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Financial Instruments and Exchange Act

Overview

The first key amendment is that the Financial Services Agency of Japan ("**JFSA**") limits the scope of non-Qualified Institutional Investors ("**non-QIIs**") that are allowed to invest in funds under the Article 63 Exemption. Under the Amendment, non-QIIs must be certain sophisticated investors such as the Government of Japan, Bank of Japan, a registered financial instruments business operator ("**FIBO**"), a fund investment management business operator in respect of the Article 63 Exemption ("**Fund Manager**") or someone with a close relationship thereto (including officers, employees, parent companies, subsidiaries, and entities entrusted with asset investment management by the Fund Manager or appointed as investment advisers by the Fund Manager ("**Closely Related Person**")), a stock company with capital of (or net assets equivalent to) JPY 50 million or more, a foreign entity, employees' pension funds or corporate pension funds expected to hold investment assets of JPY 10 billion or more, and certain wealthy individuals who are expected to hold total financial assets of not less than JPY 100 million and who have maintained an account for securities and derivative trading for over a year (collectively referred to as the "**Eligible non-QIIs**"). According to the JFSA FIBO Guidelines, the Fund Manager is required to take necessary measures to confirm its investors' attributes (i.e., whether the investor is a QII or not) and the number of the non-QIIs.

In response to severe criticism from the fund industry that the new requirements for non-QIIs will make it difficult to establish new venture capital funds, the JFSA has relaxed the above regulation for venture capital funds that satisfy the following requirements: (i) they continue to invest more than 80% of their total investment in stocks of non-listed companies; (ii) certain long-term borrowings, as well as providing guarantees, are prohibited; (iii) shares of the funds may not be redeemed during the existence of the funds; and (iv) they have an appropriate internal governance structure and an accounting audit by certified public accountants. Such venture capital funds may accept investments from not only Eligible non-QIIs, but also from certain designated investors including officers of the listed company, the officers of the general partner of the partnership that is expected to hold investment assets of JPY 100 million or more, or persons who have expert knowledge and experience

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and play a significantly important role in the newly established business, M&A, IPO or other business of the relevant company.

The second key amendment is that the Amendment and relevant regulations disqualify certain funds from utilising the Article 63 Exemption, namely in the case where: (i) all QIIs that invest in the fund are investment limited partnerships as prescribed in Article 2, Paragraph 2 of the Limited Partnership Act for Investment and its volume of contributions (excluding the amount of borrowings) do not exceed JPY 500 million; or (ii) the fund receives an investment amount equivalent to more than 50% of its total investments from an individual or entity that qualifies as a Closely Related Person. In addition, the Amendment establishes provisions with regard to grounds for disqualification from the Article 63 Exemption, including: (i) non-Japanese funds that do not have a representative in Japan, and (ii) where the relevant operator relying on the Article 63 Exemption (the "**Exempted Operator**") was subject to an order for the abolition of business or criminal punishment, etc., within the past five years. An entity that falls under any of the grounds for disqualification cannot rely on the Article 63 Exemption.

The third key amendment is that the Amendment strengthens the oversight and regulation of the Exempted Operator, which is now subject to disclosure requirements. The JFSA and the Exempted Operator must each make available to the public certain contents of the filed notification pursuant to the Article 63 Exemption. Furthermore, the Amendment introduces new annual reporting and recordkeeping requirements in relation to the business carried out under the Article 63 Exemption and introduces conduct obligations on the Exempted Operator that are similar to those already applicable to a registered FIBO. For example, the Exempted Operator is required to comply with the duty of loyalty, duty of due care of a prudent manager, advertisement regulation, suitability requirements, obligations to deliver certain contractual documents, segregation of the fund assets, etc.

Finally, the Amendment extends the regulators' enforcement powers and criminal penalties. The enforcement powers include the ability to require the submission of reports; to conduct on-site inspections; and to issue orders to improve, suspend and abolish business operations (as necessary). According to Article 192 of the FIEA, the JFSA can file a petition with the court for an injunction to stop any act in violation of the provisions of the FIEA. If a court that receives a petition from the JFSA finds there is an urgent necessity and believes that it is appropriate and necessary for public interest and investor protection, the court may issue an order to a person who has conducted or will conduct marketing activities in violation of the FIEA to prohibit or suspend such act.

In practice, since the Amendment came into force, the JFSA and the competent Local Finance Bureaus, which serve as the direct contacts for persons that have submitted or will submit the notifications, have started checking in detail the information provided in the notifications. The relevant Local Finance Bureau often has some comments on the submitted documents and sometimes makes requests to modify the documents. As such, a review by the competent Local

Finance Bureau prior to formal submission of the notification is being recommended more and more.

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