JAPAN

Investment rules of the world

DLA PIPER

About

At DLA Piper, we have one of the largest finance and projects teams in the world with more than 600 dedicated lawyers and an established local law firm network. We share knowledge and skills in debt instruments, debt securities, funds, derivatives and portfolios, as well as energy, infrastructure and other projects, across Europe, the Middle East, Africa, Asia Pacific and the Americas.

When and wherever we work for you on finance and investment deals and projects, you can rely on our international platform; we are backed by the network and resources of one the largest and most-connected business law firms in the world.

We enjoy being part of your team, bringing experience across sectors, borders and financial products, supporting you on first-of-a-kind deals, in new markets and to grow.

With global perspective, we can help you to realize your financial strategy in whichever markets you do business.

Investment Rules of the World

With input from across our global network, this guide covers key legal topics for different financial activities and projects and gives you an overview of the points you may consider when initially looking at financing or investing in particular jurisdictions. Please contact us if you would like to discuss any legal issues or solutions for your business. We also welcome your feedback about this guide via investmentrules@dlapiper.com.

Japan

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

To issue debt securities (corporate bonds), the issuing entity must determine the offering terms and approve them through the relevant corporate organ as designated by the Companies Act.

An offer of debt securities is categorized as either a private placement or a public offering under the Financial Instruments and Exchange Act. If an offer is regarded as a public offering, the issuer is required to file a Securities Registration Statement through the Electronic Disclosure for Investors' NETwork (EDINET) before solicitation and deliver a prospectus to those who wish to purchase the securities. Solicitation is allowed only after a waiting period (15 days in principle) from the filing of the Securities Registration Statement.

However, the waiting period may prevent a company from issuing the securities in a timely manner. For this reason, a company issuing bonds by way of a public offering often adopts the Shelf Registration Scheme instead of filing the Securities Registration Statement. This permits an issuer which has submitted the Shelf Registration Form in advance to issue and allocate bonds immediately after submission of Shelf Registration Supplements.

Once the company files a Security Registration Statement or submits a Shelf Registration Form, periodic disclosure obligations including the issuance of an Annual Securities Report is triggered. Conversely, if an offer is regarded as a private placement where only qualified institutional investors (QIIs) or 49 or fewer non-QIIs are solicited within a six-month period, the periodic disclosure obligations are not triggered.

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What are common issuing methods and types of debt securities?

The following are common types of debt securities:

- corporate bonds;
- convertible corporate bonds;
- equity-linked bonds; and
- asset-backed securities.

The most common debt securities are corporate bonds issued pursuant to the Companies Act.

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What are the differences between offering debt securities to institutional / professional or other investors?

Offers exclusively to qualified institutional investors (QIIs) will constitute a private placement and will not trigger periodic disclosure obligations, provided that the securities allocated to such QIIs will not subsequently transfer to non-QIIs.

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When is it necessary to prepare a prospectus?

As noted previously, it is necessary to prepare and deliver a prospectus before or upon the allocation of debt securities in a public offering. The prospectus may be delivered in electronic form with the consent of the recipients of the prospectus.

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What are the main exchanges available?

The Tokyo Stock Exchange is the primary exchange in Japan. More than 20 convertible bonds are listed on the Tokyo Stock Exchange as of March 2017.

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Is there a private placement market?

Private placements of debt securities are common in Japan. Private placement bonds issued by Japanese and overseas companies may be listed on the TOKYO PRO-BOND Market.

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Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

The Companies Act stipulates that a company issuing debt securities must appoint a bond administrator unless either:

- the minimum par value of each bond is JPY100 million or more; or
- the number of bondholders is 49 or less.

The bond administrator, which is appointed among banks or other financial institutions, will manage the bonds on behalf of the issuers and owe a duty of care towards the bondholders. In practice, most bonds do not have bond administrators.

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Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Generally

The establishment of a fund, the offering of fund interests and the operation of a fund are regulated under the Financial Instruments and Exchange Act (including applicable secondary legislation such as any relevant Cabinet Order and Cabinet Office Ordinance) and subject to regulatory oversight by the Financial Services Agency.

Collective investment schemes

The regulations apply to the offering of interests in collective investment schemes, which include the following interests (subject to certain specific exceptions detailed in relevant legislation):

- the right to receive dividends of profits or a distribution of assets arising from businesses by way of cash, securities and/or bills of exchange contributed by equity owners (equity partners); and
- the rights emanating from a partnership contract, an anonymous partnership agreement, an investment limited partnership agreement, a limited liability partnership agreement or the membership rights of an incorporated association.

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What are common fund structures?

Common fund structures include:

- a partnership created by a partnership contract under the Civil Code;
- a partnership created by an anonymous partnership agreements under the Commercial Code;
- an investment limited partnership created by an investment limited partnership agreement under the Investment Limited Partnership Act; and
- a limited liability partnership created by a limited liability partnership agreement under the Limited Liability Partnership Act.

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What are the differences between offering fund securities to professional / institutional or other investors?

The main difference between offering fund interests to professional/institutional or other investors is whether certain exemptions to the broker license requirement are applicable.

Under the Financial Instruments and Exchange Act of Japan, a license is required to solicit the sale of fund interests to Japanese investors.

However, a commonly used exemption, known as the Article 63 Exemption, exempts an issuer from the broker license requirement provided that a standard notification to make use of the exemption is made. Due to the availability of the exemption, foreign companies often offer fund units to Japanese investors without the requisite broker license.

The basic requirements for the application of this exemption are as follows:

- The foreign issuer must offer the fund units by themselves.
- At least one Japanese qualified institutional investor (QII) must be involved in the issue.
- If the pool of Japanese investors includes non-QIIs, then such non-QIIs must be eligible to be solicited (so-called "Eligible non-QIIs") and there must be no more than 49 eligible non-QIIs.

In addition, professional investors may also be exempt from other restrictions (as detailed below).

If the Article 63 Exemption applies, the general partner (GP) must fulfil certain obligations including the following:

- the creation and annual filing of a business report with the regulatory authority;
- maintaining proper accounting books and business records; and
- making filed information available for public inspection at each business location or by making the information available on a website.

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Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

The general partner (GP) of a fund is also subject to certain conduct restrictions and obligations including the following:

- a prohibition on the provision of fraudulent information in connection with the solicitation or sale of financial instruments;
- a prohibition on the indemnification of its customers against losses incurred as a result of the investment;
- a prohibition on licensing any third party to use the GP's name or conduct the GP's business operations;
- a prohibition on providing a definitive judgement on the investment;
- certain advertising restrictions;
- disclosure obligations before and upon the sale of financial instruments;
- a duty of care and loyalty to its customers;
- a duty to conduct solicitation and sales activities in accordance with the customer's investment skills, history, purpose, and financial status;
- a prohibition on soliciting and selling fund interests to investors where a segregation of the invested capital is not secured;
- a duty of good care in investment management; and
- a duty to provide a written investment report to customers.

Some of the requirements above may not apply when engaging with professional investors.

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Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

An offer of fund interests is categorized either as a private placement or a public offering under the Financial Instruments and Exchange Act. A public offering of fund interests refers to an acquisition of fund interests by 500 or more investors as a result of solicitation. In a public offering, the Securities Registration Statement via the Electronic Disclosure for Investors' NETwork (EDINET) requires the offeror to deliver a prospectus to investors who wish to purchase the securities prior to solicitation. When the company files the Security Registration Statement or submits the Shelf Registration Form, periodic disclosure requirements will be triggered. These obligations include the filing of an Annual Securities Report.

The marketing of funds is regarded as a sale of financial instruments under the Act on Sales of Financial Instruments. The act requires a firm marketing funds to establish a solicitation plan which ensures the appropriateness of sales activities and to fulfil a firm's duty to disclose to investors any risk pertaining to the funds.

The execution of agreements to purchase fund interests is designated as a transaction requiring the use of anti-money laundering measures. In particular, the firm marketing the funds must confirm the investor's identity, objective in transacting, business scope and the identity of any substantial controllers (i.e. a shareholder owning 25% or more of all shares). Records confirming this information must be kept for seven years. The parties must also report any suspicious transaction which might involve criminal proceeds to the relevant administrative agency.

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Are there any restrictions on managing a fund?

For an Investment Limited Partnership, general partners must ring-fence the invested amounts and any other assets invested in the fund from their own invested amounts and/or assets.

The Financial Instruments and Exchange Act requires a fund manager to prepare documents detailing the fund's investment activity. The specific types of required documents vary depending on the structure of the fund and the license it holds.

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Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

Under the Financial Instruments and Exchange Act, a person entering into a derivatives contract for financial instruments (such as securities and currencies), financial indicators (such as exchange rates) or certain credit derivatives must be registered with the Prime Minister.

In addition, under the Commodity Derivatives Act, derivatives contracts for commodities (such as crude oil and gold) or related commodity indices as well as activities related to the brokerage, intermediation or agency of such commodity derivatives must only be conducted by a duly licensed entity (licensed by the Minister of Agriculture and the Ministry of Economy, Trade and Industry, in principle).

The requirement for sellers to explain the risk of the derivatives at issue to potential customers when soliciting derivative contracts is an important regulation under the Financial Instruments and Exchange Act concerning derivatives.

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What are common types of derivatives?

The over-the-counter derivatives market is limited when compared with the market in the UK or US.

The market in derivatives has increased in recent years and derivative contracts are entered into in Japan for a range of reasons including hedging and speculation. Derivatives may be traded over-the-counter or on an organized exchange.

Common types of derivatives are:

- forwards;
- futures;
- options;
- swaps; and
- credit derivatives.

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Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis of 2007–2008, derivatives and particularly over-the-counter (OTC) derivatives have attracted significant regulatory attention.

A notable transparency initiative introduced in 2012 for the purposes of the regulation of OTC derivatives is the requirement to use an electronic trading system for certain types of OTC derivatives transactions.

As of September 2016, new regulations under the Financial Instruments and Exchange Act require financial institutions to collect and post collateral for OTC derivative transactions which do not use a central clearing house to effect the transaction. This requirement aims to enhance the security of large derivative transactions by limiting the instances of default.

ased on the recent amendments to the Financial Instruments and Exchange Act in May 2019, which are effective as of June 2020, derivative transactions backed by cryptocurrency defined under the Payment Service Act are also subject to registration requirements.

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Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Lending is a regulated activity. In general, a lender will need to obtain a moneylending business license or certain other licenses such as a banking license. Though the application of the Money Lending Business Act (for instance, the requirement to hold a moneylending business license) to a foreign company lending money from outside Japan to a party inside Japan is not very clear, it would be prudent for a foreign company to obtain a moneylending business license.

To obtain a moneylending business license, an entity must satisfy certain requirements. For instance, a company must:

- have minimum net assets of JPY50 million;
- have at least one office in Japan;
- have at least one director with at least three years of experience in moneylending operations;
- not conduct any operations against public benefits;
- in respect of each office it operates, have 'full-time chiefs of moneylending operations' who have passed a required examination and registered with the relevant regulatory authorities (the ratio of the 'number of chiefs of moneylending operations' against the 'number of persons engaged in money lending operations' must be 0.02 or more); and
- in respect of each office it operates, have at least one full-time director or employee who has at least one year of experience in moneylending operations.

Certain of the requirements above can restrict the ability of a foreign company to obtain a moneylending business license.

Borrowing

Borrowing is generally not regulated.

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What are common lending structures?

Lending in Japan can be structured in a number of different ways to include a variety of features, depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or a syndicated basis (multiple lenders each providing parts of the overall facility). Facilities can be divided into tranches for instance, with senior and mezzanine loans.

Syndicated facilities in tranches by their nature involve more parties (such as agents, trustees and senior lenders and/or mezzanine lenders), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate or an independent agent taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific funding objectives. Types of loans include term loans, working capital loans, bridge loans, project facilities and letter of credit facilities.

Loan durations

The duration of a loan can vary between:

- a term loan, provided for an agreed period of time;
- a revolving loan or commitment line, provided for an agreed period of time, which may be used multiple times up to the maximum outstanding amount agreed;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a bridge loan intended for use in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

Loan commitment

A loan can be:

- committed, meaning that the lender is obligated to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion as to whether or not to provide the loan.

In most cases, loans are made available as committed facilities.

Loan repayment

A loan can be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or on a scheduled basis (usually in full at maturity).

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What are the differences between lending to institutional / professional or other borrowers?

There are no notable differences between lending to institutional or professional companies such as qualified institutional investors (as defined in the Financial Instruments and Exchange Act) and lending to other companies.

Lending to individuals is subject to the requirement that the ratio of the outstanding amount of total lending against an individual's annual salary must be one third or less, unless certain exemptions apply (for instance, relating to the purchase of real estate by an individual). This is referred to as the Total Volume Control.

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Do the laws recognize the principles of agency and trusts?

Yes, both principles are recognized as a matter of Japanese law.

For instance, it is possible to appoint an agent (*dairinin*) to act on behalf of other parties or a trustee (*jutakusha*) to hold rights and other assets on trust for trust beneficiaries (*juekisha*), such as lenders or secured parties.

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Are there any other notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to several Japanese laws, including the Interest Rate Restriction Act and the Civil Code. The maximum interest rate permitted is between 15% and 20% depending on the lending amount. The maximum rate allowed for liquidated damages in the case of the borrower's default is 1.46 times the applicable maximum interest rate allowed.

Specific types of lending

When lending to individuals, the Total Volume Control which limits the amount that may be outstanding by reference to an individual's salary will apply. For this purpose, the lender is required to use credit information held by a designated credit bureau to check the individual borrower's financial credibility.

Standard form documentation

The Japan Syndication and Loan-Trading Association has standard form documentation often used by Japanese lenders. Foreign lenders typically use their own standard form documentation.

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Are there any other notable risks or issues around borrowing?

There are none to highlight for the summary purposes of this site.

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Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some key areas affecting giving and taking of guarantees and security are as follows.

Capacity

It is important to check the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the powers of directors that would otherwise restrict the provision of security. For instance, a decision to borrow and/or to give a guarantee in respect of a significant amount must be made by the board of directors and may not be entrusted to any individual director. Furthermore, a transaction giving rise to a conflict of interest (such as a guarantee by a company for the obligations of its directors) must be approved by the board of directors, with the director in conflict abstaining from the vote on the relevant resolution. Each director of a company owes the duty of care of a good manager and a duty of loyalty to the company. As such, a director must be able to demonstrate that adequate corporate benefit is derived from the giving of a guarantee or security.

Insolvency

Guarantees and security may be at risk of being set aside under Japanese insolvency laws if they are:

- provided with little or no consideration within six months of or after the company's suspension of payment;
- provided after the company becomes unable to pay its debts generally and the creditor is aware of the suspension of payment or the company's inability to pay its debts generally; or
- provided after the application for commencement of bankruptcy proceedings and the creditor is aware of such application.

Guarantees and security may also be challenged on other grounds relating to insolvency.

Provision of profit

A company may not provide any benefit to its shareholders in relation to or in connection with the exercise of shareholder rights by a shareholder.

Obligation of a lender taking a guarantee from an individual

A lender taking a guarantee from an individual is required to use credit information held by a designated credit bureau to verify the individual's credit worthiness. However, the Total Volume Control lending requirement (that the amount of total lending against the individual's annual salary must be one third or less) does not apply to guarantees given by an individual.

Upstream guarantees

Upstream guarantees are possible. However, if there is no adequate consideration for or corporate benefit derived from such guarantee, a breach of the directors' duties would be an issue.

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What are common types of guarantees and security?

Common forms of guarantees

Two types of guarantees may be given.

(NORMAL) GUARANTEE (*HOSHO*)

A guarantor has the right of defense of demand which permits a guarantor to require that the beneficiary first demand performance by the principal obligor. The further right of defense of reference permits a guarantor to require that the beneficiary first enforce against the principal obligor's property by demonstrating that the principal obligor has sufficient financial resources to satisfy the debt and that the satisfaction of the obligation could be easily performed by enforcing against the principal obligor.

JOINT AND SEVERAL GUARANTEE (*RENTAI-HOSHO*)

A joint and several guarantor does not have the right of defense of demand or the right of defense of reference. Under this type of guarantee, the guarantor owes the same obligation as the primary obligor.

Under the amended Civil Code that is effective as of 1 April 2020, regardless of the type of the principal obligation, if the guarantor of such obligation is an individual, the amount guaranteed by such individual much be subject to a clear cap. As a result, in the case of a guarantee of any type of principal obligation, including tenant's obligation under a lease agreement or purchaser's obligation under a continuous sales and purchase agreement, as long as an individual is the guarantor, the guarantee must specify the maximum amount of the guarantor's obligation. Otherwise, such individual guarantee would be invalid.

Common forms of security

Three basic types of security interest can be created under Japanese law.

MORTGAGE (*TEITOUKEN*)

A mortgage may be created on rights to real property and certain other types of property such as automobiles, aircraft and factories.

PLEDGE (*SHICHIKEN*)

A pledge may be created on an asset that can be assigned to others such as chattels, real property and rights. For a pledge (other than a pledge on right without a deed) to be effective, the asset must be 'delivered' (*hikiwatashi*) to the pledgee. In the case of a pledge on movable property, the pledgee must continuously possess the pledged asset for the pledge to remain valid.

SECURITY BY WAY OF TRANSFER (*JOTO-TAMPO*)

A security by way of transfer is not a statutory security. It is commonly used to avoid the potentially stringent requirements for a pledge on a movable property, in particular, that the pledgee must continuously possess the pledged asset. A security by way of transfer enables the pledgor to possess and use the pledged asset even during the security period.

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Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

To be valid, a guarantee must be in writing.

There is a further risk that a guarantee may be set aside if improperly obtained, for instance, by undue influence. It is best practice for a party taking the benefit of a guarantee to take steps to avoid claims of undue influence by, for example, requiring the guarantor to obtain independent legal advice.

Giving or taking security

Once granted, security must be properly perfected. Perfection formalities may include:

- 'delivery' of the pledged assets to the security holder (e.g. a pledge on a movable property);
- registration of the security (e.g. a mortgage on a real property); and
- notification to the obligor of the right pledged.

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Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Financial Instruments and Exchange Act (*Kinyu Shohin Torihiki Hou*) (securities transactions)

Foreign Exchange and Foreign Trade Act (*Gaikokukawase oyobi Gaikokuboeki Hou*) (foreign transactions)

Payment Services Act (*Shikinkessai ni kansuru Houritsu*) (fund transfer business other than banking)

Trust Act (*Shintaku Hou*) (trusts)

Consumer credit

Consumer Contract Act (*Shohisha Keiyaku Hou*) (consumer contracts)

Mortgages

Act on Securitization of Assets (*Shikin no Ryudoka ni kansuru Houritsu*) (securitization of assets using special purpose companies or special purpose trusts)

Secured Bonds Trust Act (*Tanpotsuki Shasai Shintaku Hou*) (trusts relating to secured bonds)

Mortgage Securities Act (*Teito Shoken Hou*) (mortgage securitization)

Corporations

Companies Act (*Kaisha Hou*) (company)

Banking Act (*Ginko Hou*) (banking)

Money Lending Business Act (*Kashikingyo Hou*) (moneylending business)

Funds and platforms

Limited Partnership Act for Investment (*Toshijigyouyugensekininkumiaikeiyaku ni kansuru Houritsu*) (partnerships to conduct investment business)

Act on Investment Trusts and Investment Corporations (*Toshishintaku oyobi Toshihojin ni kansuru Houritsu*) (investment in securities using investment trusts and investment corporations)

Limited Liability Partnership Act (*Yugensekininjigyoukumiaikeiyaku ni kansuru Houritsu*) (limited liability partnerships)

Other key market legislation

Interest Rate Restriction Act (*Risoku Seigen Hou*) (interest rate)

Act on Prevention of Transfer of Criminal Proceeds (*Hanzai niyoru Shueki no Itenboshi ni kansuru Houritsu*) (anti-money laundering)

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Regulatory authorization

Who are the regulators?

The Financial Instruments and Exchange Act delegates control over the disclosure of information related to securities and the regulation of securities to the Financial Services Agency, an external bureau of the Cabinet Office.

The Prime Minister has regulatory authority to order a financial instruments business or an intermediary service to:

- improve its operations;
- suspend its businesses; or
- rescind its registration.

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What are the authorization requirements and process?

Any firm engaged in financial instruments business or the provision of financial instruments intermediary services must register with the Prime Minister.

The activities of a firm engaged in financial instruments business includes the sale and purchase of securities, derivatives transactions, public offerings and private placements. A firm providing financial instruments services typically conducts intermediary services in connection with the sale and purchase of securities, public offerings or private placements.

A registration tax is payable upon submission of an application for registration. The fee is ¥150,000 for registration of a financial instruments business and ¥90,000 for registration of a financial instruments intermediary service.

When an application for registration is filed, the regulatory authority records certain mandatory information in a central registry.

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What are the main ongoing compliance requirements?

Registration does not require regular renewal.

Firms conducting financial instruments business and providers of financial instruments intermediary services are subject to compliance with general legal and regulatory requirements including disclosure obligations. Failure to comply with applicable law and regulation may result in the revocation of the firm's registration.

Minimum capital requirements apply to financial instruments businesses. A first-class financial instruments business must maintain minimum capital of ¥50 million while a second-class financial instruments business must maintain a minimum of ¥10 million in capital. There are no minimum capital requirements for providers of financial instruments intermediary services.

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What are the penalties for failure to be authorized?

A person or a corporation undertaking a regulated activity without prior registration is deemed to have committed a criminal offence and is subject to imprisonment and/or a fine.

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Regulated activities

What finance and investment activities require authorization?

Generally

An individual or a firm cannot undertake certain financial and investment business activities unless duly authorized.

The Banking Act requires a license from the Prime Minister for the conduct of banking activity. Banking activity includes the acceptance of deposits or instalment savings, the administration of loans and bill discounting.

A financial instruments business or financial instruments intermediary service cannot operate without prior registration. Activities which fall within the scope of a financial instruments business and providing a financial instruments intermediary service includes the sale and purchase of securities, market transactions in derivatives, public offerings and private placements. Similar activities conducted by a financial instruments business operator or a registered financial institution also require authorization.

Consumer credit

A financial instruments business lending money or an intermediary service providing for the borrowing of money must register under the Money Lending Business Act. The Prime Minister or a competent prefectural governor has the authority to order a lending business to improve its operations, suspend its business altogether or rescind its registration.

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Are there any possible exemptions?

Registration is not required for a non-resident financial instruments businesses or financial instruments intermediary service providers conducting investment advisory or investment management business in foreign countries, in respect of certain financial instruments businesses.

A person or corporation conducting a private placement to qualified institutional investors or a fund manager consisting of qualified institutional investors may notify the Prime Minister in advance of the placement in lieu of registration.

A lending business or intermediary service is exempt from registration for the following activities under the Money Lending Business Act:

- non-business loans;
- loans subsidiary to the sale, transportation, storage and intermediation of sale of goods; and
- loans by a business operator to its employees; and
- loans between affiliated companies or to a joint-venture company by its shareholders subject to satisfaction of statutory requirements.

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Do any exchange controls or other restrictions on payments apply?

Strict regulations are not generally imposed on foreign direct investment in Japan. However, in exceptional cases, pre- or post-acquisition notices may be required under the Foreign Exchange and Foreign Trade Act.

The Foreign Exchange and Foreign Trade Act applies to the following four categories of investment:

- inward direct investments conducted by a foreign investor;
- capital transactions;
- payments to and from foreign countries; and
- foreign trade (import and export).

Capital transactions, payments to and from foreign countries and foreign trade are regulated concurrently by the Ministry of Finance and the Ministry of Economy, Trade and Industry. Foreign trade transactions are regulated exclusively by the Ministry of Economy, Trade and Industry.

Based on the recent amendment to the Foreign Exchange and Foreign Trade Act in August 2019, the category of "restricted business sectors" requiring off-shore investors to make a prior filing with the Bank of Japan has been expanded to include, among others, the information and communication technology sector such as data processing service and internet user support services.

In addition, Japan's Cabinet approved and submitted to the Diet a draft bill of further amendments to the Foreign Exchange and Foreign Trade Act in October 2019. Under these amendments, the current pre-filing threshold of 10% for foreign investors making investments in Japanese listed companies in the "restricted business sectors" will be reduced to 1%. However, certain exemptions from this prior-filing requirement will be introduced under the amendments. For instance, proprietary trading by foreign securities firms and transactions by foreign banks or insurance companies could generally be exempted from pre filings.

Business operators, such as banks, insurance companies, financial instruments businesses, trust companies, lending businesses or other operators specified by the Act on Prevention of Transfer of Criminal Proceeds must, in respect of certain transactions, confirm:

- the purpose of a transaction;
- the identity of the relevant customer;
- the occupation or business of the relevant customer; and
- the identity of persons substantially controlling the customer's business.

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What are the rules around financial promotions?

Rules

When a financial instruments business enters into a contract for the sale and purchase of securities, a derivatives transaction, a public offering, a private placement or certain other types of transaction, specified disclosure requirements must be met before and upon execution of the transaction contract. For example, a financial instruments business must deliver explanatory documents to a customer and provide information to enable a customer to make an informed investment decision.

Exemptions

When a financial instruments business executes a contract for the transactions referred to above with professional investors, certain exemptions apply. For instance, the requirement to provide risk information when soliciting business and the prohibition on re-solicitation do not apply.

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Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most common forms of legal entities in Japan are:

- the *Kabushiki Kaisha* (KK), which is a joint-stock company; and
- the *Godo Kaisha* (GK), which is similar to a limited liability company.

While the KK is the most traditional and commonly used type of corporate entity in Japan, GKs are becoming increasingly common due to their streamlined structure which provides more flexibility in corporate governance and management decisions, lower annual costs and decreased regulation.

For both KKs and GKs, the liability of members is limited to the amount of their contribution. There are no minimum capital requirements which apply to KKs and GKs generally, unless they conduct specific types of activity which are otherwise subject to further regulation.

Funds

An Investment Limited Partnership (LPS) formed under the Limited Partnership Act for Investment is the most commonly used investment vehicle. An LPS consists of:

- one or more general partners (GPs) who manage the fund and assume unlimited liability with respect to debts owed by the fund; and
- one or more limited partners (LPs) who do not engage in management of the fund, but whose liability is limited to the amount contributed by the LPS.

An LPS is formed by agreement between its GPs and LPs. It may invest only in the types of investment targets specified in the Limited Partnership Act for Investment. Furthermore, an LPS may not invest a majority of its contributed assets in shares, options or other securities issued by foreign companies. For this reason, a limited partnership formed outside of Japan (such as in the Cayman Islands) is typically used if the fund is targeted towards non-Japanese entities.

An LPS does not pay corporate tax on its investment income because it is treated as a pass-through entity. Taxes are instead levied on each partner.

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Is it possible to conduct lending or investment business through a branch or establishment?

Lending business

Yes, a foreign-established company may conduct lending business through a branch registered in Japan.

Investment business

Yes, a foreign-established company may conduct investment business through a branch registered in Japan.

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FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

Peer-to-peer (P2P) lending is considered a type of 'cloud funding', which encompasses various types of transactions including, among others, contribution, buying and selling and capital investment. P2P lending is a lending system available on an online platform that matches individual investors or lenders with borrowers, such as small and medium-sized enterprises or individuals. P2P lending reduces funding and investment costs through the simplification and automation of lending procedures. Additionally, because investors can make a series of smaller investments through P2P platforms, they are able to diversify their investment risks.

HOW PRACTICAL IS PEER-TO-PEER LENDING IN JAPAN?

A business lending money or an intermediary service providing for the borrowing of money, which includes lenders and P2P platform providers, must register under the Money Lending Business Act. A partnership agreement (Tokumei-Kumiai) scheme may be used where registration is not practicable for lenders; they invest in platform providers as silent partners instead of lending. It should be noted however that in addition to the platform provider being required to register as a lending business, it would also need to register as a Financial Instruments Business for the sale of its equity interests under the Financial Instruments and Exchange Act.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (e.g. in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third-party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned').

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

No license is required to manage or use blockchain technology in Japan because it consists only of a distributed computer network system and distributed ledger system.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called 'smart contracts'. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced, more-complex interactions with the outside world using so called 'Oracles'. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

Smart contracts are likely to be used in various industries to conduct business, including by an investment fund raising funds by issuing electronic tokens to investors and using the funds raised to invest in target assets or businesses at the direction of the majority of investors. The investors are then eligible to receive dividends in proportion to the amount of the tokens in their possession. This investment fund programs the aforementioned process (fundraising-investment-dividend) in advance through implementation of the fully-automated smart contract mechanism.

WHAT ARE CRYPTOCURRENCIES?

Cryptocurrencies such as bitcoin or ethereum are digital, virtual currencies generated using blockchain technology.

In Japan, cryptocurrencies are not considered traditional legal currencies, such as US dollars or Japanese yen. In 2014, Mt. Gox, which was then the world’s largest virtual currency exchange, filed for bankruptcy protection in Japan due to misappropriation of customer assets by Mt. Gox operators. Recognizing the risk of virtual currency abuse by business operators for money laundering or other purposes, both the Payment Services Act (PSA) and the Act on Prevention of Transfer of Criminal Proceeds (APTCP) were amended on 25 May 2016 to address this concern. Furthermore, incidents involving loss of users’ cryptocurrencies have continued to arise following the Mt. Gox incident. In light of this situation, the PSA was further amended in May 2019 to strengthen the cryptocurrency regulations for user protection purpose.

The PSA:

- provides a definition of cryptocurrency;
- requires business operators of 'Virtual Currency Exchange Services' to register with the Financial Services Agency (FSA); and

- requires those Virtual Currency Exchange Services business operators to comply with various obligations in order to protect customers.

These amendments were seen as significant legal developments for the FinTech sector in Japan.

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

An ICO can be considered a form of crowdfunding, which typically operates by raising funds through the issuance of digital tokens. This funding method is often used by startup FinTech ventures. An ICO is similar to an Initial Public Offering (IPO); however the main difference is that investors typically do not have any voting rights or control rights similar to those associated with shares issued in an IPO. Therefore, company directors are free to manage their companies without having to worry about direct interference from shareholders.

In Japan, there are currently only a few instances of fund raising using ICOs. A unique service called 'VALU' has had more success recently in Japan. VALU is provided by a FinTech company whose target users are individuals rather than companies. On the VALU platform, individual users are provided their own 'total market price' which is automatically calculated based on their number of followers on social networking sites such as Facebook or Twitter, and these individual users can issue unique tokens to investors similar to the way companies issue shares to investors for funding.

It is also expected that Japanese financial regulations or cryptocurrency regulations will apply to ICOs depending on their structure. For example, if a company sells a cryptocurrency (as defined in the PSA) in the course of an ICO, registration is required and relevant restrictions would be imposed on the company in accordance with the PSA and the APTCP.

Under the amendments to the Financial Instruments Exchange Act in May 2019, it is now clear that tokens having the feature of a 'security' (the so-called 'Security Token') is classified as a 'Type 1 security' which is the most liquid type of securities consisting of shares of stocks, corporate bonds and debentures, share options, etc. Therefore, the issuance of Security Tokens is clearly subject to the securities disclosure requirement that mandates the filing of a Security Registration Statement prior to the offering of such tokens to the prospective investors, unless a private placement exemption applies.

Artificial intelligence and robo advisory systems

Automated advice tools known as 'robo advisors' have been introduced gradually as part of asset maintenance or investment management services. Robo advisors can provide advisory services to a wider range of individuals through personalized data analysis, and are comparable to those advisory services offered to high-net-worth clients and traditionally provided by private bankers. Investment advice services provided by robo advisors include portfolio selection, investment management and intermediary services, among others. Robo advisory providers must register as a financial instruments business and satisfy capital and organizational requirements in accordance with the Financial Instruments and Exchange Act.

Data analysis and cloud computing

The situation is the same as in England and Wales. Cloud computing enables delivery of IT services through internet-based tools and applications and cloud-based storage makes it possible to save masses of data on remote servers, accessible through the internet. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

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Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

GENERAL

The Financial Services Agency (FSA) is the Japanese governmental authority tasked with regulating companies dealing in financial businesses, which would include FinTech businesses. There are many types of FinTech products currently available, and various types of laws or regulations may apply to such products, depending on their nature and conditions. There are three main laws, among others, which govern FinTech products:

- the Financial Instruments Exchange Act (FIEA);
- the Payment Services Act (PSA); and
- the Act on the Prevention of Transfer of Criminal Proceeds (APTCP).

RESTRICTION ON FINTECH PRODUCTS

Financial Instruments Exchange Act (FIEA)

Financial business activities such as the sale or management of securities or financial instruments are subject to FIEA, which has two main categories of requirements: filing requirements and registration requirements. However, it is still unclear whether FinTech products such as cryptocurrencies are deemed 'securities or financial instruments' to be regulated by FIEA. If FIEA applies, a company dealing in FinTech products would be required to file a Securities Registration Statement and other periodical reports with the FSA as part of its filing requirements, and would also be required to obtain a certain form of registration from the FSA as its registration requirement.

Payment Services Act (PSA)

From May 2016, PSA clearly regulates virtual currency businesses, which would include the purchase, sale or exchange of virtual currency for Japanese customers. Virtual currency exchange companies which intend to enter into the Japanese market should consider the feasibility of both obtaining the registration from the FSA and complying with the restrictions on registrants.

The restrictions imposed by PSA include:

- segregation of customer funds and virtual currencies;
- provision of mandatory information to customers; and
- preparation and maintenance of transaction records for customers.

Act on the Prevention of Transfer of Criminal Proceeds (APTCP)

APTCP contains the Japanese anti-money laundering and counter-terrorist financing regulations. In general, APTCP requires financial institutions or virtual-currency business operators to implement a 'know-your-customer' process including the verification of customer identities and the maintenance of customer transaction records.

Electronic payments platforms and regulation of peer-to-peer lenders

ELECTRONIC PAYMENT PLATFORMS

The Banking Act and PSA regulate businesses which transfer funds between accounts regardless of whether or not such transfers would be considered payments; they require operators of a funds-transfer business to be registered or licensed. Because e-commerce markets such as Rakuten or Amazon use a payment process that contains a funds transfer, such payment platforms necessarily must be registered or licensed. However, as e-commerce market operators are given the authority to receive payments from online stores, whereby customer payments are made directly to these stores, such e-commerce market operators are not deemed to be transferring funds but rather only redeeming received funds. Construed in this manner, e-commerce market operators can avoid the registration obligation.

PEER-TO-PEER LENDERS

When peer-to-peer (P2P) lenders lend money as part of their business, even if such lenders are individuals, they must register as a money lending business. Since this would place an onerous registration requirement on lenders using P2P platforms, a partnership agreement (*Tokumei-Kumiai*) is used instead. Under this scheme, P2P investors do not lend but rather invest in platform providers as silent partners. An entity operating as a P2P platform provider, however, has an obligation to register as a money lending business and a financial instruments business under the Money Lending Business Act and the Financial Instruments and Exchange Act.

Regulation of payment services

In Japan, payment services are regulated mainly by two pieces of legislation:

- PSA regulates funds transfer services, issuance of prepaid payment instruments and virtual currency exchange businesses.
- Instalment Sales Act (ISA) regulates credit card issuers, merchant acquirers, payment service providers and merchants maintaining credit card services.

Funds transfer services are services provided by an entity other than a bank that involves the transfer of money in an amount of JPY 1 million or less, using a system to send money remotely. Where the amount transferred exceeds JPY 1 million, only banks are permitted to provide such service under the Banking Act. Credit card transactions are understood to be out of scope of the definition of funds transfer because such transactions are regulated by ISA instead. Prepaid payment instruments and credit cards share common features, such that they are both used in exchange for providing goods or services; however, they differ in the credit directions, in that consumers grant credit to business operators when issuing prepaid payment instruments, while business operators grant credit to consumers in credit card transactions.

Payment service providers must register their business or notify their transactions to each governing agency and maintain their internal compliance systems depending on the type of payment service and the relevant legislation. Since PSA and ISA were established separately and are regulated by separate governmental agencies, it is sometimes unclear which regime would apply to new and unique service providers. Where it is unclear which regime a business needs to be registered under, confirmation should be obtained from the governmental agencies when establishing the business.

Application of data protection and consumer laws

The Act on Protection of Personal Information (APPI) regulates the processing of personal data in Japan. For matters under its jurisdiction, the FSA has issued guidelines regarding the application of APPI which should be followed in general.

APPI was amended recently and a new concept of 'de-identified information' was introduced, meaning it would not be necessary to obtain consent to transfer de-identified information to a third party and such de-identified information can be used for any purposes regardless of the purpose for which the personal information was originally obtained. This rule may accelerate FinTech innovation in Japan. On the other hand, the new APPI also introduced other regulations including a new concept for 'sensitive information' which requires that a business entity obtain prior consent to collect 'sensitive' information from a data subject.

In 2017 the Banking Act was amended to require that settlement agents for electronic settlement systems be registered as well as imposing a duty on settlement agents to explain certain matters (e.g. compensation) to consumers. The amendments are due to become effective in 2018.

Money laundering regulations

Under APTCP, business operators such as banks and money lending business operators should conduct identity verification procedures when lending money or intermediating such money lending while also creating and maintaining records regarding identity verification. If the transactions are not conducted face-to-face, business operators should ask the borrowers for a copy of their identity verification documents and send any documents related to the transaction to them as a transfer-prohibited postal item.

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What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

GENERAL

The basic funding arrangements for FinTech companies are substantially different from those used by more traditional companies. Initial funding in a FinTech startup may be provided by family and friends of the founder or other high-net-worth individuals (known as business angels) who are interested in the firm's business for seed financing, and after this initial stage, the FinTech startup would receive investments from venture capital (VC) as a series A round.

CROWDFUNDING

Crowdfunding is a method of funding for a new project or business to raise small amounts of capital from a large number of individuals through the internet. Firms using the crowdfunding system are subject to the Financial Instruments Exchange Act (FIEA) and must register with the competent authority. However, FIEA was amended on 23 May 2014 to relax registration requirements to promote the growth of crowdfunding businesses. There are two types of registration available under FIEA for crowdfunding businesses: Type I registration or Type II registration. Applicability of these registration types depends on the form of securities issued to investors. For example, Type I registration is required in the case of issuance of shares or share options through crowdfunding.

Venture capital and debt

VENTURE CAPITAL

Startups typically receive investments as equity from VC funds which are private equity investment vehicles. VC funds often invest in startups by purchasing preferred stock. Startups will enter into many complex agreements with VC funds, such as shareholder agreements and investment agreements. In addition, as described above, VC funds often demand preferred stocks which must be designed in line with the requirements of the Company Act and comply with certain processes in order to issue the preferred stocks legally.

VENTURE DEBT

It is rare for startups to raise funds such as venture debt, since such small or medium-sized firms do not have enough ability to make payments against the principal and interest on the debt. However, in some cases, startups can borrow money from banks or other companies as bridge financing until receiving investment from VC funds.

Warehouse and platform funding

Warehouse financing is available to businesses in Japan. Warehouse financing may be suitable for FinTech companies which own a portfolio of assets and are aware of any difficulty in raising money from capital markets.

Peer-to-peer (P2P) lending platforms such as maneo, which is the pioneer in this field in Japan, are also accessible to FinTech companies in Japan. However, because there are numerous restrictions on businesses conducting P2P lending services in Japan, including those arising under Money Lending Act and Financial Instruments and Exchange Act, P2P lending platforms are still not very popular in Japan.

Senior bank debt and capital markets funding

In general traditional banks take a stringent attitude towards lending money to venture-backed companies, but have become more open to lending money to FinTech startups.

Japan has both debt and equity capital markets which are accessible to businesses.

An Initial Public Offering (IPO) is one of the funding arrangements for the companies including FinTech companies that have grown to a certain size. An IPO is the initial sale of company shares on a public exchange, such as the Tokyo Stock Exchange's market of the high-growth and emerging stocks. Recently more and more venture-backed companies conduct an IPO and FinTech startups are expected to do the same.

In line with current trends, FinTech startups are now raising finance by way of a rights offering, for example:

- QUQINE JAPAN, which manages a virtual currency exchange, raised about JPY 1.7 billion through a rights offering in 2016.
- Exchange Corporation K.K., which offers a credit service without the use of cards (Paidy), raised about JPY 50 million in 2014 and about JPY 1.5 billion in 2016 through a rights offering.
- More recently, Kyash K.K., which offers a free remittance application (Kyash), raised more than JPY 1 billion through a rights offering.
- freee K.K., which offers cloud accounting software, raised JPY 800 million in 2014 and JPY 4.5 billion in 2015 through a rights offering.

Incentives and reliefs

The National Diet (Japan's legislature) recently amended the Consumption Tax Law (Japanese Value Added Tax) such that the purchase of virtual currency became exempted in 2017. The Ministry of Economy, Trade and Industry issued its 'FinTech Vision', which provides their basic policies and recognition of issues. The Governor of Tokyo announced that the Tokyo Metropolitan Government is planning to reduce corporate taxes and subsidize personnel expenses to attract FinTech companies.

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Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

A loan can be sold on an individual basis or packaged with other loans as a portfolio grouped by certain underlying terms.

Occasionally, loans are transferred for syndication. For example, a single lender may make an initial loan due to time constraints and subsequently syndicate the loan by transferring part of the loan to other lenders.

Assignment of rights

Subject to contractual restrictions, the assignment of rights can be completed without the consent of the debtor. Partial assignments are also possible. Perfection can be accomplished through notice to or acknowledgement by the debtor on an instrument bearing a certified date (Notice or Acknowledgement).

Assignment of contractual status

Subject to the consent of the debtor, a total or partial assignment of a lender's contractual status, including any or all rights and obligations, is possible. A transfer of a revolving loan includes a transfer of the lender's obligation to lend money to the debtor and therefore cannot be accomplished only through the assignment of rights.

Novation

A novation results in the formation of a new contract between the continuing party and the transferee, while the transferor is released from all its obligations.

Sub-participation

Sub-participation is a transfer of the economic interest in a loan without changing the legal relationship between the existing parties. Sub-participations involve the purchaser taking on double the credit risk, being that of the seller and of the borrower. Some participation agreements have a triggering event (such as poor financial performance by the original lender) which requires a change to the sub-participation arrangements to effectively transfer the loan to avoid the new lender assuming the original lender's risk.

Loan transfers are commonly documented using standard form agreements made available by the Japan Syndicate and Loan-Trade Association and consisting of a master agreement for all transactions between the parties and an individual agreement for a specific transaction between the parties. In the case of any discrepancy between the two documents, the tailored individual agreement will prevail for the specific transaction. For more complex transactions, a more bespoke form of sale and purchase agreement is typically used. The form and content of the transfer documentation will depend on the nature of the loan assets.

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What are the main considerations when transferring a loan and related security?

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise. Some of the key considerations include:

- **confidentiality** – whether the seller is allowed to disclose information relating to the loan to a potential purchaser;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **undrawn commitment** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the purchaser or reduce claims made by the purchaser;
- **transfer mechanics** – whether there are any steps that must be taken to transfer the loan such as obtaining the consent of the borrower, a third party or both;
- **security** – whether the security is properly transferred to the purchaser (for example, a transfer of a revolving mortgage before the principal is fixed requires the mortgagor's consent);
- **perfection** – whether the transfer is perfected by way of notice or acknowledgement or by a registration of the assignment of the claim (in the case of a registration, the assignment is perfected against third parties at the time of the registration, while it is not perfected against the debtor until the registered matters are notified to or acknowledged by the debtor); and
- **allocation of repayments** – the allocation of repayments between the seller and the purchaser depends on whether the borrower's payment obligations accrue before or after the base date (which could be the date of the loan transfer) or if the borrower's payments are actually made before or after the base date (the latter is often used for a transfer of problematic loans).

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Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

The ownership of energy and infrastructure assets in Japan varies by industry. The primary infrastructure industries are:

- economic infrastructure (energy, aviation, rail and telecommunications); and
- social infrastructure (including education and health).

Key sectors are detailed below.

Energy

Assets of the gas and electricity industries in Japan are privately owned. Generation, transmission, distribution and supply services are provided by companies in the private sector.

Telecoms infrastructure

Assets of telecommunications networks (such as mobile phones and television) in Japan are also privately owned by several different service providers other than the Japan Broadcasting Corporation/*Nippon-Hoso-Kyokai* (NHK) and Japan Post Holdings Co., Ltd. NHK is a publicly-owned broadcast business operator established by the Broadcast Act and under the jurisdiction of the Ministry of Internal Affairs and Communications. Japan Post Holdings Co., Ltd. is a mail and logistics operator which was recently partly privatized and listed on the Tokyo Stock Exchange.

Transport infrastructure

Assets of the transport industry in Japan are privately owned.

Social infrastructure

There are public and private schools and hospitals in Japan. The ownership of assets of these schools and hospitals depends on their public or private designation.

Water and wastewater services

Water and wastewater services in Japan are delivered by public organizations which own the relevant infrastructure assets. However, certain public organizations entrust the operation of such services to private companies.

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Are there special rules for investing in energy and infrastructure?

Generally

There is no specific regulatory regime governing or restricting investment in energy or infrastructure projects in Japan over and above existing regulations for investors and funders more generally. However, a particular investment may be subject to legislative or regulatory control. For instance, foreign investors should comply with foreign exchange legislation under which foreign investment in certain business sectors (including electricity, gas, heat supply and telecommunications) requires a prior notification to enable authorities to determine whether such investment will be permitted. Further conditions relating to planning and implementation may require co-ordination with authorities.

Energy

The Electricity Business Act is the main legislation regulating businesses involved in the generation, transmission, distribution and sale of electric power. An electric business operator is required to obtain a business license or register with a competent authority, or may be required to file a notification prior to commencing operations. As for the business of distribution and sale of electric power, based on the amendments to the Electricity Business Act that became effective as of 1 April 2016, all business operators are able to engage in such business subject to registration, in contrast to the monopoly of the transmission business by certain utility companies. The operator of a power plant is required to meet certain technical requirements.

The Atomic Energy Fundamental Act, the Act on Compensation for Nuclear Damage and other specialized regulations govern the production and supply of nuclear power. A company which intends to have a power-generating nuclear reactor is required to obtain a business license from the Nuclear Energy Council and to maintain its facilities to meet certain technical requirements.

The Gas Business Act is the primary legislation regulating businesses involved in liquefied natural gas (LNG). The primary legislation regulating businesses involving liquefied petroleum gas (LPG) is the Act on Securing the Safety and Optimization of Transactions of Liquefied Petroleum Gas (the LPG Act). The LNG or LPG business operator is required to obtain the relevant business license or register with a competent authority prior to starting its business. The amendments to the Gas Business Act, that became effective as of 1 April 2017, enable all business operators to engage in the distribution and sale business involving LNG subject to registration, as is the case for business involving LPG (in contrast to the monopoly of transmission business involving LNG by certain utility companies). The LNG or LPG business operator is required to have appropriate safety regulations in place and submit those regulations to the competent authority.

Telecoms infrastructure

The Telecommunications Business Act is the primary legislation regulating businesses involved in telecommunications. A telecommunications business operator is required to obtain a business license and may be required to file a notification prior to starting its business. Television broadcasting is primarily governed by the Broadcast Act.

Transport infrastructure

The railway industry is primarily governed by the Railway Business Act. A railway business operator is required to obtain a business license. Railway operations are subject to government inspections, for instance, to ensure compliance with safety regulations.

Other infrastructure

The operation of schools is primarily regulated under the School Education Act, the National University Corporation Act and the Private Schools Act. An operator of a private school is required to obtain prior government approval.

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What is the applicable procurement process?

The Public Accounting Act and the Local Autonomy Act set out the procedure for public procurement in Japan.

Investing in energy and infrastructure

There are three types of procurement process:

- an open bid where all contractors may bid;
- a selective bid where contractors designated by the central government or local public authorities may bid; and
- a single tender where a specific contractor may secure the public contract under special circumstances, such as urgent circumstances or where the relevant service or product considered can only be provided by a single supplier.

Where the government tenders a design and construction contract for a public project to private companies, a construction company may sometimes participate in the bid as a part of a consortium. A common form of a consortium involves a construction company as bidder, who subcontracts the building design or other consultation work to a construction consultant. As part of the bidding process, it is necessary for bidders who form a consortium to submit relevant information about subcontractors (such as past records of such subcontractor and a quotations) to the government in the course of the bidding process.

The general procedure for an open bid consists of the following:

- notification of tender opportunities;
- pre-bid meeting;
- commence bidding; and
- determine winning bid.

The general procedure for a selective bid consists of the following:

- qualification examination for the selective bid;
- notice of designation;
- commence bidding;
- determine winning bid; and
- conclusion of a contract.

The general procedure for a single tender consists of the following:

- selection of a counterparty; and
- conclusion of a contract.

Financing energy and infrastructure

When inviting bidders, public organizations may require the bidders to describe their funding arrangement or financial plan for the tendered public project. Specifically, bidders are required to provided information, such as their expected composition ratio of equity and debt and a redemption schedule of for such debt and equity.

Public organizations occasionally obtain funds directly from financial institutions by a procurement process.

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What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of private sector funding/investment in energy and infrastructure in Japan are as follows.

Funding

Common forms of funding in energy and infrastructure include:

- **senior debt** – loans made on a corporate finance basis, loans made on a project finance basis to a special purpose company and bond finance; and
- **mezzanine debt** – mezzanine loans and mezzanine bond finance.

Each method of funding can be greenfield funding (funding at the outset of a project) or brownfield funding (refinancing or additional funding through the course of a project).

Investing

Common forms of investing in energy and infrastructure include:

- equity investments in ordinary shares;
- equity investment in preferred or subordinated shares; and
- other equity investments such as acquiring partnership interests.

Investments above are often made into a special purpose vehicle which subcontracts with other civil companies to build or operate the relevant infrastructure.

Each method of investment can be made by way of green field investment or brown field investment.

A listed infrastructure fund market which is similar to a listed real estate investment trust market was established in the Tokyo Stock Exchange in April 2015. Most listed infrastructure funds take the form of an investment corporation (*toshi hojin*).

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Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

The Securities and Exchange Surveillance Commission (SESC) may investigate breaches of relevant law and regulations, market misconduct and criminal violations. Following an investigation by the SESC, administrative disciplinary actions may be recommended to the Financial Service Agency or criminal charges may be filed by public prosecutors.

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What regulatory penalties may apply?

Regulatory penalties include any of the following:

- a public announcement of misconduct;
- revocation of the relevant license;

- business suspension; and/or
- administrative fines.

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What criminal penalties may apply?

Criminal penalties may be imposed in cases involving:

- false statements;
- insider trading;
- rumour spreading;
- fraud; and
- market manipulation.

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Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

Stamp duty may be imposed depending on the type of instrument, if the instrument is executed within Japan. Registration tax is payable for registration of a real estate mortgage, a chattel mortgage or an assignment of a loan repayment right.

ADVANCE OF LOAN

Loan agreements are subject to stamp duty. The amount of stamp duty assessed varies depending on the loan amount. For example, JPY 100,000 would be assessed on a loan agreement with a loan amount of between JPY 100 million and JPY 500 million.

No registration, transfer or other similar taxes are payable on an advance of a loan.

TRANSFER OR ASSIGNMENT OF A DEBT UNDER A LOAN

Stamp duty is payable on an instrument evidencing an assignment of a loan repayment right. The assessed amount is JPY 200 per instrument.

Registration and transfer taxes are not, in principle, chargeable on the transfer or assignment of a loan. However, when utilizing the registration of an assignment of a loan repayment right in order to perfect the loan rather than informing a debtor of the transfer, which is the ordinary and tax-exempt method of perfection, a registration tax of JPY 7,500 would be imposed on each filing.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

TAKING OF A MORTGAGE OR SECURITY INTEREST

A mortgage instrument is not subject to stamp duty.

Registration tax is payable upon registration of a real estate mortgage, a chattel mortgage or an assignment of a security interest. The assessed amount is 0.4% of the loan amount for real estate mortgages however, a tax reduction measure can apply in certain cases such as where the mortgage concerns a factory. The assessed amount of registration tax for the filing of a chattel mortgage or assignment of a security interest is JPY 7,500.

TRANSFER OR ASSIGNMENT OF A MORTGAGE OR SECURITY INTEREST

Stamp duty is generally not chargeable on an instrument evidencing the transfer or assignment of a mortgage. If the instrument includes an assignment of a loan repayment right, an assessment of JPY 200 would apply.

The transfer of a real estate mortgage is assessed with a registration tax at a rate of 0.2% of the loan amount. When the transfer is caused by inheritance or as the result of a merger, a reduced taxation rate of 0.1% is applicable.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g. a bond)?

ISSUE OF DEBT SECURITY

Bond instruments are subject to stamp duty when issued by a company in hardcopy (paperless bonds are not subject to stamp duty). The assessed amount differs based on the stated amount of the bond. For example, JPY 200 is assessed per bond instrument with a stated amount of JPY 5 million or less.

No registration, transfer or other similar taxes are payable on the issue of bonds.

TRANSFER OR ASSIGNMENT OF DEBT SECURITY

No stamp duty, registration, transfer or other similar taxes are assessed on the transfer or assignment of bonds.

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Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (e.g. secured bond holders)?

Secured lenders and secured bond holders take priority over national and local taxation authorities regarding the enforcement of security, provided that the relevant debts are secured before the mandated deadline for tax payment. Also, once a loan or bond is secured, the priority position of the lenders and bond holders are maintained even if the collateral subject to the mortgage is transferred to a taxpayer with a tax liability to national or local tax authorities.

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Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

There is no withholding tax when persons resident in Japan (including a domestic corporation) receive interest payments under a loan.

Interest paid to persons not resident in Japan (including foreign corporations) is generally subject to withholding tax.

If so:
What is the rate of withholding?

The applicable withholding tax rate on interest paid to persons not resident in Japan (including foreign corporations) is 20.42%.

What are the key exemptions?

Double taxation treaties entered into by Japan may provide exemption, in whole or in part, from withholding tax on interest payments.

Would the same analysis apply to interest payments under a debt security (e.g. a bond)?

For a bond, the withholding tax rate on interest paid to persons not resident in Japan (including foreign corporations) is 15.315%. The double tax treaties that may apply to interest payments under a loan may also apply to interest payments under bonds.

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Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding tax (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (e.g. by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (e.g. a bond)?

Yes.

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