20 million (approximately USD 173,000), which can be used to cover initial costs such as initial office rents, costs of hiring, registration, and visa application.

The latest reform under the IFC Initiative Policy was issued on 18 January 2022 by the Financial Services Agency of Japan (the FSA), which has proposed expanding the functions of the Financial Market Entry Office (Proposed Order). The Financial Market Entry Office currently accepts registration and supervision in English in relation to Investment Management Business Operators (Investment Manager), Investment Advisory and Agency Business Operators (Investment Adviser), and Type II Broker-Dealers[1] (Type II BD). This allows eligible institutions to submit registration application documents in English with respect to one or more of these categories of businesses, and to be subject to post-registration supervision in English, including submission of annual reports in English with respect to such businesses. However, these measures currently apply only to new registrants for these three categories of licenses; and do not apply to existing registrants.

The Proposed Order would expand this allowance of English to eligible institutions applying for Type I Broker-Dealer[2] (Type I BD). If the Proposed Order were adopted, Japan would allow all types of financial instrument-related businesses (Type I BD, Type II BD, Investment Manager, and Investment Adviser) to register and to be supervised in English. This would be an additional significant structural change welcomed by global financial institutions eyeing registration in Japan. Under the Proposed Order, English registration and supervision would not be available to existing registrants unless they intend to apply for additional categories of registration and

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satisfy eligibility requirements. FSA is accepting public comments regarding the Proposed Order until 17 February 2022, and comments can be submitted in English.

This alert provides a summary of the final exemptions and an overview of the Financial Start-Up Support Program. It also reviews the Proposed Order in more detail, including eligibilities for English registration.

FOREIGN INVESTOR FUND EXEMPTION AND TRANSITION PERIOD EXEMPTION

On 10 November 2021, the FSA released the final amendments to relevant regulations to implement the two licensing exemptions introduced under the legislation that amended the Financial Instruments and Exchange Act of Japan (Act No. 25 of 1948, as amended) (the FIEA). The final regulations became effective on 22 November.

The exemptions are:

3. "Specially Permitted Business For Foreign Investors, etc." (Foreign Investor Exemption) – this is an exemption from Type II broker-dealer and investment management registration for fund operators of certain partnership-type funds (which have "primarily" foreign investors) when offering certain eligible partnership-type funds and managing assets invested in those funds; and
4. "Specially Permitted Business During Transition Period" (Transition Period Exemption)- this is an up to five-year registration moratorium for foreign managers registered with a foreign authority who have foreign investors only and who satisfy certain eligibility requirements (collectively, "Exemptions").

Exemption Requirements

Below we set forth a summary of requirements for these new Exemptions:

	Foreign Investor Fund Exemption	Transition Period Exemption
	▪ Permitted to offer funds and manage assets in the funds without Type II Broker-Dealer and Investment Manager registration	▪ Investment Manager registration moratorium for up to five years ▪ Currently available until 21 November 2026.
Manager Conditions	▪ Human resources must be sufficient to operate exempt activities in an appropriate manner. ▪ Compliance may be outsourced to a third party or an affiliate; however, the FSA indicated that an employee who has at least one year of experience and is in charge of compliance is necessary at the Japan	▪ The applicant or its parent company must be registered to engage in investment management business and has been in the investment management business for at least three years in one of the designated jurisdictions, which are currently: United States, United Kingdom, Australia, Singapore, Switzerland, Germany, France, and Hong

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	office. ▪ The FSA also indicated that an employee who has at least one year of experience and is in charge of investment decisions is necessary at the Japan office. ▪ An effective internal control system. ▪ An office in Japan. ▪ (If the applicant is a foreign entity) A representative in Japan. ▪ None of the applicant, its officer, or key employee falls under disqualifying factors.[3] ▪ No major shareholder falls under disqualifying factors.[4]	Kong. ▪ Human resources must be sufficient to operate exempt activities in an appropriate manner. ▪ Compliance may be outsourced to a third party or an affiliate; however, the FSA indicated that an employee who is in charge of compliance is necessary at the Japan office. ▪ The FSA also indicated that an employee who has at least one year of experience and is in charge of investment decisions is necessary at the Japan office. ▪ An effective internal control system. ▪ An office in Japan. ▪ (If the applicant is a foreign entity) A representative in Japan. ▪ None of the applicant, its officer, or key employee falls under disqualifying factors.[5] ▪ No major shareholder falls under disqualifying factors.[6]
Exempt Activities	Activities must be one or more of the following: ▪ Offering of partnership-type funds. ▪ Managing money invested in those types of funds.	Activities must be one or more of the following: ▪ Investment management activity pursuant to a discretionary investment management agreement.

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		▪ Investment management activity for a foreign investment trust and solicitation and offering of interests in such foreign investment trust. ▪ Investment management activity for a foreign partnership-type fund, and solicitation and offering of interests in a foreign partnership-type fund. If a Japanese subsidiary of a foreign investment manager: ▪ Investment management activity must be pursuant to a discretionary investment management agreement with its parent foreign investment manager.
Asset Condition	N/A	No more than 50% of the assets under management (AUM) of the foreign manager can be invested in voting securities of Japanese issuers.
Investor Conditions	▪ More than 50% of the money invested in an eligible fund must be invested by non-resident investors; and ▪ All investors in the fund must satisfy one of the following criteria: ▪ Eligible foreign corporations or foreign resident individuals, i.e., (1) foreign corporations; or (2) a foreign individual with (a) net asset of 300 million yen or more, or (b) investable financial assets of 300 million yen or	All investors/clients must satisfy one of the following criteria: ▪ A foreign corporation or an individual resident in a foreign country; ▪ Investment Manager;[7] ▪ Parties closely related to the foreign investment manager, including: ▪ Officers and employees; ▪ Related companies and their officers and employees;

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	more, or (c) having a securities or derivatives account for more than one year; or (3) investors who are "professional investors" in a foreign country; ▪ Qualified institutional investors (QII); ▪ Professional Investors (also known as Specified Investors), which include: financial institutions, certain pension plans, publicly traded companies, companies with assets of 500 million yen, and foreign corporations. ▪ Foreign employees' pension funds or corporation pension funds; and ▪ Parties closely related to the manager, i.e., related companies, officers and employees of the manager, and officers and employees of the manager's related companies. In sum, a wide range of non-Japanese investors including non-Japanese corporations (with no asset requirement) and Japanese Professional Investors including QIIs are permitted.	▪ Manager or adviser with which the foreign investment manager engages for investment management or investment advice, and their officers and employees; or ▪ Certain relatives of the foreign investment manager (if the foreign investment manager is an individual).
Notification Requirement	Prior notification must be submitted. Notification and attachments can be submitted in English.	
Reporting	Annual report filing requirements	
Public Disclosure	Public disclosure of certain notified matters is required	
Anti-money laundering	Subject to Japanese AML requirement	

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(AML)	
Other Applicable Regulations	▪ Recordkeeping ▪ Subject to certain conduct regulations and investor protection requirements, such as internal operation management requirements, advertising rules, investor notice disclosures prior to investment, prohibition on compensating investors for investment loss, suitability requirements, separation of client assets, investor reporting requirements, and certain other disclosure requirements
Supervision	Supervision by the Financial Market Entry Office in English is available.
Notes	The foreign investment manager must apply for Investment Manager registration to continue its activities in Japan upon expiry of the transition period.

Both Exemptions, as adopted, provide meaningful access to Japanese investor communities. For example, the Foreign Investor Fund Exemption permits access to a wide range of Japanese professional investors so long as funds from Japanese investors stay below 50% of the AUM of the relevant fund (See Investor and Asset Conditions in the chart above.). Further, the Transition Period Exemption allows the foreign investment manager to act as a sub-manager for (Japanese) Investment Managers pursuant to a discretionary investment management agreement, which will allow the foreign investment manager to build Japan-related track records at its Japan office while relying on the Transition Period Exemption.

Challenges for foreign asset managers will likely include housing sufficient and qualified human resources at the relevant Japan office. For example, while the FSA appears to permit some levels of outsourcing with respect to compliance and investment decision-making functions, it still expects employees who are designated to be in charge of these functions and have one-year of relevant experience, which would present challenges for certain foreign managers eyeing Japan. However, as we discuss below, the FSA is currently providing monetary incentives to cover initial costs including hiring costs, which may mitigate the challenges. Although, it is worth noting that having an office in Japan may have Japanese tax implications for the manager and the relevant funds.

FINANCIAL START-UP SUPPORT PROGRAM

The FSA currently invites foreign managers eyeing an office in Japan to apply for the Financial Start-up Support Program, which includes supports to set up an entity in Japan and for immigration, hiring and registration, and notably, a monetary incentive of JPY 20 million (approximately USD$173,000). Further, the FSA has appointed a corporate services company experienced with assisting foreign companies launching business in Japan. Application for the program will be done and support will be provided in English. The current program is set to expire at the end of March 2022, however, it is possible that the program will be renewed. The program is operated for a Japanese administrative fiscal year and hence interested managers should plan for eligible payments within the applicable fiscal year.

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PROPOSED ORDER

Currently, certain foreign-based companies applying for Investment Adviser, Investment Manager or Type II BD registration may submit application documents and post-registration documents, including annual reports in English. This was made possible in January 2021 as one of the first reforms that was implemented under the Japan IFC Policy.

The FSA now intends to expand the scope of English application and supervision to include the applicants for Type I BDs who satisfy all of the following conditions:

5. The applicant's clients in Japan would be limited to Professional Investors;
6. The applicant would, in Japan, engage in sales, purchase, an intermediary, brokerage or agency service of certain foreign securities that include: beneficiary interests of foreign investment trusts, foreign investment securities (certain securities issued by foreign investment corporations), certain securities issued by foreign issuers, beneficial interests in foreign credit fund in trust form, certain foreign options, and foreign CDs (certificates of deposit) only as it relates to its Type I BD business; and
7. Either (a) the applicant is authorized to conduct securities businesses similar to Type I BD in a foreign jurisdiction, (b) the applicant is an affiliate of such company, or (c) the applicant's officer or key employee was previously with such company.

The Proposed Order would only allow Type I BD applicants who intend to engage in a subset of Type I BD business; for example, institutions who wish to engage in brokerage business involving securities issued by Japanese issuers or underwriting business do not appear to be eligible for the proposed measures. Under the Proposed Order, the Japanese regulator would be able to instruct eligible institutions to submit Japanese translation for all or a portion of the documents or Japanese summaries thereof.

As noted above, the English measures would not apply to existing registrants, however, would apply to existing registrants who would look to add additional categories of business and satisfy eligibility requirements. Interested parties may consider submitting their comments by 17 February 2022.

As discussed above, now presents a great opportunity for global asset managers to expand their footprints in Japan. Please contact the authors for more information or any questions.

FOOTNOTES

[1] A Type II Broker-Dealer may engage in: (i) public offering or private placement of certain securities such as partnership type fund interests or beneficiary securities of investment trusts; (ii) sales or purchase, brokerage for clearing, dealing in public offering, secondary distribution or private placement of Type II Securities (certain rights that are deemed securities such as partnership type fund interests); and (iii) purchase (not for purposes of resale) of certain beneficiary securities of investment trusts. Only Type II BD applicants who intend to engage in public offering or private placement of certain securities in relation to their investment management business as it relates to Type II BD business are eligible for the English measures.

[2] Type I Broker-Dealer may engage in (i) sales or purchase, brokerage for clearing, dealing in public offering, secondary distribution or private placement of Type I Securities (ii) underwriting; and (iii) certain custody activities.

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As we discuss later, under the Proposed Order, institutions eligible for the English support would be limited to Type I BD applicants who intend to engage in a subset of Type I BD business.

[3] Disqualifying factors include: there is no pending bankruptcy proceeding, they have not received any government order, or served any sentence, in relation to any violation of the FIEA or other financial service related laws in the last five years, they are not declared incapacitated, and they are not members of so-called anti-social forces.

[4] *See id.*

[5] *See id.*

[6] *See id.*

[7] This means that the foreign investment manager relying on the Transition Period Exemption may act as a sub-manager to an Investment Manager.

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