NEW JAPANESE FUND REGULATORY FRAMEWORK: FSA'S PROPOSED RULES AND PUBLIC CONSULTATION

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On May 27, 2015, an amendment bill[1] to the Financial Instruments and Exchange Act of Japan ("FIEA") passed the Diet, which would come into effect sometime next year but no later than June 3, 2016 ("2015 Amendment"). The 2015 Amendment effectively limits the availability of, and requires significant additional requirements to rely on, a licensing exemption under Article 63 of the FIEA. Many non-Japanese fund operators of partnership-type funds have relied this exemption, the so-called "Special Business Activities for Qualified Institutional Investors and etc." exemption ("Article 63 Exemption") in offering their funds to, and managing their funds on behalf of, Japanese resident investors. Generally, under the FIEA, offering and/or managing partnership-type funds requires certain types of licenses (registration); however, the Article 63 Exemption provides an exemption for such licensing requirements for fund operators. These partnership-type non-Japanese funds include funds typically structured as partnerships, limited partnerships, limited liability companies, and, in some cases, trusts (such as Massachusetts business trusts and Delaware statutory trusts). The Japanese financial services regulator, Financial Services Agency of Japan ("FSA"), reported in its recent publication that, as of March 31, 2015, there were 749 non-Japanese fund operators who filed notifications with the regulator to rely on the Article 63 Exemption.[2]

FSA'S PROPOSED RULES AND PUBLIC CONSULTATION AND WHAT FOLLOWS THEREAFTER

On November 20, the FSA released draft amendments to the relevant ordinances, cabinet orders and supervisory guidelines under the FIEA to implement the 2015 Amendment ("Proposed Rules"), and requested public comments. Comments must be submitted in Japanese; the deadline for public comments is December 21, 2015, 3:00 p.m. JST. Importantly, the FSA stated in the release[3] that it intends to make necessary adjustments to the Proposed Rules based on the public comments it receives and also finalize the "transitional measures" that the fund operators with existing filings, *i.e.*, the fund operators that are currently relying on the Article 63 Exemption, would need to comply with the new regulations. In addition, the FSA typically provides their views on, and responses to, public comments and publicizes such views and responses as future guidance. As such, public consultation provides a great opportunity for industry to address their concerns.

Upon completion of the public consultation, the FSA will examine all the comments and views submitted during the consultation period, and finalize the final form of amendments to the relevant ordinances, cabinet orders, and supervisory guidelines. The final form of these rules, together with the FSA's responses to the public comments

and guidance, which are typically released by the FSA at the time it issues the rules in the final form, would detail the exact availability and requirements for the Article 63 Exemption going forward as well as requirements that need to be complied under the 2015 Amendment by the fund operators with existing filings. Once the FSA finalizes these rules, the 2015 Amendment would go live, which is expected to happen sometime next year but no later than June 3, 2016. All fund operators with existing filings will be required to submit interim filings as transitional measures to comply with the new regulatory framework under the 2015 Amendment within six months of effectuation of the 2015 Amendment.

KEY CHANGES UNDER THE 2015 AMENDMENT AND THE PROPOSED RULES

The key changes under the Amended FIEA and the Proposed Rules include, among others, (i) comprehensive revision of the application form for an Article 63 Exemption (Form 20), which requires the notification of much wider information relating to nature of the fund and investors than the current form; (ii) disqualifying some fund operators (particularly disqualification of non-Japanese fund operators that "do not designate a representative in Japan"); (iii) disqualifying certain non-Qualified Institutional Investors ("QII") (*i.e.*, eligible non-QII investors are limited to certain sophisticated investors and parties related to the funds (with exceptions for venture capital funds)); (iv) introducing new bookkeeping and annual reporting obligations; (v) introducing a new public disclosure requirement; and (vi) increased oversight by the regulator. It is important to note that some of these key changes will apply to fund operators with existing filings with the Japanese regulator, in particular items (ii) (disqualification of certain fund operators), (iv) (bookkeeping and annual reporting obligations), and (v) (new public disclosure requirement), among others. For further discussion on these changes, please see our previous publication.

While the Proposed Rules present details of items (i) (new Form 20), (iii) (eligible non-QII investors), (iv) (new bookkeeping and annual reporting requirements), and (v) (public disclosure requirement) to some extent, it is still unclear as to what the FSA expects from non-Japanese fund operators in "designat[ing] a representative in Japan." For example, there is no guidance in the Proposed Rules whether such "representative" must be a representative of the fund operator's base of operation located in Japan, in other words, whether the 2015 Amendment in effect requires non-Japanese fund operators to open a base of operation (*e.g.*, branch or subsidiary) in Japan or whether a person outside the corporate structure, *e.g.*, outside counsel or tax adviser, can be designated as "representative in Japan"; further, it is unclear from the Proposed Rules what role the regulator expects to be played by such "representative in Japan," other than that such requirement was intended to help the regulator to effectively communicate with non-Japanese fund operators in the context of the regulatory supervision or enforcement, or whether any liabilities are associated with serving in such a role. In addition, while the Proposed Rules allow the fund operators to comply with newly introduced bookkeeping, annual reporting, and public disclosures in the English language, *i.e.*, the fund operators are not required to create and retain books or make annual reports or public disclosures in Japanese, compliance with such additional requirements would require fund operators to employ additional procedures in managing their funds. In this sense, those fund operators that are currently relying on the Article 63 Exemption need to start thinking about how to respond to this new regulatory development, which may include reconsideration of availability of other types of exemption under the FIEA.

Notes:

[1] We discussed the key changes proposed in the amended bill in our prior publication. The amendment bill passed the Diet in the proposed form.

[2] *See* FSA, *Results of the Fund Monitoring Inquiry (October 2015)*, available at http://www.fsa.go.jp/news/26/syouken/20141007-1/01.pdf (in Japanese only). There are 2,351 Japanese fund operators who filed notifications as of the same date. *Id.*

[3] http://www.fsa.go.jp/en/news/2015/20151120-1.html.

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