



Japan Regulatory Update

Japan

DT Legal Japan

August 18, 2016

On-going Obligations for Article 63 Exemption Operators under the Amended Article 63 Exemption Regime

A. BACKGROUND

As discussed in our prior Client Alerts¹, the amendment to the Financial Instruments and Exchange Act of Japan (the “**FIEA**”) in March resulted in a significant overhaul of the “Exemption for Special Business Activities Directed at Qualified Institutional Investors” (the “**Article 63 Exemption**”) including the implementation of expanded obligations and prohibitions.

Furthermore, in our prior Client Alerts, we have covered the analysis for general partners that currently operate under the Article 63 Exemption (“**Article 63 Exemption Operators**”) to determine whether they need to continue to operate under this specific exemption as well as a summary of the steps that must be taken by Article 63 Exemption Operators should they wish to continue to operate under this exemption by the August 31, 2016 deadline.

This Client Alert will focus on the various new obligations and prohibitions applicable to those Article 63 Exemption Operators who have filed or will file to continue to operate under the Article 63 Exemption.

We believe that this issue may be particularly

relevant as we are aware that certain Japanese institutional investors are contacting the Article 63 Exemption Operators to confirm that such Article 63 Exemption Operator has taken the necessary steps to comply with the new rules of conduct as applicable to it.

We believe that most Article 63 Exemption Operators should have minimal difficulty in complying with these new rules in general. However, as the application of some of the new rules is Japan specific and may not be familiar to the Article 63 Exemption Operators, we recommend that Article 63 Exemption Operators operating under this revised regime seek to properly understand the new rules of conduct as applicable to it.

B. SUMMARY OF OBLIGATIONS AND PROHIBITIONS

The Article 63 Exemption is an exemption available to general partners of limited partnership funds with respect to two financial instruments businesses regulated in Japan: (i) self-offering; and (ii) self-management.

Under the revised Article 63 Exemption regime, Article 63 Exemption Operators marketing their

¹ [“Revisiting the Article 63 Exemption”](#) dated April 14, 2016

[“Immediate Actions to be taken by August 31, 2016 - the Article 63 Exemption”](#) dated July 7, 2016

limited partnership fund interests (“**LP Interests**”) to Japan investors in reliance on the “self-offering” aspect of the Article 63 Exemption will now be subject to rules of conduct that would be applicable to a registered Type 2 financial instruments business operator with respect to marketing activities.² Similarly, under the revised Article 63 Exemption regime, Article 63 Exemption Operators managing the funds of Japan limited partners in reliance on the “self-managing” aspect of the Article 63 Exemption will now be subject to the rules of conduct that would be applicable to a registered investment manager in Japan (an “**Investment Manager**”) to the extent applicable in the nature of its business conduct.³

Below is a brief summary of some of the key new obligations and prohibitions which may be applicable to Article 63 Exemption Operators depending on the type of activity that such Article 63 Exemption Operator is engaged in.

(i) Article 63 Exemption Operators engaging in “Self-Offering” Activities

Some of the new obligations/prohibitions on Article 63 Exemption Operators engaging in “self-offering” activities include:

- Prohibition against providing conclusive evaluations or statements on matters which are uncertain;
- Prohibition against the offering of LP Interests where the relevant limited partnership does not properly segregate the assets contributed by limited partners in the manner prescribed under the FIEA; and
- Prohibition against the offering of LP Interests where the Article 63 Exemption Operator is aware that the funds contributed by the limited partners have been misappropriated.

In light of the nature of the new rules regarding

“self-offering”, we do not anticipate that Article 63 Exemption Operators will have any material difficulty in complying with these new rules of conduct. However, one new obligation that we do wish to highlight is the obligation of the Article 63 Exemption Operator to confirm that the limited partnership is properly segregating the assets of the limited partners. While we recognize that the assets of most, if not all, limited partnerships are properly segregated, the revised Article 63 Exemption regime requires that such segregation obligations be properly documented in certain fund documents.

(ii) Article 63 Exemption Operators engaging in “Self-Management” Activities

Some of the new obligations/prohibitions on Article 63 Exemption Operators engaging in “self-management” activities include:

- Article 63 Exemption Operators having a general fiduciary duty towards its limited partners;
- Duty to manage the relevant assets of the limited partnership to ensure the segregated custody of the assets of the limited partnership; and
- Prohibition against cross-trading between the assets of limited partnerships managed by an Article 63 Exemption Operator or between the limited partnership and the Article 63 Exemption Operator (or its officers).

Furthermore, as noted, each Article 63 Exemption Operator engaging in “self-management” activities is required to comply with most of the rules of conduct and regulations applicable to an Investment Manager. As the rules of conduct applicable to an Investment Manager is quite comprehensive, we would recommend that any Article 63 Exemption Operator engaging in “self-management” activities undertakes some level of

² Specifically, the Article 63 Exemption Operators will need to comply not only with the FIEA but also its subordinate Cabinet Orders as well as the guidelines issued by the Japan FSA.

³ Same as above.

review of its full obligations to ensure that it is complying with these new rules of conduct.

(iii) Article 63 Exemption Operators in General

Lastly, we have provided a brief list of the new obligations applicable to Article 63 Exemption Operators generally under the new regime:

- Duty of good faith towards each of Japan limited partners; and
- Prohibition against engaging in “name lending” activities.

It is important to note that all of these new obligations/prohibitions will be applicable to both new Article 63 Exemption Operators as well as those Article 63 Exemption Operators which re-registered under the new regime.

Lastly, we do recognize that the application of these new obligations/prohibitions may be problematic for an Article 63 Exemption Operator if such obligations/prohibitions are not consistent with the historic operation of the limited partnership for which the Article 63 Exemption Operator acts as a general partner. For example, if prior to the recent amendments, the Article 63 Exemption Operator had been permitted to engage in certain types of cross-trades and investors who had subscribed were aware of this, these new obligations/prohibitions may be deemed as restrictive and altering the agreed permissible conduct of the Article 63 Exemption Operator. In that sense, certain limited partnership funds may need to amend their fund documents to reflect obligations/restrictions imposed under the new regime.

C. CONCLUSION

The revised Article 63 Exemption regime provides new obligations and prohibitions on Article 63 Exemption Operators and we recommend that all Article 63 Exemption Operators take steps to properly comprehend such new obligations and prohibitions which may be applicable to them under the new Article 63 Exemption regime.

The Investment Management Group of DT Legal Japan has extensive experience in advising Article 63 Exemption Operators with respect to navigating the rules of the amended Article 63 Exemption regime and is happy to assist Article 63 Exemption Operators assessing their compliance status under the new rules.

For anyone who did not receive this Client Alert and wishes to be placed on the mailing list for Japan regulatory updates issued by the Investment Management Group of DT Legal Japan or otherwise interested to receive past Client Alerts, please do not hesitate to contact us.

Client Alert Archives

To see past client alerts, please visit our website.

www.deloitte.com/jp/en/legal/client-alerts

Contacts

DT Legal Japan (Tokyo)

Koji Yamamoto, Partner koji.yamamoto@tohatsu.co.jp
Yoshiyuki Omori, Partner yoshiyuki.omori@tohatsu.co.jp

Issued by

DT Legal Japan

Shin-Kokusai Building 2F, 3-4-1 Marunouchi, Chiyoda-ku, Tokyo 100-0005, Japan

Tel : +81 3 6870 3300

Corporate Info.: www.deloitte.com/jp/en/dtlegal

Investment Management Services: www.deloitte.com/jp/en/legal/im

Deloitte Tohmatsu Group (Deloitte Japan) is the name of the Japan member firm group of Deloitte Touche Tohmatsu Limited (DTTL), a UK private company limited by guarantee, which includes Deloitte Touche Tohmatsu LLC, Deloitte Tohmatsu Consulting LLC, Deloitte Tohmatsu Financial Advisory LLC, Deloitte Tohmatsu Tax Co., DT Legal Japan, and all of their respective subsidiaries and affiliates. Deloitte Tohmatsu Group (Deloitte Japan) is among the nation's leading professional services firms and each entity in Deloitte Tohmatsu Group (Deloitte Japan) provides services in accordance with applicable laws and regulations. The services include audit, tax, legal, consulting, and financial advisory services which are delivered to many clients including multinational enterprises and major Japanese business entities through over 8,700 professionals in nearly 40 cities throughout Japan. For more information, please visit the Deloitte Tohmatsu Group (Deloitte Japan)'s website at www.deloitte.com/jp/en.

Deloitte provides audit, consulting, financial advisory, risk management, tax and related services to public and private clients spanning multiple industries. Deloitte serves four out of five Fortune Global 500® companies through a globally connected network of member firms in more than 150 countries bringing world-class capabilities, insights, and high-quality service to address clients' most complex business challenges. To learn more about how Deloitte's approximately 225,000 professionals make an impact that matters, please connect with us on Facebook, LinkedIn, or Twitter.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.