

THE PRIVATE EQUITY  
REVIEW

EIGHTH EDITION

Editor  
Stephen L Ritchie

THE LAWREVIEWS

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REVIEW

EIGHTH EDITION

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# PREFACE

The eighth edition of *The Private Equity Review* follows an extremely active 2018. While the number of global private equity deals completed declined from 2017, the total value of such deals was the highest since 2007, and the third-highest of all time. Deal activity was weighted towards the upper end of the market, and included several large take-private transactions. Fundraising activity was also strong, as institutional investors remained extremely interested in private equity as an asset class because of its strong performance relative to public markets. As a result, private equity funds have significant amounts of available capital, leading to very competitive transactions being completed at increasing purchase price multiples. This has caused private equity firms to become even more creative as they seek opportunities in less competitive markets or in industries where they have unique expertise. Given all of this, we expect private equity will continue to play an important role in global financial markets, not only in North America and western Europe, but also in developing and emerging markets in Asia, South America, the Middle East and Africa. In addition, we expect the trend of incumbent private equity firms and new players expanding into new and less established geographical markets to continue.

While there are potential headwinds – including trade tensions, a slowing Chinese economy, Brexit and an eventual end to one of the longest-running recoveries in US history – on the horizon for 2019 and beyond, we are confident that private equity will continue to play an important role in the global economy, and is likely to further expand its reach and influence.

Private equity professionals need practical and informed guidance from local practitioners about how to raise money and close deals in multiple jurisdictions. This review has been prepared with this need in mind. It contains contributions from leading private equity practitioners in 25 different countries, with observations and advice on private equity deal-making and fundraising in their respective jurisdictions.

As private equity has grown, it has also faced increasing regulatory scrutiny throughout the world. Adding to this complexity, regulation of private equity is not uniform from country to country. As a result, the following chapters also include a brief discussion of these various regulatory regimes.

I want to thank everyone who contributed their time and labour to making this eighth edition of *The Private Equity Review* possible. Each of these contributors is a leader in their respective markets, so I appreciate that they have used their valuable and scarce time to share their expertise.

**Stephen L Ritchie**

Kirkland & Ellis LLP

Chicago, Illinois

April 2019

Part I

# FUNDRAISING

# JAPAN

*Keiko Shimizu*<sup>1</sup>

## I GENERAL OVERVIEW

In Japan, no official statistics are published by any government organisation on the size of the private equity fundraising markets or the number of private equity funds offered in Japan.

Although there are no government-published statistics, the Japanese fundraising markets have remained strong, as the Bank of Japan's negative interest rate policy seems to be pushing Japanese pension funds, financial institutions and other investors in Japan to consider allocating more money to alternative investments (including private equity funds) that have the potential to achieve greater profits than investments in government bonds or other traditional assets. Japan's Government Pension Investment Fund has increased its investment in alternative investments, including private equity funds (both onshore and offshore), and many other pension funds seem to be following this trend.

Private equity funds offered in Japan include funds that make private equity investments in Japan managed by Japan-based fund operators or offshore fund operators, as well as funds that make private equity investments outside Japan managed by Japan-based fund operators or offshore fund operators. Many of the Japan-based fund operators are now launching third, fourth or fifth funds, and new fund operators established by professionals that have spun-off from existing Japan-based fund operators are also launching their new funds. Amid the strong interest in alternative investments by investors, institutional investors have shown increased interest in co-investment deals. Naturally, the high demand and strong interest in alternative investments have increased the diversity of alternative investment funds, and not only traditional buyout or venture capital funds, but also infrastructure funds, real estate funds, funds of funds and other funds with special themes are offered in Japan.

## II LEGAL FRAMEWORK FOR FUNDRAISING

Limited partnerships (LPSs) are the legal structures most commonly used as vehicles for private equity funds offered in Japan – typically offshore limited partnerships organised under foreign law, and limited partnerships for investment business (JLPSs) organised under the Limited Partnership Act for Investment Business<sup>2</sup> in Japan. Historically, private equity funds managed by non-Japanese fund operators have often used Cayman Islands-exempted limited partnerships as the fund vehicles for private equity investments offered to investors in Japan, and Japan-based fund operators have mainly used either Cayman Islands-exempted limited

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1 Keiko Shimizu is a partner at Nagashima Ohno & Tsunematsu.

2 Limited Partnership Act for Investment (Act No. 90 of 1998).

partnerships or JLPSs. These days, an increasing number of non-Japanese fund operators are offering LPSs formed in other offshore jurisdictions to investors in Japan, and an increasing number of Japan-based fund operators are using or considering using JLPSs for offerings to investors in Japan and Cayman Islands-exempted limited partnerships for offerings to offshore investors and Japanese investors who choose to invest through offshore vehicles.

Other possible fund structures under Japanese law include a general partnership (NK) established under the Japanese Civil Code.<sup>3</sup> These alternative vehicles are also pass-through vehicles for Japanese tax purposes but the JLPS is usually the first choice of Japan-based fund operators as it provides limited liability for its limited partners and is treated as a pass-through vehicle for tax purposes. With regard to an NK, on the other hand, its partners' liability in regard to claims against them brought by *bona fide* third parties will not be limited. One disadvantage of the JLPS structure is that the Limited Partnership Act for Investment Business limits the scope of investments that can be made by a JLPS. Generally speaking, a JLPS may not invest more than 50 per cent of its assets in foreign securities (i.e., securities issued by non-Japanese issuers), and because of this restriction a JLPS cannot be used for private equity funds that invest mainly in securities of non-Japanese companies. In this chapter, it is assumed that the fund under discussion is organised as a foreign limited partnership (a foreign LPS) or a JLPS (collectively referred to as LPS funds) unless reference is specifically made to another type of vehicle.

The Financial Instruments and Exchange Act of Japan (FIEA), which is the main statute encompassing securities regulations in Japan that not only sets out the rules for securities offerings but also regulates securities brokers and fund managers, is basically applicable if either an investor of a fund vehicle or the general partner of an LPS fund is in Japan. As a general rule, unless one of the exemptions from registration applies (as discussed below in more detail), a fund operator of a foreign LPS or JLPS will have to be registered as a financial instruments business operator under the FIEA to make an offering of foreign LPS interests or serve as the investment manager of the fund's assets.

### **i General rules for offering of interests in, and conducting investment management of, LPS funds**

Where an offering of LPS fund interests is made in Japan, the entity conducting the solicitation, in principle, is considered to be engaging in the business of offering securities in Japan, and thus is required to be registered as a financial instruments business operator engaging in Type II financial instruments business (Type II registration) under the FIEA. If a general partner of an LPS fund solicits investors in Japan to invest in the LPS fund, the general partner will, in principle, be required to obtain Type II registration. However, if the general partner delegates all solicitation activities to a third party (which, in principle, is required to have Type II registration) and does not itself engage in any solicitation activities, then the general partner does not have to obtain Type II registration.

In addition, in the case of private equity funds, as the assets of the LPS fund will be mainly invested in securities, the general partner will, in principle, be considered to be engaging in investment management business and thus will have to be registered as a financial instruments business operator engaging in investment management business under the FIEA (investment manager registration). Unlike the Type II registration discussed above, the

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3 Civil Code (Act No. 89 of 1896).

general partner, generally, will be subject to the investment management business regulations even if it delegates the investment management authority to another investment manager entirely. This investment manager registration requirement is only triggered when 50 per cent or more of the assets of the LPS fund is invested in securities or derivatives.

## **ii Exemptions from the registration requirements**

The FIEA provides several exemptions from the registration requirements discussed above.

### ***Qualified Institutional Investor special business exemption***

One of the exemptions used by many general partners is an exemption from both the investment management business registration and Type II registration requirements (the Qualified Institutional Investor (QII) special business exemption), which is available to the general partner of a fund structured in the form of a partnership. This QII special business exemption is available when the Japanese investors investing in the LPS fund consist of at least one QII and 49 or fewer non-QIIs who meet the statutory criteria, and the general partner meets certain other criteria (see Section III). This exemption is only available to the general partner and is not available to a third party that has been delegated the responsibility for solicitation of the interests in the LPS fund or the authority to perform the investment management of the fund assets. Therefore, if an investment manager who is not the general partner of the fund vehicle were to engage in solicitation activities in Japan, the investment manager would not be able to qualify for the QII special business exemption and would have to obtain Type II registration, unless other exemptions from registration requirements apply.

If a general partner qualifies for the QII special business exemption, the general partner must file a notification (an Article 63 Notification) with the Local Finance Bureau (and in the case of a foreign general partner, with the Kanto Local Finance Bureau) prior to commencing business in Japan. Also, the general partner who files the Article 63 Notification will be subject to certain compliance requirements (including the appointment of an agent or representative in Japan and, in the case of a foreign general partner, adherence to certain code-of-conduct rules and disclosure requirements, and maintenance of certain statutorily required books and records).

Requirements for the QII special business exemption were substantially amended, with effect from 2016. The requirements and regulations applicable to the QII special business exemption following this amendment are outlined and discussed in Section III below.

### ***Outsourcing of solicitation activities***

Although not strictly an exemption from the registration requirements, as discussed above, if a general partner outsources marketing activities entirely to a third party (usually a firm with a Type II registration) and does not engage in any solicitation activities by its own actions, then the general partner is not required to have Type II registration and does not have to concern itself with exemptions from registration requirements. This means that if a general partner does not engage in any solicitation activities in Japan by its own actions by engaging a private placement agent, there is no requirement for the general partner to file Article 63 Notification prior to accepting investors in Japan. However, it should be noted that the definition of solicitation that triggers the registration requirement under the FIEA is broad, so if the general partner has direct communications with a potential investor or investors, those communications may be considered solicitation if the communications relate to the fund or a potential investor's possible investment in the fund.

***Foreign fund or de minimus exemption for investment management***

For foreign LPSs, there is a special exemption from the investment management registration requirement (the foreign fund exemption, often also referred to as the *de minimus* exemption). In essence, this exemption is available when: (1) the fund's direct investors in Japan are limited to QIIs and persons who have submitted an Article 63 Notification with respect to the investment management of the fund; (2) the fund's indirect investors who invest through partnerships formed under Japanese law (indirect investors) are limited to QIIs; (3) the fund has fewer than 10 direct and indirect investors in Japan in total; and (4) the amount invested by the fund's direct investors in Japan is one-third or less of the total amount invested by all investors in the fund. With reference to the foreign fund exemption (*de minimus* exemption), a direct investor is a resident of Japan who directly holds interests in a foreign LPS, and an indirect investor is a resident of Japan who holds interests in partnerships formed under Japanese law (such as a fund of funds formed under Japanese law, including a JLPS, NK, TK or LLP) that hold interests in a foreign LPS.

***Outsourcing of investment management activities to investment managers registered under the FIEA***

The general partner may be exempted from the above-mentioned investment manager registration requirement by outsourcing all the investment management activities to an investment manager who has investment management business registration under the FIEA, subject to certain additional requirements. These requirements include the filing of a notification by the investment manager, and certain limited information concerning the LPS fund and its general partner must be included in the notification.

**iii Private placement rule**

For an offering of interests in an LPS fund that invests more than 50 per cent of its contributed funds in securities or derivatives, a public offering process (which includes the filing of a securities registration statement) must be followed unless the private placement requirements under the FIEA are satisfied. The private placement requirements for interests in partnerships mandate that fewer than 500 investors in Japan should acquire and hold the interests of the partnership as a result of an offering. As long as fewer than 500 investors in Japan ultimately acquire the interests as a result of the offer, the number of offerees may be 500 or more. In the case of private placement of securities, the general partner (or a third party conducting the solicitation) must notify the investors in writing that the offering meets the requirements for a private placement of the LPS fund interests and, accordingly, is not being registered under the FIEA, and that the LPS fund interests fall under a certain right provided in a certain provision of the FIEA ('the rights set forth in Article 2, Paragraph 2, Item 6 of the FIEA', in the case of interests in foreign LPS funds). This document must be delivered to the investor concurrently with or prior to the investor's acquisition of the LPS fund interests.

**iv Use of a JLPS**

The Ministry of Economy, Trade and Industry (METI) has published on its website a model limited partnership agreement for a JLPS. According to METI, the model limited partnership agreement was prepared based on its research of terms contained in both onshore and offshore limited partnership agreements, and with an objective of having the key terms of the model



limited partnership agreement be consistent with those found in similar agreements used in other jurisdictions. In light of the existence of this model limited partnership agreement for a JLPS, Japan-based general partners who choose to use JLPSs tend to use this model agreement as the basis for preparing their limited partnership agreements, but experienced fund sponsors tend not to rely so much on the model agreement. Also, the most recent version of the model limited partnership agreement for a JLPS is intended to be a model for venture capital funds to be formed in Japan, and the sample terms in the model limited partnership agreement would have to be carefully reviewed and modified depending on the type of the fund. Moreover, there is an increasing trend to use offshore limited partnerships as an alternative fund vehicle for investments by non-Japanese investors, and when this parallel fund structure is employed, the terms regarding the JLPS tend to be adjusted to substantially match the terms regarding the parallel fund. Non-Japanese fund operators do not usually use a JLPS as a fund vehicle for investors in Japan, but rather utilise non-Japanese limited partnerships as fund vehicles for offerings to investors in Japan.

### III REGULATORY DEVELOPMENTS

In response to the rising number of incidents that led the Japanese regulatory authority to conclude that the QII special business exemption did not provide sufficient protections for some investors, the Diet substantially amended the regulations addressing the QII special business exemption. Under the amendment that came into effect in 2016, the qualifications and requirements imposed on fund operators engaging in solicitation of investors or management of fund assets under the QII special business exemption (such as businesses covered under the QII special business exemption, i.e., specially permitted businesses) were significantly strengthened. Many of the compliance requirements, such as adherence to certain code-of-conduct rules, record-keeping requirements and public disclosure requirements that were previously only applicable to firms with Type II registration or investment manager registration status became applicable to fund operators engaging in a specially permitted business.

#### **i Requirements for the QII special business exemption**

For a general partner to qualify for the QII special business exemption, in addition to other requirements, the LPS fund must meet the criteria stipulated in items (a) to (f) below (although the criteria set out at (e) and (f) only apply if the general partner is seeking exemption from the Type II registration requirements):

- a* at least one of the investors in Japan, other than the general partner, is a QII;
- b* the number of non-QII investors in the fund in Japan is 49 or fewer;
- c* the non-QII investors satisfy certain criteria (non-QII investors that satisfy these criteria are termed 'qualified purchasers');
- d* in the case of certain fund of funds, subject to certain exceptions (such as where a sub-fund is a limited partnership and the total number of non-QII investors in Japan in the fund and the sub-fund is 49 or fewer), no non-QII investor is an investor in any of the sub-funds of the fund;
- e* the offering of the LPS fund interests qualifies as a private placement; and
- f* the limited partnership agreement or the subscription agreement provides that (1) if an investor is a QII, it may not transfer any interest to a non-QII, and (2) if an investor is

a non-QII, it may only transfer interests to a qualified purchaser or a QII, and may not transfer interests to any other person unless it transfers all its interests at once to that person in a single transfer.

Even where the private equity fund vehicle is an employee fund or a general partner carry vehicle, if any of the officers or employees investing in the vehicle are based in Japan, the fund vehicle must be eligible for the QII special business exemption.

## **ii Disqualifying certain fund operators**

Additionally, to qualify for and benefit from the QII special business exemption, certain criteria apply for fund operators (i.e., the general partner in the case of a limited partnership); for example, if the only QII investing in the fund is a JLPS, the fund operator of that fund will not be able to qualify for the QII special business exemption unless the JLPS satisfies a certain asset value threshold requirement. In addition, a fund operator will not be able to take advantage of the QII special business exemption if 50 per cent or more of the capital contribution in the LPS fund is made by investors who have close relationships (as defined in the FIEA) with the fund operator (with certain exceptions). Based on this rule, certain employee funds or carry vehicles may be disqualified from the QII special business exemption.

## **iii Disqualifying certain non-QIIs**

Investors that may invest in a particular fund qualifying for QII special business exemption are limited to QIIs and 49 or fewer qualified purchasers, provided certain other criteria are satisfied. Qualified purchasers are specifically listed in the applicable regulation, and include, among others, the following:

- a* financial instruments business operators registered under the FIEA;
- b* those having a close relationship with the relevant fund operator;<sup>4</sup>
- c* listed companies;
- d* corporations whose net asset value or capital is at least ¥50 million;
- e* subsidiaries or affiliates of (a), (c) or (d) above;
- f* domestic pension funds and foreign pension funds with investment-oriented financial assets<sup>5</sup> totalling ¥10 billion or more;
- g* foreign entities;
- h* individuals with investment-oriented financial assets<sup>6</sup> totalling ¥100 million or more and who have held a securities account for more than one year;
- i* corporation with investment-oriented financial assets<sup>7</sup> totalling ¥100 million or more;

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4 “Those having close relationship with the relevant fund operator” include, among others: directors and employees of the fund operator; the parent, subsidiary and brother or sister companies of the fund operator; the investment adviser or manager of the relevant fund; and the directors and employees of the parent, subsidiary or brother or sister companies of the fund operator or investment adviser or manager of the fund.

5 ‘Investment-oriented financial assets’ include instruments such as securities, derivatives and derivative deposits, but do not include cash, ordinary deposits and real estate.

6 Ibid.

7 Ibid.

- j* general partners of partnerships who hold investment-oriented financial assets totalling ¥100 million or more; and
- k* foreign funds in the form of partnerships.

#### **iv Filing of an Article 63 Notification**

The general partner of an LPS fund who wishes to engage in a specially permitted business and to qualify for the QII special business exemption is required to file an Article 63 Notification (or Form 20) prior to accepting subscriptions from investors in Japan. The Article 63 Notification may be prepared in English and must include certain information concerning the general partner, such as its name, the amount of its stated capital, the names of its officers and certain key employees, and the location of its principal office (also, if the business operation is delegated to a third party, information concerning the third party is to be provided) and, in the case of a foreign fund operator, the name of its representative or agent in Japan. The Article 63 Notification must also include the name of the fund, a brief description of the investments made by the fund and the number, names and types of all the QIIs investing in the LPS fund. This notification must be updated on an ongoing basis if there is any change to the information contained in the notification.

A foreign fund operator must appoint a representative or agent in Japan in advance of the filing. The designated representative or agent in Japan will be the authorised contact person for the foreign fund operator if the Japanese regulators wish to contact the foreign fund operator. In addition, as noted below, a general partner who files the Article 63 Notification is subject to certain public disclosure requirements, and foreign fund operators without an office in Japan are expected to make the necessary public disclosures on a website. The address of the web page where the public disclosures are to be made must also be included in the Article 63 Notification filed by any such foreign fund operator.

#### **v Application of certain code-of-conduct rules under the FIEA**

Certain codes of conduct rules that apply to firms with Type II registration or investment manager registration status are applicable to fund operators who filed the Article 63 Notification. Some of the code-of-conduct rules applicable to fund operators include: duty of good faith, prohibition on name lending, regulations on advertising, etc., delivery of document prior to conclusion of contract, delivery of document upon conclusion of contract, etc., prohibition on providing false information, prohibition on providing conclusive evaluations, prohibition on providing special benefits, prohibition on loss compensation, principle of suitability, segregation of assets, and prohibition on offerings, etc. when the fund operator uses the fund assets for other purposes.

Some of the codes of conduct rules that are only applicable to investment management of fund assets include: duty of loyalty and duty of prudent manager, prohibition on trading with itself, prohibition on trading between assets managed by itself, prohibition on loss compensation, segregation of assets, and preparation and provision of investment report.

Some additional notes regarding the prohibitions or requirements are set out below.

#### ***Segregation of assets***

The requirements for segregation of assets that apply to offering of interests and investment management of fund's assets are different. The requirements for segregation of assets that apply to offering of interests focuses on segregation of cash and must be expressly stated in the

partnership agreement or other fund-related agreement (such as the subscription agreement). The segregation of assets that apply to fund operators with respect to the investment management of fund's assets applies not only to cash but also to securities in the fund assets.

### ***Professional investor and non-professional investor***

Fund operators must confirm whether an investor is a QII or a non-QII, and if the investor is a non-QII who is a qualified purchaser, they must further confirm whether the investor is a professional or non-professional investor. A professional investor as defined in the FIEA includes, among other things, a QII, a listed company, a Japanese *kabushiki kaisha* (a joint-stock company, as defined under the Companies Act of Japan) whose capital is reasonably anticipated to be ¥500 million or above, a financial instruments business operator registered under the FIEA, a legal entity that has filed the Article 63 Notification, and a foreign entity. In addition, the fund operator must notify each professional investor that is not a QII that investors may choose to be treated as non-professional investors. Certain code-of-conduct rules (such as regulations on advertising, the requirement to deliver certain documents prior to the conclusion of a contract, the requirement to deliver certain documents upon the conclusion of a contract, etc., the principle of suitability, and the requirement to deliver a statutory performance report) do not apply in relation to an investor who is a professional investor.

### ***Record-keeping obligations***

Fund operators who have filed the Article 63 Notification are required to prepare and maintain certain books and records that include matters required under the FIEA and its subordinated regulations. These include customer ledgers, transaction records and copies of certain statutory documents.

### ***Annual business report filing requirement***

Each fund operator who has filed the Article 63 Notification must file a business report (Form 21-2) for each fiscal year, within three months of the end of the fiscal year. The annual business report may be prepared and filed in English and must include the financial statement of the fund operator. Please see below for the public disclosure requirement of certain matters included in the business report.

### ***Public disclosure requirements***

A fund operator who has filed the Article 63 Notification is subject to two different public disclosure requirements: (1) one requiring the fund operator to disclose certain information included in Article 63 Notification, and (2) the other requiring the fund operator to disclose an explanatory document, which is a document that contains certain (but not all) information included in the annual business report.

### ***Public disclosure of matters included in the Article 63 Notification***

Matters included in the Article 63 Notification other than the names of the QIIs and the identity of the representative or agent in Japan of a foreign fund operator must be disclosed to the public by making them available at the fund operator's principal place of business and at all the offices that engage in the specially permitted business, or on the website of the fund operator. If the fund operator does not have any office or place of business in Japan,

the fund operator must make the disclosure on a web page or through other means that can be easily accessed by investors in Japan. The responsibility for making of this public disclosure can be delegated by the fund operator but the fund operator must take appropriate measures to ensure that investors can easily find where the public disclosure is made. This public disclosure may be made in English.

*Public disclosure of the explanatory document*

The fund operator is required to prepare an explanatory document (Form 21-3) that includes certain information included in the annual business report, and disclose the explanatory document to the public by making it available at its principal place of business and at all offices that engage in the specially permitted business, or on the website of the fund operator. The financial statement of the fund operator that is attached to the annual business report is also a part of the explanatory document and must be publicly disclosed. The timing and method by which a foreign fund operator is to make such a disclosure are the same as those for the public disclosure of matters included in the Article 63 Notification. The explanatory document may be prepared in English.

*Increased oversight and enforcement by the regulator*

Under the FIEA, the Japanese regulator is vested with enhanced oversight authority over fund operators. For example, the regulator may issue an administrative order against a fund operator ordering the operator to improve, suspend or discontinue its business operations with respect to a specially permitted business, and the regulator may instruct the fund operator to submit reports or allow the regulator or its designee to conduct on-site inspections when it deems necessary to protect the interests of investors. In addition, the amendments that came into effect in 2016 introduced more severe penalties to be imposed on fund operators who fail to make the required notifications or who file false notifications.

## **IV OUTLOOK**

The regulatory environment for fund operators without Type II registration or investment manager registration status changed substantially in 2016 following the amendments to the FIEA concerning the QII special business exemption. We see more and more foreign fund operators choosing to benefit from the foreign fund exemption so that maintenance of Article 63 Notification is not required after fundraising is completed, thus avoiding both public disclosure of the explanatory document and having to comply with various compliance requirements under the FIEA. Although Japanese regulators have been actively conducting on-site inspections of fund operators that have problematic operations, the extent to which regulators are likely to actually require and conduct on-site inspections of fund operators generally is still not clear.

Fund operators intending to benefit from the QII special business exemption should carefully consider whether they can comply with the applicable Japanese regulations and should also carefully examine whether other exemptions from registration requirements available under Japanese law may apply, prior to filing the Article 63 Notification. We expect that more fund operators who have filed the Article 63 Notification will be keen to submit a notification to discontinue their specially permitted businesses where possible.

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