

Overview of the Asset Management Task Force Report (Published on December 12, 2023)

Finance Law Newsletter

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1. Publication of Asset Management TF Report

On December 12, 2023, the Asset Management Task Force of the Financial System Council (the “Asset Management TF”) and the Working Group on Capital Market Regulations of the Financial System Council (the “Capital Market Regulations WG”) jointly compiled and published the “Report of Working Group on Capital Market Regulations and Asset Management Task Force of the Financial System Council” (the “Asset Management TF Report” or “the report”).¹ The Asset Management TF was established under the Capital Market Regulations WG on October 3, 2023, under circumstances wherein the realization of the promotion of Japan as a leading asset management center is the government’s major policy issue, in order to carry out expert discussions, including regarding an institutional framework for asset management. The government’s policy plan for realization of promoting Japan as a leading asset management center is scheduled to be arranged within the year mainly by the Subcommittee for Promoting Japan as a Leading Asset Management Center of the Council of New Form of Capitalism Realization, among which the matters under the jurisdiction of the Financial Services Agency were deliberated by the Asset Management TF. The Asset Management TF Report summarizes the discussion results deliberated at all four meetings by the Asset Management TF from October 2023 to November 2023 (one meeting among them is a joint meeting with the Capital Market Regulations WG).

This newsletter provides an overview of the Asset Management TF Report, focusing on recommendations that are expected to affect the business practices in the financial field. As the author, I would like to hereby mention that although I am a member of the Capital Market Regulations WG and the Asset Management TF, opinions in this newsletter are my own views and do not represent the views of the Capital Market Regulations WG, Asset Management TF, or other organizations.

¹ https://www.fsa.go.jp/en/refer/councils/singie_kinyu/20231213.html

2. Overall picture of the Asset Management TF Report

The composition of the Asset Management TF Report is as follows:

[Composition of the Asset Management TF Report]

<p>I Introduction</p> <p>II Toward Promotion of Japan as a Leading Asset Management Center – Basic Idea –</p> <p>III Enhancement of Asset Management Business</p> <p>1. Enhancement of the asset management capability and improvement/reinforcement of governance in major financial groups</p> <p>2. Ensuring product governance of asset management companies</p> <p>3. Promotion of new entries into the asset management business</p> <p>IV Strengthening of Asset Owners’ Capabilities</p> <p>V Efforts Toward Effective Implementation of Stewardship Activities</p>	<p>VI Realization of Financing for Growth and Diversification of Investment Opportunities</p> <p>1. Issues concerning venture capital</p> <p>2. Encourage investment trusts and investment corporations to invest in unlisted equities</p> <p>3. Development of public offering/private placement systems and investment-type crowdfunding systems</p> <p>4. Vitalization of unlisted securities transactions</p> <p>5. Development of disclosure regulations concerning stock-based compensation</p> <p>6. Diversification of investment instruments</p> <p>VII Conclusion</p>
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As shown above, the Asset Management TF Report summarizes basic ideas concerning a policy plan seeking promotion of Japan as a leading asset management center, and also summarizes discussions and recommendations concerning various policy issues in four sub-sections: (i) “Enhancement of Asset Management Business,” (ii) “Strengthening of Asset Owners’ Capabilities,” (iii) “Efforts Toward Effective Implementation of Stewardship Activities,” and (iv) “Realization of Financing for Growth and Diversification of Investment Opportunities.” It should be noted that although the contents of the Asset Management TF Report are mainly related to the asset management field, recommendations for financing for growth are included in the “Realization of Financing for Growth and Diversification of Investment Opportunities” sections.

The contents of the Asset Management TF Report are sorted into items: (a) Recommendations for Development of Systems Accompanied by Revisions of Laws and Regulations, and Soft Laws, (b) Recommendations for Market Players’ Efforts, and (c) Institutional Issues Continued to be Discussed, and overviews thereof are provided below.

3. Recommendations for Development of Systems Accompanied by Revisions of Laws and Regulations, and Soft Laws

(1) Ensuring product governance of asset management companies

To encourage appropriate formulation and management of financial instruments, as well as ensure transparency, suitable asset management company product governance descriptions should be included in the Principles of Customer-Oriented Business Operations, and a governance system that allows such companies to manage the quality of individual financial instruments should be established.

(2) Relaxation of requirements for entry into the investment management business

Registration requirements for investment management businesses (capital, system development, etc.) should be relaxed in cases where a business operator seeking to enter the investment management business outsources middle- and back-office operations to an outsourcee registered as described in (3) below, or in cases where the business operator does not receive money or other deposits by itself, in principle.

(3) Outsourcing services for middle- and back-office operations

A voluntary registration system regulation (that “provides an option” to register) should be introduced for business operators who accept outsourcing of all or part of middle- and back-office operations of an investment management business, and registered outsourcees should be subject to conduct regulations (e.g., duty of due care of a prudent manager, etc.), as well as the supervision of the authority, while a system to relax the requirements for entry into the investment management business be introduced for business operators who outsource middle- and back-office operations to registered outsourcees as described in (2) above.

(4) Entrustment of all authority for giving investment instructions

Under existing laws, it is prohibited for investment management business operators to entrust to an outside party all authority for giving investment instructions (Article 42-3, paragraph (2) of the Financial Instruments and Exchange Act (the “FIEA”), Article 12, paragraph (1) of the Act on Investment Trusts and Investment Corporations (the “Investment Trust Act”)); however, a necessary system for management of the trustees should be developed and provisions that prohibit the entrustment of all authority for giving investment instructions should be rectified.

(5) Principles for venture capital funds

In light of the circumstances surrounding start-up companies in Japan and global business practices, etc., it is recommended to formulate Venture Capital Principles (tentative name) that aim to enhance governance, etc., for entire venture capital fund (VC) financing from wide range of institutional investors.

(6) Vitalization of listed venture funds

Toward vitalization of the use of the Tokyo Stock Exchange's venture fund market, it is recommended that (i) the Tokyo Stock Exchange discuss the details and frequency of information disclosure in light of the differing nature of listed and unlisted companies, and that (ii) investment corporations be allowed to acquire their own investment units, subject to insider trading regulations.

(7) Simplification of disclosure on small amount public offerings

Under the FIEA, matters to be stated in a securities registration statement for public offerings of securities with financing amounts between 100 million and 500 million yen for 50 or more general investors (small amount public offerings) have been simplified; however, further simplification should be promoted.²

(8) Vitalization of investment-type crowdfunding

Under the FIEA, a framework of regulations on small amount electronic public offering services has been established for crowdfunding (CF) service providers; however, from the viewpoint of the vitalization of investment-type CF, it is recommended that (i) the limitation on (a) the total amount of issuable securities and (b) the investment limit of general investors under the small amount electronic public offering services be relaxed,³ and that (ii) only when there is a request from an investor, the investment-type CF, in which solicitation by phone calls, visits, or the like is prohibited by self-regulating rules, be allowed to be explained by voice calls to a certain extent.

On the other hand, some institutional investors dislike a large number of individual shareholders, and believe that as the number of individual shareholders grows, the smooth business operations of the equity investment-type CF may become difficult. It also is noted that it may be difficult for startup companies to receive financing from institutional investors in the future. Therefore, it may be appropriate for CF service providers to take measures, such as confirming whether startup companies appropriately understand the above-mentioned possibilities, and that the authority monitor whether CF service providers appropriately conduct business operations.

² Specifically, it is recommended that, for example, (i) statements of sustainability information be made voluntary, (ii) statements in financial statements for the most recent five (5) business years be changed to those for the most recent two (2) business years, and (iii) certain non-financial information be presented to the same extent as matters stated in business reports under the Companies Act.

³ Specifically, it is recommended that (a) the total amount of issuable securities under small amount electronic public offering services that is stipulated as less than 100 million yen per year be raised to less than 500 million yen per year, and that (b) the investment limit of general investors under small amount electronic public offering services that is stipulated as 500,000 yen per year for each investee be revised so that the investment limit is stipulated depending on the annual income or net assets of each investor. In addition, it is also recommended that (c) if a private placement with professional investors is conducted as a small electronic public offering service, instead of setting the maximum total amount of issuable securities to less than 500 million yen combined with the amount by a solicitation for investors including general investors, a certain maximum amount be set separately.

(9) Relaxation of requirements for entry of financial instruments business operators that engage in brokerage business for unlisted securities targeting professional investors

The registration requirements, etc., for the type I financial instruments business (capital regulations, capital adequacy ratio, regulation on concurrent business, etc.) should be relaxed when the requirements (including the following) are satisfied: (i) a financial instruments business operator specializes in brokerage business for primary transactions and secondary transactions of unlisted securities; (ii) in principle, a financial instruments business operator's counterparties are limited to professional investors;⁴ and (iii) in principle, a financial instruments business operator does not accept deposits of securities or money.

(10) Relaxation of requirements for entry into PTS business only handling unlisted securities

Under existing laws, an entity is required to obtain authorization if it conducts PTS (proprietary trading system) services (Article 30, paragraph (1) of the FIEA). However, it is recommended that, on the premise that regulations necessary for the management, etc., of transactions are applied, a financial instruments business operator be allowed to enter into PTS business (handling only unlisted securities for which the liquidity or transaction scale, etc., is limited) under the registration system for the type I financial instruments business without authorization, and that property regulations, such as requirements for capital or net assets or system-related requirements, etc., be relaxed for such PTS business.

(11) Development of disclosure regulations concerning stock-based compensation

For post-delivery type stock-based compensation, such as RSU (restricted stock unit), PSU (performance-based share unit), and share delivery trust, it is recommended that (i) regarding the "act of setting out and notifying directors, etc., of stock-based compensation rules, etc.," when stock-based compensation is introduced as the first step of solicitation for the acquisition of securities, such act be recognized to be subject to a public offering or secondary distribution of securities, and that (ii) special provisions allowing submission of an extraordinary report instead of submission of a securities registration statement be established in the same way as stock options and RS (restricted stock).

(12) Facilitation of the issuance of foreign-currency-denominated domestic bonds (i.e., Origami bonds)⁵

From the viewpoint of promoting an environment for efficient and safe issuance and distribution of foreign-currency-denominated domestic bonds, on the premise that (i) the bonds are available for a limited scope of investors with high capabilities of risk-judging and (ii) domestic account

⁴ It is considered appropriate that sales by general investors in a certain range, such as founders of companies issuing unlisted securities, be allowed.

⁵ "Origami bonds" are described as a name of services related to foreign-currency-denominated domestic bonds provided by Euroclear Bank, which is a foreign account management institution.

management institutions, etc., that open investor accounts, appropriately explain to investors that, depending on the investors' attributions, etc., the framework covering erroneous descriptions, etc., does not apply to foreign account management institutions, it is recommended to allow domestic account management institutions to be established under foreign account management institutions so that domestic investors may more widely use DVP (delivery versus payment) settlement platforms for foreign currency operated by foreign account management institutions.

(13) Clarification of the standard concerning material revisions to the basic terms and conditions for an investment trust

Under the Investment Trust Act, legal procedures are provided for cases where there is any "material revision" to the basic terms and conditions for an investment trust, and it is stipulated that the standard is that the material revision is a revision which "changes its basic characteristics as a financial instrument" (Article 17, paragraph (1) of the Investment Trust Act, Article 29 of the Regulation for Enforcement of the Act on Investment Trusts and Investment Corporations). In this regard, the authority published a "Q&A regarding investment trusts" in which cases considered not to be subject to "a material revision" are provided as specific examples for each type. On this point, it is recommended that the Q&A be further clarified, for example, regarding revisions contributing to customers' interests.

(14) Raising the upper limit for cumulative investment contracts with credit card settlement

Under the FIEA, a purchase of securities through credit card settlement is only allowed subject to certain requirements.⁶ Considering that the new NISA system will be launched, and the installment-type investment limit will be raised to 100,000 yen per month if the investment is made under a monthly cumulative investment contract, a requirements review should be conducted concerning credit card settlement amounts so that the investment of 100,000 yen per month will be possible in practice.

4. Recommendations for Market Players' Efforts

(1) Enhancement of the asset management capability and improvement/reinforcement of governance in major financial groups

While major financial groups play a large role in asset management, there is concern that financial instruments may have been formulated and/or managed with priority being given to sales promotion rather than customers' interests. Moreover, it is important for major financial groups to clarify the positioning of the asset management business within the group from the

⁶ All of the following requirements are required to be satisfied: (i) the payment is made in the following month in a lump sum; (ii) the credit amount does not exceed 100,000 yen; and (iii) the purchase is made under the cumulative investment contract (Article 148 of the Cabinet Office Order on Financial Instruments Business, and other relevant provisions). However, with respect to requirement (ii) for the credit amount, in light of the settlement cycle in credit card companies, it is stipulated that the investment limit per month be generally limited to 50,000 yen in current business practices.

viewpoint of management strategy and to formulate and publish plans to improve and reinforce governance for business operations in consideration of improving asset management capability and pursuing customers' best interests.

(2) Support program for emerging managers (Japanese EMP (Emerging Managers Program))

Acknowledging that it is difficult to acquire operating funds (seed money) when launching a new asset management business, because new entrants have no track records, programs for the facilitation of emerging manager financing (via public and private sector cooperation) should be formulated to develop an environment in which financial institutions and asset owners can realize the best interests of beneficiaries through emerging manager asset management outcomes.⁷

(3) Promotion of single-check calculation of investment trust net asset values

As a business practice in Japan, so-called double-check calculations are carried out for investment trust net asset values in which the values are calculated by both an asset management company and an entrusted company so as to be cross-checked. However, considering that it is pointed out that such practice may be a factor in additional costs or entry barriers for investors, it is stated that the industry is expected to work together on environment development, etc., with the "Study Panel of Officials on Net Asset Value Calculation" established by the Investment Trusts Association, Japan playing a central role, for the realization and dissemination of single-check calculations.

(4) Clarification of materiality policy for investment trusts⁸

It is recommended that it is appropriate to specify in the supervisory guidelines, etc., that, when an asset management company establishes a materiality policy for investment trusts, the company needs to set appropriate standards, and that it is important to familiarize investors with the policy. In addition, it is stated that in formulating a materiality policy, it is desirable for an asset management company to determine a general idea concerning standards, etc., with the involvement of management, and to present the general idea to investors.

(5) Strengthening of asset owners' capabilities

It is stated that reform of asset ownership, which is being discussed by the Subcommittee for Promoting Japan as a Leading Asset Management Center established under the Council of New

⁷ Specifically, as the Japanese EMP, it is recommended that (i) financial institutions and asset owners manage assets actively utilizing emerging managers, or widely add emerging managers to options to entrust asset management without excluding the emerging managers simply because of their short business history, and that (ii) the government, etc., publish various efforts toward utilizing emerging managers or make efforts such as providing a list of emerging managers for financial institutions and asset owners.

⁸ It is described that the materiality policy for investment trusts is to correct net asset values of investment trusts in cases only where there is a mistake in the calculation of net asset values, the degree of which is material, exceeding a certain standard.

Form of Capitalism Realization, is expected to show concrete progress.⁹ Moreover, in line with the strengthening of asset owners' capabilities, financial institutions supporting asset owners' management also are required to make efforts to ensure the best interests of the asset owners, the customers, and households, the ultimate beneficiaries.¹⁰

(6) Efforts toward effective implementation of stewardship activities

As examples of efforts toward effective implementation of stewardship activities through engagement by institutional investors, the report highlights movements aimed at raising the overall market level and at diversification and enforcement of approach methods for stewardship activities by adopting a passive management model focusing on stewardship (a compensation system different from normal passive management), efforts toward engagement by multiple investors to hold collaborative discussions with corporations, and efforts by multiple asset owners to collaboratively monitor asset management institutions. As the number of investors making such various efforts grows, effective implementation of stewardship activities is expected to develop further.¹¹

(7) Promotion of fair value measurement for venture capital funds

There are advantages to introducing fair value measurement for VC funds, for example, expansion of fund scale through financing from overseas investors and enhancement of transparency in securities valuations; accordingly, the development of an environment that continuously promotes fair value measurement should proceed promptly.

(8) Incorporation of unlisted equities in investment trusts

For the incorporation of unlisted equities in investment trusts, financing for growth and diversification of investment opportunities, through a framework of investment trusts, are expected to be promoted. Moreover, the following idea is provided: after measures for ensuring liquidity, such as those which make sure restrictions on cancellation are appropriately taken separately from the existing framework and business practices of publicly offered investment trusts, it also would be desirable to design certain types of financial instruments, such as those in which assets with low liquidity are mainly managed. When such types of investment trusts are sold, from the viewpoint of investor protection, the conformity of investors needs to be determined appropriately, and sufficient explanations regarding risks related to investment in unlisted equities

⁹ At a speech at the Nikkei Sustainable Forum on October 2, 2023, Prime Minister Fumio Kishida announced that the Asset Owner Principles clarifying the roles required of asset owners will be formulated by the summer of 2024.

¹⁰ In particular, it is pointed out that there is a concern that DC (defined contribution pension plan) operational management institutions may not have selected the best financial instruments including investment trusts of other financial groups. Operational management institutions are expected to conduct appropriate business operations with original and innovative participant-oriented thinking.

¹¹ As an institutional problem related to stewardship activities, it is pointed out that lack of clarity of the scope of "an act of making an important proposal" or "joint holders" under the large shareholding reporting system hinders engagement. The Working Group on Tender Offer Rule and Large Shareholding Reporting Rule of the Financial System Council has been discussing this point.

need to be made to investors, depending on the nature or risk tolerance, etc., of the investors' investment funds.

5. Institutional Issues Continued to be Discussed

(1) Formation of investment trusts targeting emissions credits

Regarding the addition of emission credits to the main investment assets of investment trusts, it is necessary to examine carbon credit market conditions, such as whether sufficient liquidity and smooth and appropriate price formation are ensured for investment targets of investment trusts that are set and cancelled in the manner in which individual investors, etc., participate.

Therefore, it is appropriate to discuss the addition of emissions credits to the main investment targets of investment trusts in the future.

(2) Incorporation of foreign investment trusts in publicly offered domestic investment trusts

Considering that the Investment Trusts Association, Japan began discussing the review of a framework related to the incorporation of unlisted foreign investment trusts that make alternative investments, etc., (i) a company formulating domestic investment trusts that seeks to incorporate unlisted foreign investment trusts is required to conduct due diligence more stringently with respect to whether there is any hindrance to investor protection, and to establish domestic investment trusts appropriately from the viewpoint of investor protection and fairness between investors based on price calculation frequency or sales frequency, etc., of foreign investment trusts which will become investment targets, and that (ii) when the company designs certain types of financial instruments mainly incorporating unlisted foreign investment trusts that make alternative investments, etc., separately from the existing publicly offered investment trusts, measures for sufficient investor protection, such as giving investors sufficient explanations of risk at the time of sales, should be taken.

(3) Classified beneficial interests under investment trusts

It is considered appropriate for the Investment Trusts Association, Japan, etc., to discuss the classified beneficial interests in investment trusts that are utilized in the West, as well as grasp overseas cases and situations, in order to organize specific needs and problems from the viewpoint of business practices and investor protection.¹²

¹² The current Investment Trust Act stipulates that the "beneficial interests in investment trusts must be divided equally" (Article 6, paragraph (1) of the Investment Trust Act) but does not assume the issuance of classified beneficial interests.

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