

## Client Alert

February 2016

### The New SEB Rule (Article 63 Exemption Rule): Impact on Inbound Fund Business in Japan

#### When the new rule becomes effective?

A new rule on fund business will come into effect in Japan soon, which will have a large impact on fund businesses in the Japanese market. A number of market players have taken note of this movement, and on January 29, 2016 the amendments to the Order for Enforcement of the Financial Instruments and Exchange Act and relevant Cabinet ordinances (the "Amendments") on activities in relation to certain partnership-type funds in Japan, known as Special Exempted Business for Qualified Institutional Investors, etc. ("SEB") ("*Tekikaku Kikan Toushika Tou Tokurei Gyomu*") were finally approved at a Cabinet meeting of the Japanese government. Draft regulations were disclosed by the Japanese Financial Services Agency ("JFSA") on November 20, 2015, and afterward, the agency conducted a public comments process and disclosed various Q&As relating to the Amendments on February 3, 2016. The Amendments have been finalized without any material changes to the draft regulations from November.

The prevailing view among market players in this fund business market is that the Amendments are more stringent. The Amendments provide transitional measures, under which entities such as general partners who filed Article 63 notification in Japan before the effective date of the Amendments may have about six months of "moratorium period", but they are required to submit certain documents and comply with certain disclosure and reporting obligations as part of the transition process by the end of this period.

The Amendments will come into effect on March 1, 2016.

#### Background of the new rule

In principle, under the Financial Instruments and Exchange Act of Japan (the "FIEA"), it is necessary to obtain a license in order to conduct marketing and investment management activities for partnership-type investment funds which have certain connections with the Japanese market and/or investors.

However, the license can be exempted (i.e., is not required) if one or more Qualified Institutional Investors ("QII") invest in the fund and certain other requirements are met, as well as if a simple notification known as Form 20 under Article 63 of the FIEA is filed with the JFSA. As previously mentioned, the exemption rule is called the SEB Rule (or the Article 63 Exemption Rule), and it has been very popular among fund businesses who invest in securities (including trust beneficiary interests and REIT) since such notification is simple and convenient. As a result, now more than 3,000 Japanese and non-Japanese entities are utilizing this exemption. However, the exemption has led to some unfortunate cases of "abuse", targeting unsophisticated individual investors. In order to deal with these, the Japanese government moved forward and amended the relevant requirements.

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## Key features of the new rule

Under the Amendments, certain obligations and restrictions will apply to entities under the SEB Rule, and they will be treated more like licensed Financial Instruments and Exchange Business Operators in Japan. For example, the “suitability doctrine” and the obligation to deliver certain explanatory documents to investors before a transaction is performed will be applicable to such entities. Also, when organizing funds, target investors must be limited to certain sophisticated investors, in addition to one or more QII as explained above. This requirement did not exist before and entities under SEB could invite various investors without restrictions before the Amendments. On the other hand, the new rule also allows certain obligations and restrictions to be exempted with certain thresholds.

It should be noted that certain disclosure and filing obligations of entities under SEB are also introduced, such as the filing of a periodical “business report” with certain designated form on an ongoing basis during the management of the fund. As to Form 20 notification filing, now additional materials are required, such as articles of incorporation (or memorandum of association), certificate of residence and director’s personal CVs. These documents should be available in Japanese language as well for JFSA’s reference.

Under the new SEB Rule, it becomes necessary to appoint a “representative in Japan.” While this phrase was not necessarily clear when first introduced, there was concern whether non-Japanese entities under SEB should always have a registered branch office in Japan going forward. However, according to JFSA’s published Q&A, it has been clarified that a “representative in Japan” can be a “contact point” with Japanese authorities, and therefore, a Japanese lawyer may act as such “representative” for the purpose of the SEB, thus resolving this issue.

We understand that the newly introduced relevant forms for filing are available at Japanese government agencies and should be made in accordance with Japanese legal forms only. In this connection, we will need to keep an eye on the development of practical operations under the new SEB Rule in order to ensure that non-Japanese applicants “fit” the requirements.

## Impact of the new rule and other options

Under the Amendments, any entity that files Article 63 notification for the SEB on and after the effective date, i.e., March 1, 2016, must use the new form of the notification and submit the new required materials. Entities that have filed the notification for the SEB before March 1, 2016 are required to submit the new required attachment documents and make new notifications under the new SEB Rule within the moratorium period, i.e., by September 1, 2016.

As previously mentioned, those who will apply under the new SEB Rule (Article 63 Exemption Rule) should now consider the scope of the new rule and determine whether the possible burden under the new rule is acceptable. Depending on the circumstances, with regard to investments into Japan, it would be advisable to consider various options beforehand, not only the notification under SEB Rule but also other options such as the so-called full delegation exemption, changes to the ratio of fund assets to exempt relevant license requirements, the so-called off-shore fund exemption threshold, etc. We are happy to assist you with practical advice on such options based on our long experiences in this market.

Finally, we believe investments into Japan remain feasible towards the 2020 Olympic Games and beyond, and the Japanese government will continue to welcome investments into Japan from abroad.

If you are interested in more details on this topic, please feel free to contact us.