

# Japan

## Regulation

HEDGE FUNDS 2009

### Hedge fund managers/advisors

#### Regulation

##### Authorization requirements and process

There is no specific legal definition of the term hedge fund in Japan. However, many hedge funds have features of collective investment schemes (CIS) and are regulated as CIS under Japanese legal framework.

Authorization requirements for hedge fund managers/advisors depend on what licenses they believe they need to carry out their business. Most hedge fund managers/advisors register as investment advisors.

If a hedge fund is structured as an investment trust or a discretionary investment fund, the brokerage firms and the registered financial institutions that offer and sell interests in the fund and investment trust managers as well as licensed investment advisors that make investment decisions, must comply with legal restrictions on their activities to protect investors.

Other types of hedge funds are regulated by Financial Products Trading Law of Japan. This law treats hedge funds as deemed securities and therefore subject to the rules associated with these securities.

##### Regulatory capital requirements

The minimum regulatory capital and net worth requirements for a licensed discretionary investment company is JPY 50 million.

##### Significant restrictions on marketing to investors

A company needs a Type 1 or Type 2 brokerage license to offer or sell hedge fund interests products and must comply with the related regulations. A fund needs a Type 2 brokerage license if it is a CIS.

Private CIS offerings only to qualified institutional investors do not require registration if they are a direct issue of the fund. Restrictions on sales and offers are also relaxed.

### Hedge fund structures

#### Regulation

##### Authorization requirements

Hedge funds may use an investment trust structure in Japan which requires that most investments be in specific assets such as, securities, real estate, and derivatives. If investment in securities exceeds 50 percent of total investment trust assets, the investment trust is regarded as a securities investment trust. Public and privately offered securities investment trusts may not invest in a fund of funds, use borrowed money to repay investors who cancel their investment, or pay dividends on certain investment trusts. Privately offered funds are not subject to public restrictions on short selling or repurchase transactions.

##### Restrictions on types of investments, concentration levels, and the manner in which hedge funds can invest and/or strategies

Short selling restrictions require that funds disclose whether or not they own the securities when they are sold on the stock exchange. Since this includes both their own securities and customers' securities the investment fund manages, fund managers must ask if the transaction is a short sale when selling securities at a customer's request. Restrictions on the short selling price require that the price can't be below the most recently quoted price on the securities exchange.

In publicly offered funds, the net worth of the investment trust assets must exceed the total of:

- fair value of the securities acquired under credit transactions;
- fair value of borrowed shares; and
- fair value of borrowed bonds.

The FSA and SESC regulate the kind of securities the trust can hold, the acquisition of shares and transactions in futures for securities investment trusts and funds of funds.

### Accounts and prospectus publishing rules

Funds must file an annual disclosure report in a prescribed format. Other reporting and the contents of the disclosure under the FIEL depends on the kinds of licenses that the fund holds. In practice, however, it is possible to structure vehicles that require limited or no disclosure. Contracts between the fund and the investors, rather than regulations generally govern fund disclosures.

### Investors

### Regulation

#### Restrictions on which type of investors can invest in a hedge fund and/or the minimum/maximum number of investors in a hedge fund

There are no restrictions on the investors in a fund. However, the fund has the responsibility to perform due diligence on its investors. Investors may be classified as qualified institutional investors (QII), amateur investors, professional investors, or professional investors who choose to be classified as amateurs.

A fund serving Qualified Institutional Investors needs at least one QII. A fund that serves only non-QII investors is limited to 50 investors or less.

The Financial Instrument and Exchange Law is designed to protect Japanese investors and therefore funds with Japanese investors get more scrutiny in connection with licensing than funds who restrict their investors to non-Japanese.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.