

Finance Law Newsletter



Japan: Proposed Regulatory Regimes for Foreign Investment Managers and Deregulation of Foreign Corporate Client Information Handling

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1. Publication of the Market System Working Group First Report

On 23 December 2020 the Market System Working Group (the “MSWG”) under the Financial System Council (*kinyu shingikai*), an advisory group to the Commissioner of the Financial Services Agency of Japan, released their first report concerning establishment of an international financial center in Japan (the “First Report”). The First Report argues for new foreign investment manager regulatory regimes as well as deregulation of foreign corporate client information firewalls between banks and brokers/dealers. This newsletter provides a summary of the First Report, as it is likely that discussion items therein will lead to amendments to the Financial Instruments and Exchange Act (the “FIEA”) and other related laws and regulations.¹

2. Two New Regulatory Regimes for Foreign Investment Managers

Among the various situations exerting pressure on the international economy (and society) such as the coronavirus and destabilization of Hong Kong’s political circumstances, some argue that Japan should take steps to enhance its attractiveness as an international financial center. One such step under discussion is to improve Japan’s licensing system for foreign investment managers. To this end, the First Report suggests ‘special exemptions’ for the following investment management businesses:

- Fund management businesses that mainly manage foreign monies (the “Foreign Money Exemption”)

¹ Please note that Naoya Ariyoshi, one of the authors of this newsletter, serves as a member of the MSWG; however, opinions described in this newsletter solely reflect those of the authors and do not indicate those of any other members of MSWG or other related organizations.

- Investment managers that only manage foreign monies during a transition period (the “**Transition Period Exemption**”)

(1) Foreign Money Exemption

The Foreign Money Exemption permits, following mere filing of a notification to the authority, an investment manager not registered as a financial instruments business operator (investment management business) pursuant to the FIEA to conduct self-management (*jiko unyou*) of partnership-type collective investment schemes (Article 2, paragraph 8, item 15(c) of the FIEA), if its main clients are foreign corporations and foreign individual residents with certain assets. Note that the First Report suggests that establishing a base in Japan is one of the requirements for utilizing the Foreign Money Exemption. Even if an investment management business’ main clients are foreign corporations and individuals, the Foreign Money Exemption is suggested to permit investments from domestic qualified institutional investors and related persons of the investment manager to the extent that the percentage of the domestic investments is less than 50%.

The First Report suggests that if an investment manager files the Foreign Money Exemption notification noted above, it will be subject to conduct regulations and supervision/inspection by the regulators similar to the Article 63 exemption under the FIEA (a current exemption regime available to investment managers of collective investment schemes for professional investors). Also as per the Article 63 exemption, the First Report assumes that an investment manager subject to the Foreign Money Exemption is able to conduct solicitations of interest for partnership-type collective investment schemes (self-offering; *jiko boshu*) by filing a notification.

The intent of introducing the Foreign Money Exemption is to entice foreign investment managers to enter the Japanese market. However, to allow for the equal footing of foreign and domestic investment managers, the latter are expected to be able to rely on the Foreign Money Exemption as well. For clarification purposes, a comparison between the Foreign Money Exemption and the Article 63 exemption is provided below.

Comparison: Foreign Money Exemption and Article 63 Exemption for Investment Managers

	Foreign Money Exemption	Article 63 Exemption	Investment Management Business ¹
Domicile restrictions (Japan or overseas)	No restrictions	No restrictions	No restrictions
Range of clients	<ul style="list-style-type: none"> Foreign corporations Foreign individual residents with certain assets Domestic QII² and related persons of the investment manager with less than 50% domestic investments 	<ul style="list-style-type: none"> One or more QII Forty-nine (or less) certain investors permitted under the Article 63 exemption 	No restrictions
Entry procedures	Notification	Notification	Registration
Scope of business	Self-offering and self-management	Self-offering and self-management	–
Regulation³	Applicable	Applicable	Applicable
1. Reference; 2. QII = Qualified Institutional Investor; 3. Including supervision & inspection by regulator			

(2) Transition Period Exemption

The Transition Period Exemption is designed for foreign investment managers managing solely foreign monies pursuant to foreign laws and regulations and considering entry into the Japanese market. It intends to allow a certain transition period during which they are permitted, upon filing of the appropriate notifications, to conduct the same investment management business in Japan, so that they may establish the necessary systems for obtaining registration and other FIEA-pursuant exemptions. Note that the First Report suggests that establishing a base in Japan is one of the requirements for utilizing the Transition Period Exemption.

More specifically, the First Report proposes the following:

- (a) during its activity in Japan, the foreign investment manager continues to have a license from a regulator in a foreign country where there are overall market rules similar to those of Japan and the foreign regulator conducts its supervision based on principles which are basically the same as those of the Japanese regulator;
- (b) the foreign investment manager has a certain overseas asset management track record;
- (c) the main investments in the overall fund are foreign securities (the percentage of domestic securities is less than 50%); and
- (d) the foreign investment manager has the necessary human resources and appropriate system maintenance mechanisms in place.

Further, the First Report suggests a transition period of approximately five years. However, the First Report also suggests the Transition Period Exemption should be introduced as a temporary measure for approximately three to five years.

3. Deregulation of the foreign corporate client information firewall between banks and brokers/dealers

The regulation of information firewalls between banks and brokers/dealers is applicable to groups of financial institutions in Japan. In principle, sharing of clients' non-public information among group entities requires prior written consent from the clients. This led to the following discussion points at the MSWG: *i*) Japanese financial institutions face a competitive disadvantage compared with overseas financial institutions as it is difficult for them to obtain consent from clients in foreign countries that do not have the same regulation; and *ii*) restrictions limit opportunities for companies to obtain combined proposals from banks and brokers/dealers belonging to the same domestic financial group.

Given the above, the following opinions were offered during discussions at the MSWG with respect to the regulation of information firewalls affecting foreign corporation client information:

- (a) It is desirable to consider relaxation of the regulation from the perspectives of securing equivalence with foreign regulations and enhancing international competitiveness with foreign financial institutions; and
- (b) When considering Japanese regulation of information firewalls, especially against the backdrop of the existing client protection arrangements in other foreign countries (such as those targeting conflicts of interests), Japanese regulation of information firewalls in addition to the existing local foreign regulation on clients engaged in economic activities is not of high necessity.

Based on these opinions, the First Report suggests the non-public information of foreign corporation clients be excluded from the regulation of information firewalls.

4. Outlook

Based on the First Report, we expect that if the drafting of legislation comprised of the Foreign Money Exemption and the Transition Period Exemption proceeds smoothly, it will be discussed at the Diet convened in 2021. On the other hand, we also expect that the deregulation of information firewalls pertaining to corporate client information will be addressed via amendments to the relevant cabinet office ordinances in the near future.



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