



JAPAN

FINANCIAL SECTOR ASSESSMENT PROGRAM

May 2024

TECHNICAL NOTE ON REGULATION AND SUPERVISION OF INVESTMENT FUNDS

This Technical Note on Regulation and Supervision of Investment Funds for the Japan FSAP was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on April 16, 2024.

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REGULATION AND SUPERVISION OF INVESTMENT FUNDS

Prepared By
**Monetary and Capital Markets
Department, IMF**

This Technical Note was prepared by Cristina Cuervo (IMF) in the context of the Financial Sector Assessment Program (FSAP) in Japan, led by Mahvash Qureshi (IMF). It contains the technical analysis and detailed information underpinning the FSAP findings and recommendations. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>.

CONTENTS

Glossary	3
EXECUTIVE SUMMARY	4
INTRODUCTION	7
INSTITUTIONAL FRAMEWORK	10
REGULATION AND SUPERVISION OF INVESTMENT FUNDS	12
A. Regulatory Framework	12
B. Registration	23
C. Supervision	27
D. Enforcement	34
E. International Cooperation	35
F. Systemic Risk Monitoring	35
BOXES	
1. Promoting Japan as a Leading Asset Management Center	9
2. Japanese Securities Intermediaries: Financial Instrument Business Operators	11
TABLES	
1. Recommendations on Regulation and Supervision of Investment Funds	6
2. Main Types of Investment Fund	14
3. Documentation Review Authority by Fund Type	26
4. Supervision of Entities Providing Asset Management Services	27
5. Number of Firms Under Supervision by Respective Authorities	27
6. SESC/LFBs Onsite Inspections	31

Glossary

AUM	Assets Under Management
BOJ	Bank of Japan
CIS	Collective Investment Schemes
FIEA	Financial Instruments and Exchange Act
FIBO	Financial Instruments Business Operator
Type I FIBO	Type I Financial Instruments Business Operator
Type II FIBO	Type II Financial Instruments Business Operator
IMB	Investment Management Business
IMBO	Investment Management Business Operator
IAABO	Investment Advisory and Agency Business Operator
IOSCO	International Organization of Securities Commissions
ITIC	Investment Trusts and Investment Corporations Act
FSA	Financial Services Agency
JIAA	Japan Investment Advisers Association
JITA	The Investment Trusts Association, Japan
JSDA	Japan Securities Dealers Association
LFB	Local Finance Bureau
MMF	Money Market Funds
MMOU	Multilateral Memorandum of Understanding
MRF	Money Reserve Funds
NAV	Net Asset Value
SESC	Securities and Exchange Surveillance Commission
SPBOI	Specially Permitted Business for Overseas Investors
SPBOOI	Specially Permitted Business Operators for Overseas Investors
SPBQII	Specially Permitted Business for Qualified Institutional Investors
SPBOQII	Specially Permitted Business Operators for Qualified Institutional Investors
SPBTP	Specially Permitted Business for the Transitional Period
SPBOTP	Specially Permitted Business Operators for the Transitional Period

EXECUTIVE SUMMARY¹

This technical note reviews the functioning and effectiveness of the regulation, supervision, and systemic risk monitoring of investment funds in Japan. It focuses on the requirements that are directly relevant to maintaining financial stability, namely, valuation, segregation and safekeeping of fund assets, liquidity risk management and redemption of fund units. The note also reviews the efficacy with which the authorities: i) analyze and monitor the systemic risk arising from fund management activities in Japan; ii) apply the domestic regulatory framework pertinent to investment funds; and iii) supervise compliance with the regulatory framework. The note sets out a series of recommendations to further strengthen the domestic regulatory, supervisory, and risk monitoring frameworks.

The Japanese investment fund industry has grown steadily in the past few years. The total assets under management (AUM) of the investment fund sector in Japan stood at ¥419 trillion, almost 1.5 times larger than at the time of the last Financial Sector Assessment Program (FSAP) in 2017. The government is paying increasing attention to the sector to make Japan a leading international asset management center by improving access of foreign players to the domestic financial market.

The industry is dominated by Investment Management Business Operators (IMBOs) that are part of major financial groups and the majority of AUM are invested in equities via securities investment trusts. A large portion of these trusts invest in foreign equity and most asset management companies outsource the management of those investments to overseas firms. The real estate fund management sector represents a much smaller portion of AUM, while the use of Money Market Funds is very limited.

The regulatory framework has been recently enhanced with relation to liquidity risk management. In line with global standard setting efforts, the framework for IMBOs has been amended to reflect increased attention to liquidity risk management and authorities are actively engaged with the industry to ensure adequate implementation.

The authorities have also recently implemented a new supervisory approach that relies on an enhanced offsite monitoring of firms. The Financial Services Agency (FSA) has increased its data collection efforts and launched a number of targeted initiatives to get a better insight of the industry, in particular in relation to certain practices that the FSA determines require more attention, such as liquidity risk management. This is complemented by the onsite monitoring framework, where a limited number of firms are inspected per year.

¹ This Technical Note has been prepared by Ms. Cristina Cuervo, Senior Financial Sector Expert from the Monetary and Capital Markets Department of the IMF. The on-site work supporting the findings and conclusions was conducted during September 2023. The information in this note is current as of January 2024. The FSAP thanks the authorities for the constructive dialogue and the insights that they have shared.

The FSA is increasingly paying attention to the financial stability risks posed by investment funds as part of its systemic risk monitoring framework. While the reporting framework was until recently relatively fragmented and did not enable authorities to have a comprehensive view of the sector, the newly enhanced data collection by authorities will enable a better assessment of risks to financial stability from this industry.

Authorities should ensure a broader coverage of their onsite inspection program while maintaining their offsite enhancement focus. This needs to be combined with an in-depth and forward-looking assessment of necessary resources for an adequate supervision of the sector, especially in the current context of expected growth due to planned government initiatives. Authorities should also continue their efforts to further strengthen collaboration among all different regulators, as well as to engage with the industry in relation to the implementation of liquidity risk management rules. Going forward, authorities should also consider introducing the stress testing of investment funds as part of their systemic risk monitoring framework.

Table 1. Japan: Recommendations on Regulation and Supervision of Investment Funds

Recommendations	Timing¹	Authorities
Regulatory framework		
Continue to engage with the industry on the implementation of the liquidity risk management rules, including on (i) practicalities of the stress testing requirement and (ii) liquidity classification of assets	I	FSA/JITA
Expand engagement with exchange-traded fund (ETF) service providers to understand the robustness of their arrangements with authorized participants and market makers.	NT	FSA
Monitor the money market fund/money reserve fund (MMF/MRF) market for potential developments that may warrant regulatory updates in the future.	MT	FSA/JITA
Continue to monitor sector developments and newly permitted asset classes (e.g., crypto) to assess any need to update the regulatory perimeter.	MT	FSA
Supervision		
Continue to strengthen cooperation to ensure effective supervision of the investment funds sector (Financial Services Agency (FSA), Securities and Exchange Surveillance Commission (SESC), Local Finance Bureaus (LFBs)) and ensure adequate resource allocation for the FSA to carry out its coordination role.	I	FSA, SESC, LFBs
Consider expanding coverage of the data reporting framework for a more comprehensive view of the industry, and increasing the frequency of the Fund Survey to allow for a prompt identification of risks.	ST	FSA
Strengthen on-site monitoring approach, including: <ul style="list-style-type: none"> • More frequent visits to large IMBOs. • Incorporate newly licensed firms into the criteria to identify firms for inspection. • Onsite inspections to the JITA and other SROs as needed. 	ST	SESC
Continue to monitor relationship of IMBOs and trust banks.	I	FSA, SESC
More resources should be assigned to enhance the supervision of the asset management sector as it continues to grow.	ST	Government, FSA
Systemic risk monitoring		
Continue efforts to incorporate investment funds sector as part of the systemic risk analysis framework.	I	FSA
Introduce stress testing for investment funds as a component of systemic risk analysis.	MT	FSA
¹ I Immediate (within 1 year); ST Short Term (within 1-2 years); MT Medium Term (within 3–5 years).		

INTRODUCTION

1. This note reviews the functioning and effectiveness of the regulation, supervision and systemic risk monitoring of investment funds, using as benchmarks the relevant International Organization of Securities Commissions (IOSCO) Principles and Standards.

2. ² IOSCO generally uses the term Collective Investment Scheme (CIS) to ensure a more globally comprehensive definition of investment funds, and both terms will be used interchangeably in this Technical Note (TN). Emphasis in the TN is placed on requirements with most direct relevance for financial stability, namely valuation, segregation and safekeeping of fund assets, liquidity risk management and redemption of fund units. The note also reviews how the FSA applies the regulatory framework to the investment fund sector and supervises compliance with it, and how the authorities analyze and monitor the systemic risk arising from fund management activities.

3. The investment fund industry in Japan has grown significantly in the past few years. As of end 2022, the total assets under management (AUM) in the investment fund industry in Japan stood at ¥419 trillion, almost 1.5 times that of 2017.³ Of this amount, ¥338 trillion was held by publicly offered investment trust funds as well as privately placed investment trust funds, ¥28 trillion in real estate-related corporation-type investment funds, and ¥52 trillion in privately placed investment funds (partnerships). Most of the assets held by publicly offered investment funds are invested in equity and bonds. Although limited data is available, the AUM of hedge funds seem to be small, with only 1 per cent of AUM of publicly offered investment trusts falling in this category. Still, when looking at the size of the investment funds against the total financial assets held by the households, there is significant room for growth:⁴ as of the first quarter of 2023, investments in funds (i.e., investment trusts) represented only 4.4 per cent of retail investors financial portfolio, with the vast majority of their portfolio (54.2 per cent) held in deposits and in insurance and pension products (26.2 per cent).

4. The COVID-19 pandemic did not seem to have a major impact on the investment fund sector. Unlike in some other parts of the world, investment funds in Japan generally did not experience any significant outflow pressures. At the same time, IMBOs saw an increase in the demand for online access to investment fund subscriptions during that period.

5. The industry is dominated by IMBOs that are part of major financial groups. The IMBOs belonging to major financial groups led by major securities firms, as well as most of the major banks

² The relevant IOSCO documents used are: Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation, August 2011, Principles of Suspensions of Redemptions in Collective Investment Schemes (CIS), January 2012, Policy Recommendations for Money Market Funds, October 2012, , Principles for the Valuation of CIS Assets, May 2013, Standards for the Custody of CIS Assets, November 2015, Recommendations for Liquidity Risk Management for CIS, February 2018, Recommendations for a Framework Assessing Leverage in Investment Funds, December 2019.

³ Investment funds' AUM is about 8 percent of total financial sector assets as of end-March 2023 (compared to about 5 percent as of end-March 2016).

⁴ See Box 1 also for Government initiatives to promote the sector.

are the largest CIS managers. Out of the 20 largest IMBOs, more than 70 per cent are affiliated with financial institution group companies, and less than 30 per cent are independent IMBOs. The share of the industry in the hands of managers that are part of Fintech groups remains small, although it is expected to continue growing steadily as the preference of the younger population is more tilted towards online access to financial products. The industry is also relatively concentrated. Out of 111 IMBOs for investment trusts, the top 10 control about 60 per cent of total AUM.

6. Foreign investment funds are distributed in Japan, and there is significant investment in foreign assets by domestic funds. As of July 2023, there were over ¥7.2 trillion AUM in “foreign investment trusts” distributed in Japan.⁵ Separately, foreign investment funds are distributed as “Domestic investment trusts” which are managed by local IMBOs. A large portion of such domestic funds’ AUM is invested in foreign equity, with the management of these assets outsourced to foreign asset managers or through Fund of funds structure. Of the total net flows that went into publicly offered investment trusts in 2022, approximately 61 per cent was invested in foreign equity, of which approximately 90 per cent of active fund management was outsourced due to limited expertise within Japanese IMBOs to manage global assets.

7. The size of the Money Market Fund (MMF) sector is small and composed exclusively of Money Reserve Funds (MRFs). These funds are specifically prescribed under JITA regulation to be used for the purpose of settlement of securities transactions done by retail investors.⁶ They are therefore exclusively held by retail clients and used by securities firms to carry out settlement of investors’ trades. They are also mainly invested in cash, with some of the funds also invested in commercial paper.

8. The government has recently announced a plan to promote Japan as a leading international asset management center. The detail of the initiative remains under discussion among the pertinent government authorities (including the FSA) but includes both enhancing management capabilities of domestic IMBOs, as well as promoting competition via the identification and removal of existing barriers to entry in the sector (see Box 1).

9. Beyond IMBOs, other financial institutions also play a role in managing assets linked to pension funds. Particularly, some life insurance companies have large asset management departments and act as lead managers of defined benefit pension systems. The license required for them to operate a third party’s defined-benefit pension plan is an insurance business license under the Insurance Business Act.⁷

⁵ These are managed by foreign asset managers and distributed by Type I Financial Instruments Business Operators, as further explained in the Regulation and Supervision of Investment Funds section below.

⁶ Article 1 of the JITA Rules Concerning the Management of MMFs, etc., prescribes that MRFs shall be acquired or held by individuals who are natural persons and intended to be used in the exchange of money related to securities transactions with securities firms in Japan.

⁷ Please note that this TN does not cover insurance or pension-related asset management activities.

Box 1. Promoting Japan as a Leading Asset Management Center

The Japanese authorities have been undertaking steps to develop the asset management sector in Japan for several years, and their efforts have gained new momentum in recent months with several planned initiatives.

In November 2022, the Council of New Form of Capitalism Realization announced the Doubling Asset-based Income Plan. The purpose of the plan is to channel cash and deposits of Japanese households (currently over 50 per cent of household savings' assets) into investments and grow their exposure to investment funds (currently representing nearly five per cent) and to stocks.

A central part of this initiative is the introduction of an updated Nippon Individual Savings Account (NISA) program—the “New NISA.” The NISA system was introduced in 2014 and provided a tax exemption framework for households' investments in stocks and investment trusts. The New NISA, starting in January 2024, significantly increases the amounts of the tax-exempt holding limits and allows for an indefinite investment period. Individuals can invest in either or both types of NISA: (i) *Installment* NISA to invest in certain types of investment trusts suited for long-term, installment and diversified investment and (ii) *growth* NISA to invest in listed stocks and investment trusts. Both types exclude investment trusts with a trust period of less than 20 years, monthly dividend type trusts, and certain investment trusts using derivative transactions.¹

The FSA has also undertaken several initiatives in recent years to improve the competitiveness of the sector. The report of the monitoring process for enhancing asset management business in 2020 has served as a platform to engage with the industry for identifying potential barriers to the development of the sector, as well as potential areas for improvement and non-optimal practices that could be impacting the industry. As part of this initiative, the FSA is encouraging the industry to review their product structure and governance to adapt it to investors' needs and to provide for better longer-term options for investment. It is also reviewing the potential impact of the Japanese practice of double calculation of the Net Asset Value (both the IMBOs and the trust bank calculate and reconcile daily) in back-office costs and efficiency. The FSA and LFBs also introduced the Financial Market Entry Office in 2021, which provides a single point of entry for foreign asset managers seeking to obtain a license by the competent authority, with all communications carried out in English.

In September 2023, the Prime Minister announced its intention to further promote the asset management sector in Japan. Planned efforts include addressing barriers to entry, introducing a new program to assist new entrants, and promoting deregulation to enable asset management firms to outsource their back-office operations.² It is expected that this latest impulse from the government will take the form of more concrete action in due course and could include regulatory reforms, as well as more incentives for new foreign asset managers and further simplification of administrative processes.

In December 2023, the FSA published in its website an overview of the Cabinet's Policy Plan for Promoting Japan as a Leading Asset Management Center. The plan includes the designation of “special zones” with the aim of promoting domestic and overseas asset management business and attracting investment capital for specific domestic growth areas. It considers “deregulation” as one of the potential tools for promotion of these areas, as well as potentially for the sector as a whole. The implementation of the Plan will be finalized after the FSAP assessment, but it is not planned at this stage to include any deregulation which affects the current overall regulatory framework and requirements for the provision of asset management services. The FSA published in January 2024 a Request for Proposals for these special zones and, in cooperation with relevant government ministries and agencies, is expected to review applications in due course. When considering the regulatory and supervisory framework for the asset management industry in such zones, the FSA should address issues relating to regulatory arbitrage vis-a-vis the general system. It should also ensure that any resulting regulatory and supervisory framework does not deviate from international standards.

¹ Sales practices for investment trusts in Japan tend to incentivize investors to move frequently from existing funds to newly launched funds. This practice results in a very large number of funds, most of which have very low AUM. The New NISA initiative aims to attract investors to longer-term options for young generations to grow their financial assets over time.

² Source: Prime Minister Kishida's Remarks to the Economic Club of New York, September 21, 2023. https://www.fsa.go.jp/internationalfinancialcenter/lp/japanweeks/index_en.html.

INSTITUTIONAL FRAMEWORK

10. The regulation and supervision of CIS in Japan is primarily entrusted to the FSA, although several responsibilities are delegated or shared with other authorities and institutions. The FSA is an integrated regulator responsible for the regulation and supervision of entities that carry out financial services in Japan, including credit institutions, insurance companies and securities firms. The responsibilities of the FSA are delegated by the Prime Minister through the Financial Instruments and Exchange Act (FIEA). Its mandate is to ensure the stable functioning of Japan's financial system; the protection of depositors, policy holders and securities investors; and the facilitation of finance.

11. Along with the FSA, however, a number of other authorities and institutions share responsibilities over the regulation and supervision of investment funds.

- The FSA is mainly responsible for policy formulation, off-site monitoring, and imposition of enforcement actions on Financial Instruments Business Operators (FIBOs), which include IMBOs.
- The Securities and Exchange Surveillance Commission (SESC) is an independent bureau within the FSA, governed by a Chairman and two Commissioners appointed by the Prime Minister. It exercises its authority under delegation from the FSA Commissioner. The SESC's Executive Bureau is responsible for its main functions, which are carried out by the respective divisions. The SESC is in charge of on-site inspections of FIBOs and can recommend enforcement actions to the FSA.
- The Local Finance Bureaus (LFBs) carry out the registration of FIBOs, including IMBOs and the notification process for certain non-registered institutions (see sections B and C below for more details), as well as for investment corporations, and the off-site monitoring and on-site inspections of smaller size firms. LFBs also conduct the review of funds registration statements and of the periodic information submitted by them, including prospectus and offering documents.
- The Investment Trust Association, Japan (JITA) is an association for management companies for investment trust and/or investment corporation and performs functions related to rule making, inspections and disciplinary action. Its functions are not delegated from the authority of the FSA/SESC and membership is voluntary, although in practice, almost all fund managers are members of the JITA.⁸ The JITA is required to enforce its rules and oversee their compliance by members and it is, therefore, considered a Self-Regulatory Organization (SRO) from the point of view of the IOSCO Principles.

⁸ Those IMBOs that decide not to be members of JITA are required to adopt similar internal rules to those enforced by JITA on their membership. As of the date of this note, out of the 422 IMBOs, there are 111 IMBOs that have a license to provide investment trust management services and only 3 out of 111 IMBOs were not members of JITA but all of them belong to Japan Investment Advisers Association (JIAA), another self-regulatory organization. This is because they have applied to manage only "foreign investment trusts", not "domestic investment trusts" which JITA is responsible for.

- The Japan Investment Advisers Association (JIAA) is an association of those Financial Instruments Business Operators (FIBOs, please see Box 2 for more details) registered for investment management that conduct discretionary investment management business and/or fund management business for partnership as well as for investment advisory and agency business. Some JIAA members provide only investment advisory and/or agency services.

Box 2. Japanese Securities Intermediaries: Financial Instrument Business Operators

The provision of securities activities in Japan requires being licensed as a Financial Instrument Business Operator, FIBO. There are four main types of FIBOs, depending on the types of services they provide, and the assets linked to those services:

- Type I FIBO: brokerage, dealing, and corporate finance activities in a wide variety of “liquid” financial instruments (shares, government bonds, corporate bonds, and other securities defined in Article 2(1) of the FIEA, which include units of investment trusts and investment corporations). Generally referred to as “securities firms”.
- Type II FIBO: brokerage and dealing in and distribution of certain “illiquid” financial instruments (beneficial interest and other securities specified in Article 2(2) of the FIEA and related derivatives. These include rights in partnership agreements, anonymous partnership agreements and investment limited partnership agreements).
- Investment Management Business Operator (IMBO): the license for the management of investment funds that is the focus of this TN.
- Investment Advisor and Agency Business: Firms providing investment advice and intermediary or agency for conclusion of investment advisory contracts or discretionary investment contracts.

Banks and other financial institutions can conduct only limited securities business. Without registration under the FIEA, they can only invest on their own account as permitted by other laws (such as the Banking Act) or invest on behalf of a trustee under a trust agreement. By registering under the FIEA, they may, in addition, distribute unit trusts and trade in bonds and related derivatives for non-investment purpose.

The following associations conduct self-regulatory activities vis-à-vis FIBOs:

- *Japan Securities Dealers Association (JSDA)*: a financial instruments firm association authorized under the FIEA, whose members are engaged in securities-related business and over the counter (OTC) derivatives transactions (excluding financial futures transactions), mainly Type I FIBOs.
- *Type II Financial Instruments Business Operators Association*: The association’s members are FIBOs registered for Type II financial instruments business. In practice the members are engaged in partnership fund distribution business.
- *Financial Futures Association of Japan (FFAJ)*: Its regular members are Type I FIBOs and registered financial institutions carrying out financial futures business.
- *The Investment Trusts Association, Japan (JITA)*: Its members are FIBOs registered for investment management business managing investment trusts (Category A) and investment corporations (Category B) as well as supporting members (other securities firms and banks).
- *Japan Investment Advisers Association (JIAA)*: JIAA members consist of FIBOs registered for investment management business that conduct discretionary investment management business (Category C) and fund management business for partnership (Category D) as well as for investment advisory and agency business. Some JIAA members provide only investment advisory and/or agency services.

- The Japan Securities Dealers Association (JSDA) is an association of certain type of securities firms (Type I FIBOs under FIEA, please see Box 2 for more details). It is the main SRO for securities firms which are licensed, inter alia, for the distribution of units of investment trust funds to the public.

REGULATION AND SUPERVISION OF INVESTMENT FUNDS

A. Regulatory Framework

Investment Fund Types and Related Licenses

12. CIS in Japan are regulated primarily by the Investment Trusts and Investment Corporations Act (ITIC) and FIEA. ITIC is the main body of regulation for the investment vehicles that take the form of either investment trusts or investment corporations, while FIEA deals with the entities that can provide offering and management services of these vehicles.

13. The concept of CIS in Japan is linked to the legal structure adopted by the investment vehicle and the types of assets it invests in (Table 2). An investment trust is defined in Article 2 of ITIC as a “trust whose purpose is for trust property to be invested mainly in securities, real property, and other assets that Cabinet Order specifies as those in which it is necessary to facilitate investment (“specified assets”) (...) and whose purpose is for the beneficial interest to be divided and for multiple persons to acquire it.” An “investment corporation” is defined as “association incorporated based on this Act for the purpose of investing assets, mainly in specified assets.” Further, FIEA considers the units of both investment trusts and investment corporations as securities further to Article 2. In practice, investment trusts mainly invest in securities—including units of other investment trusts (“securities investment trusts”) while investment corporations mostly invest in real estate (REITs). A vast majority of the industry is represented by securities investment trusts, with real estate corporations constituting a much smaller segment of the sector.

14. Along with investment trusts and investment corporations, FIEA also contemplates the concept of partnerships. Generally based on all forms of partnership under the Civil Code or a silent partnership under the Commercial Code, partnerships can be of two types depending on the assets they invest in: (i) mainly securities; or (ii) other assets (e.g., solar energy plants). If the partnership invests more than 50 per cent of its assets in securities, then it is subject to FIEA both in relation to its offering and solicitation, as well as in relation to the management requirements. Partnerships investing in other assets, however, would not be subject to FIEA as regards to their management requirements, but would need to be subject to FIEA for their offering and solicitation. Partnerships are generally used as vehicles for venture capital and private equity type funds. This

sector is relatively small, with a total of about ¥4 trillion in AUM.⁹ Recent media announcements point to the possibility of some of these vehicles investing in crypto assets in the near future, which is currently not permitted under the Limited Partnership Act for Investment.¹⁰ This change would require an amendment to the Limited Partnership Act by the Ministry of Economy, Trade and Industry. If the partnership invests in securities more than 50 per cent of its assets, and also invests in crypto assets, it would be subject to FIEA in relation to its management activities. They would also be subject to FIEA if offered to the public, irrespective of asset composition.

15. In general terms, investment trusts, investment corporations and partnerships need to be managed by a licensed IMBO, which is one of the four licenses of FIBO, the Japanese term for securities intermediaries. An asset manager must be registered as IMBO. It must have a governance system/structure that is suitable for the types of funds it manages. Within the IMBO license, there are four categories, depending on the types of funds managed: (i) Category A¹¹—for investment trusts, (ii) Category B—for investment corporations (REITs and J-REITs), (iii) Category C—Discretionary Investment Management (segregated accounts), and (iv) Category D—fund management business for partnerships (i.e., fund management license for General Partners). An IMBO must specify each category of funds it wishes to manage.

16. There is an additional category of management service provider that does not need to be licensed but is subject only to a notification requirement. These are the “Specially Permitted Business” (SPB) categories contemplated by FIEA. The main subcategory of this is the SPB for Qualified Institutional Investors (SPBQII),¹² which is an entity wishing to market and manage partnerships that (i) invest more than 50 per cent in securities, and (ii) are exclusively offered to: (a) one or more Qualified Institutional Investors (as defined by FIEA¹³) and (b) 49 or less non-QIIs. In these cases, no IMBO license is required to manage their assets.

17. The type of vehicle chosen also has implications for what type of entity can distribute its units to the public. Generally, units of investment trusts and investment corporations can be offered by Type I FIBOs, but they can also be distributed by Type II FIBOs in those cases when they distribute the units of the funds they have themselves established (i.e. self-offering). On the other

⁹ This figure includes partnerships managed by SPQOII, not offered to the general public; The size of AUM for partnerships managed by IMBOs amounts to ¥750 billion.

¹⁰ Partnerships can already invest in crypto assets when taking the form of Silent Partnerships under the Commercial Code. There is currently one Silent Partnership investing in crypto assets.

¹¹ The use of “Categories A - D” in this document is for illustration purposes only. Such categorization is not used in day-to-day supervisory work.

¹² Two more SPB sub-categories were introduced in 2021 to try to promote foreign asset managers’ entry into Japan: SPB for Overseas Investors and SPB for the Transitional Period. Notwithstanding the fact that these categories permit foreign IMBOs to provide certain management services in Japan without being licensed by the FSA (following only a notification requirement), they have rarely been used as they require having an office presence in Japan, which triggers corporate tax requirements that do not seem to be attractive to foreign firms.

¹³ FIEA lists QIIs as banks, insurance companies, trust banks and Type I FIBOs or IMBOs. A person with a securities balance of JPY 1 billion who complies with certain additional requirements can also notify the FSA to request eligibility as QII.

hand, units of partnership funds can generally be offered by Type II FIBOs (except in cases where SPBOQII can distribute, see Section D below, in which case no Type II FIBO distributor is required).

18. Managers of investment funds are subject to a specific regulatory framework that varies depending on the types of funds they manage. The following subsections will focus on key aspects of the regulatory frameworks relevant to financial stability. Where no distinction between the regulatory frameworks is made, it implies that the framework applies to all IMBOs for all types of funds. Otherwise, the note will specify to what types of funds and managers the regulatory framework is applicable.

Table 2. Japan: Main Types of Investment Fund

Type of CIS	Entities that can distribute	Entities that can manage	Rules and regulations	SRO	Types of assets
Investment trust	Type I FIBOs, Type II FIBO (only when the IMBO conducts self-offering of the Investment trust it has established by itself), registered financial institutions, SPBOTP	IMBOs (Category A), SPBOTP	ITIC (regulates vehicles) FIEA (regulates IMBOs) Guidelines for Supervision JITA Rules	JITA	Mostly securities (equities and bonds)
Investment corporation	Type I FIBOs Type II FIBO (only when the IMBO conducts self-offering of Investment corporation it has established by itself) Registered financial institutions,	IMBOs (Category B)	ITIC (regulates vehicles) FIEA (regulates IMBOs) Guidelines for supervision JITA Rules Real Estate Brokerage Act (regulates IMBO if investing in real estate)	JITA	Mostly in real estate (REITs and J-REITs)
Partnerships (venture capital partnerships, securitization vehicles)	Type II FIBOs SPBOQII SPBOOI SPBOTP	IMBOs (Category D) SPBOQII SPBOOI SPBOTP	FIEA (regulates IMBOs) Guidelines for supervision JIAA Rules (only for IMBOs)	JIAA	(i) Securities (ii) Other assets* (e.g., renewable energy plants) *Only distribution activities subject to FIEA

Money Market Funds

19. MMFs are regulated via the JITA Regulations Concerning the Operation of MRFs and MMFs. These funds invest in short-term fixed income assets and have to keep a weighted asset life of no more than 90 days, and a weighted average maturity of maximum 60 days. They offer a constant NAV and the rules permit amortized accounting for its assets. IMBOs for MMFs (Category A) have to formulate and regularly review a contingency plan for the event that the principal of the MRF is damaged. The plan has to be submitted to the FSA for its review.

20. Currently, MRFs are the only MMF product in the market. These are offered by Type I FIBOs for the settlement of their retail clients' transactions in the primary and/or secondary market. Due to the negative interest rate environment, these instruments are mainly invested in cash and CPs.

Conduct of Business Rules

21. IMBOs are subject to a general duty of care. Further to FIEA, IMBOs have a duty of loyalty and due care of a prudent manager, and they are prohibited from conducts that will be detrimental to the beneficiaries of the funds they manage or that are otherwise specified in the rules and regulation. FIEA also establishes requirements that are applicable to all FIBOs, including IMBOs and others that may be distributors of investment funds. These are mainly requirements intended to protect investors, like disclosure of relevant documents and carrying out suitability assessments (prohibition of inappropriate solicitation in the light of investors' knowledge and experience).

22. IMBOs are also expected to notify the FSA or LFBs of any internal problematic conduct. As soon as IMBOs become aware of any of their officers or employees having carried out any conduct that violates any law or regulation (including the general duty of loyalty and due care), they must submit an "Incident Report" to their head supervisor, the FSA or the LFBs (details of assignation of head supervisor are explained in Section D below). The report is expected to include all relevant background on the conduct, as well as the measures that the IMBO is putting in place to prevent this conduct from repeating itself. The FSA and LFBs will follow up with IMBOs as needed and Incident Reports are also considered as part of the offsite monitoring process and to determine the potential need of an onsite inspection. IMBOs must also notify both the FSA and their SROs should the internal problematic conduct be a breach of SRO rules.

Asset Allocation Requirements

23. Investment funds have to follow an investment policy that adequately manages credit and liquidity risk. FIEA and ITIC prohibit IMBOs to make investments that do not comply with the investment method determined in advance by the IMBOs as a method for appropriately managing credit risk. Likewise, IMBOs are prohibited from making investments without taking reasonable measures for liquidity risk management.

24. Investment trusts and investment corporations have limits on assets to be incorporated in their portfolios, depending on the types of trust/corporations they are set up as. The JITA Management Rules set out specific limitations on the types of assets trusts/corporations can invest in, depending on whether they are set up as Securities Trusts (more than 50 per cent of NAV has to be invested in securities as per ITIC Art. 2) or trusts/corporations investing in other than securities (which in practice means real estate assets: more than 50 per cent of NAV invested in real estate and asset-backed securities). Securities trusts/corporations have limitations in the total exposure to one issuer, as well as total investment in units of other trusts/corporations.

Valuation of Assets

25. There is a complex set of rules governing accounting and valuation of assets in CIS in Japan. Primarily, all funds must follow Japanese Accounting Standards (J-GAAP). Specific accounting and valuation requirements for the different types of funds, however, are set in SRO rules. The “Rules for Valuation and Accounting of Investment Trust Properties” (JITA Valuation Rules) and the “Rules Concerning Calculation of Investment Trust Assets” are the main pieces of regulation regarding asset valuation. In addition, specific requirements for real estate and infrastructure trusts and corporations are found in the “Rules for Real Estate Investment Trusts and Infrastructure Investment Corporations” and in the “Rules on Investment Reports for Investment Trusts and Investment Corporations”. Separately, the “Accounting Rules for Investment Trusts”, the “Rules on Accounting for Investment Corporations” and the “By-laws for Accounting Rules for Investment Trusts”, also both issued by the JITA, provide the main requirements for the financial statements of trusts and corporations.

26. The main difference between J-GAAP and the International Financial Reporting Standards (IFRS) is the valuation requirements for non-listed securities. Further to J-GAAP these are valued at acquisition cost, while IFRS requires fair value. JITA Valuation Rules, however, are currently being revised to require that non-listed securities be priced at fair value.

27. In general, assets of investment trusts are required to be calculated at market value and on a daily basis. The JITA Valuation Rules establish that assets in the portfolios of investment trusts and investment corporations should in principle be valued at market value and that continuity should be maintained (i.e., calculated on a daily basis for investment trusts).¹⁴ When IMBOs have to deviate their valuation process from the JITA Valuation Rules, the methodology used, and background need to be recorded in writing and kept for seven years. There are specific provisions for investment corporations investing in real estate and infrastructure, including the requirement to involve an independent third party for valuation of the assets. When a third party is involved in setting prices of assets, the validity of this price must be periodically verified by the management

¹⁴ Investment corporations do not have a daily NAV requirement, given that they typically invest in real-estate. While it is possible for investment corporations to invest in securities and be publicly offered, this has never happened, due to tax and other administrative reasons that make this option not attractive. There is currently only one corporation which invests in non-public shares, and it is privately offered.

company (in practice this is done in discussion with the auditor of the IMBOs), which must also maintain an internal system for such verification.

28. Assets of public investment trusts and investment corporations are subject to audit.

Further to FIEA, the accounting of public investment trusts and investment corporations are subject to periodic auditing by independent auditors for each accounting period (which cannot exceed one year). An audited report also needs to be filed with the LFBs and disclosed to investors.

29. The JITA also retains the ability to revise or tailor its Rules, in particular exceptional circumstances where valuation may become an issue for a specific asset class. Should a situation arise (e.g., a conflict, natural disaster, etc.) that would render the valuation of certain assets held by Japanese funds complicated, The JITA can provide specific recommendations on how to apply its Rules for those particular scenarios.¹⁵

Treatment of Pricing Errors

30. IMBOs are required to appropriately manage the calculation process to ensure accurate calculation of the NAV. When there is a notable fluctuation in the NAV, it needs to identify the cause of the fluctuation and, if a serious problem is found, it has to report it to the internal control division or Board of directors. What constitutes a “notable fluctuation” is defined by each IMBOs in the Terms and Conditions of the funds they manage. In practice, domestic funds very rarely incur in pricing errors as a deviation of 1 yen is considered unacceptable in practice. Due to this expectation, and the fact that IMBOs as issuers of funds’ units are ultimately responsible for the valuation of assets in the funds, both the IMBOs and the trust bank daily independently calculate and reconcile the NAV price, to ensure 100 per cent accuracy.

31. Further to ITIC, an IMBO that due to negligence causes damages to the investors in the investment trust or investment corporation, must compensate them. Accordingly, should an IMBOs incur in pricing errors when calculating the NAV, it would be liable to damaged investors. There is no requirement for IMBOs to report pricing errors to the FSA or LFBs, although in practice authorities consider entities take this issue very seriously and always voluntarily report it.

Management of Liquidity Risk

32. The regulation of liquidity risk management for investment trusts has been recently upgraded. Particularly, the Cabinet Office Order on Financial Instruments Business, etc., the Ordinance for Enforcement of the Act on Investment Trusts and Investment Corporations and relevant JITA Management Rules were amended in June 2020 to incorporate IOSCO’s Recommendations for Liquidity Risk Management for CIS (February 2018), for publicly offered investment trusts. The upgraded framework entered into force in January 2022.

¹⁵ The JITA has recently used its capacity to provide recommendations on valuation of assets affected by the war in Ukraine.

33. Further to the new rules, IMBOs that have established a publicly offered investment trust have to take reasonable measures to ensure the appropriate management of liquidity of the trusts they manage. Further to JITA Management Rules, the liquidity risk management systems shall take into account the size of the Investment Trust during the process from the product design to redemption, nature of the trading conditions, assets held, investment strategy, points of sale (Type I FIBOs or registered financial institutions), characteristics of the anticipated investors, conditions for establishment and early cancellation, product characteristics, market trends and market environment, the impact of these factors on liquidity risk, and the results of any stress tests carried out.

34. Further, for publicly offered investment trusts, the JITA Management Rules require assets held by trusts to be classified internally in accordance to their liquidity. The Rules consider the following liquidity categories for classification: (i) highly liquid assets, those that can reasonably be deemed to be sold within three business days or less, taking into account market impact; (ii) medium-liquidity assets, those that can reasonably be deemed to be sold within four to seven business days, (iii) low-liquidity assets: those reasonably deemed to take eight business days or more to sell, and (iv) non-liquid assets: those deemed to take eight business days or more to sell and to have a significant market impact. This classification is internal, although the newly introduced pilot survey includes some of this information as a reporting requirement. IMBOs must monitor the proportion of assets in order to comply with the trust's terms and conditions and maintain a trail of monitoring methods and results. Should the trust cross its established thresholds for the different liquidity categories, the IMBOs must escalate this to the appropriate internal committee (or the Board) and, if appropriate, carry out a more detailed liquidity analysis to determine any other changes in the portfolio and whether communication to the investors is needed.

35. Stress testing is also now expected for publicly offered investment trusts. Further to the new JITA Rules, IMBOs must draft internal rules specifying the implementation of stress tests, taking into consideration the characteristics of the funds. JITA Rules require that management companies carry out stress tests, on a regular basis and "as necessary", and depending on the results, conduct further detailed liquidity analysis and take appropriate actions, such as considering changes to the portfolio. The FSA does not currently carry out any stress tests of investment funds, neither is this under consideration for the near future.

36. The laws and regulations do not prescribe what liquidity risk management tools funds can use. Investment trusts and investment corporations are free to use any particular liquidity risk management tools, as long as this is detailed in their Terms and Conditions at the time of incorporation. Terms and Conditions can also be amended for the purpose of incorporating more tools without the need to obtain investors' approval if they are considered as beneficial to the investors. In practice, some investment trusts incorporate the use of a fixed anti-dilution levy that is charged to all redeeming investors, irrespective of whether the fund incurs on net inflows or outflows. Trusts also generally incorporate the possibility of deferring or limiting withdrawals for large redemption requests. Open-ended REITs (investment corporations) generally include an order

amount limit and prior notice system for redemptions; most also set a redemption frequency that is very limited (e.g., semi-annually) to account for the illiquid nature of their assets.

37. The FSA is currently discussing the use of liquidity risk management tools by investment trusts with the industry, as well as the potential challenges in applying such tools.

The FSA initially gathered data via a sample survey of some IMBOs on their use of tools for investment trusts and is now in discussion with the industry on the particularities of the Japanese market and its implications for the possible use of the different tools. In particular, there is an ongoing working group between the FSA, JITA and the industry to better understand the appropriateness of introducing variable anti-dilution levies and the potential practical challenges to implement such a tool in the Japanese investment fund sector.

Suspension of Redemptions

38. The possibility to suspend redemptions of CIS units is contemplated in JITA Rules. It is referred to as “measures to be taken in the event of an emergency,” where several situations are considered emergencies such as the suspension of trading on exchanges and foreign markets, turmoil in trading markets, failure of market infrastructure, etc. Should any of those situations arise, IMBOs can determine the need to suspend subscriptions and redemptions, in which case it has to promptly notify distributors, the JITA and FSA. In the case of a widespread emergency affecting the sector, the JITA will form a Special Measures Committee to decide a general “Acceptance Suspension Measure” that will be notified to members and distributors. In practice, all investment trusts and investment corporations include the possibility to suspend redemptions in their documents of the basic terms and conditions and the FSA/LFBs check whether this is the case, at the time of receiving them.

39. IMBOs may also suspend redemptions to manage unusually large requests. This possibility needs to be included in the Terms and Conditions of individual funds and further to information provided by the FSA and JITA, is in practice done by all IMBOs.

Use of Leverage and Securities Financing Transactions

40. Investment trusts can only borrow funds under very limited circumstances. This is only permitted for the purposes of: (i) providing funds for payment of redemption orders; (ii) the payment of dividends for dividend reinvestment type investment trusts, and (iii) in connection with incident handling (e.g. when trying to use expected cash collateral for a day’s funding, borrowing would be allowed to cover the funds needed due to the delay in receipt of such cash collateral), and during a limited period and under certain conditions. In practice, borrowing by investment trusts is virtually non-existent.

41. Investment corporations do not have regulatory limitations on the use of leverage. In practice, however, many IMBOs consider a 50 per cent limit (of the fund’s NAV), as banks would not typically lend beyond that level.

42. Investment trusts and investment corporations can use derivatives within certain limits. The FIEA and JITA Rules establish that if the value at risk from fluctuations in interest rate, currency value, quotations on a financial instruments market or other indicators exceeds the net assets of the fund, it will not be allowed to carry out derivatives transactions. The calculation of the value of these risks has to be done further to a reasonable formula predetermined by the IMBOs. The FSA does not receive information on funds' derivatives exposures but would expect IMBOs to report if the relevant limit, as calculated by the IMBOs, has been breached, which can be a legal violation. Any investment trust or investment corporation that can use derivatives transactions for purposes other than hedging must clearly indicate this in their Terms and Conditions.

43. Investment trusts can make use of securities financing transactions, but these are generally limited to their NAV. Further to article 15 of the JITA Rules, IMBOs can enter into margin transactions, securities lending and borrowing, repos, short selling and other similar transactions for the investment trusts that they manage, but the value of these transactions must be within the total NAV of each particular fund. Investment Corporations don't have a limit on the use of these transactions.

44. The FSA expects investment trusts and investment corporations to have policies in place regarding securities financing transactions, should they use such strategies. Further to the Supervisory Guidelines, the FSA expects IMBOs that engage in securities financing transactions for leveraged funds, to formulate appropriate internal policies and procedures concerning collateral valuation and management, including details on the type of accepted collateral, contingency plans for the failure of significant counterparties, and management of margin calls. The FSA currently relies on self-reporting by management companies regarding the use of securities financing transactions, but is considering a process to proactively monitor this going forward.

45. The new reporting survey that the FSA is piloting includes reporting of some leverage information. The FSA currently receives no detailed information in relation to the leverage position of investment trusts and investment corporations. However, further to the new survey being tested by the FSA, IMBOs are required to report information on leverage for the funds they manage that have over JPY 50 billion in AUM. The FSA will consider whether to expand the request for information on leverage use by funds with more granular data on derivative balances and details on long-short positions and counterparty exposure once it has completed the analysis of the current Survey Results.

Safekeeping and Segregation of Fund Assets

46. The regulatory framework prevents IMBOs from receiving the assets of the CIS they administer and requires the custodians to segregate the entrusted assets. Further to ITIC, the custody of investment trusts' assets must be entrusted to a trust bank, that must segregate the trusts' assets from its own and from assets of other clients. The custody of investment corporations' assets must be entrusted to an asset custody company, that equally is required to segregate the assets. An "asset custody company" can be either a bank, or other type of regulated institutions that are authorized to be custodians. In practice, however, both investment trusts and investment

corporations entrust the custody of their assets to trust banks. These are regulated further to the Banking Act and supervised by the banking supervision group of the FSA. Both offsite functions of the FSA (banking and asset management) exchange information as needed in relation to any findings on the custodian business side.

47. The regulation does not require that the custodian be an independent entity, separate from the financial group of the IMBOs. Further to IOSCO Principles, a custodian should be functionally independent of the operator of a CIS and must always act in the best interests of investors. While structural independence is not required, certain safeguards are expected to be in place to ensure independence at a functional level. In Japan, trust banks can be part of the same group as the IMBOs managing the CIS and therefore the Supervisory Guidelines require functional segregation in the form of a separate board¹⁶ and separate compliance functions, as well as the separation of the portfolio management and sales functions of the firm. Additionally, both trust banks and IMBOs are expected to draft internal rules to manage conflicts of interest. These rules are not regularly reviewed as part of the licensing processes, but the FSA recently did a specific review in relation to its monitoring process for enhancing the asset management business (See Supervision Section C below) and engaged with firms in relation to any findings and improvements required.

Delegation

48. IMBOs are not permitted to delegate the full authority to manage all of their investment trusts and investment corporations, but partial delegation is allowed. When partial authority is delegated, both the IMBOs and the delegates are jointly and severally liable to compensate the beneficiaries for any damage that could be caused. Delegation conditions must be included in the Terms and Conditions of the CIS. In practice, most IMBOs delegate the management of foreign assets in the domestic investment trusts' portfolios.

49. IMBOs are expected to exercise appropriate due diligence when choosing their delegates and to monitor compliance with appropriate regulation. This is reviewed as part of the offsite monitoring on a reactive manner, since there is no specific reporting by firms on how they carry out this requirement. The FSA will look into it when a problematic issue is reported by the IMBO. Also, the supervisory framework considers the extent of delegation and outsourcing when determining the need to onsite inspect firms.

Fees and Commissions

50. Investment trusts are subject to a number of fees. At the time of purchase, investors often pay a distribution commission to the distributor, which is a percentage of the subscription amount. A management fee is paid during the holding period, based on the unit of the fund the investor holds. In addition, for some funds, there are redemption fees paid to the distributor at the time of redeeming the units in the fund and success fees may also be charged depending on

¹⁶ Both IMBOs and Trust Banks have to be incorporated as independent stock companies, therefore having separate boards of directors.

investment performance. A detail of all these fees must be clearly reflected in the fund disclosure documents.

51. The FSA has recently focused on fees and commissions of investment funds as part of its progress report for enhancing asset management business in Japan. As part of the review for 2023, the FSA analyzed in particular the share of fees charged to investment trusts investors, split between distributors and IMBOs. It noted that irrespective of whether the funds are actively or passively managed, the fees are equally distributed between distributors and IMBOs approximately on a 50-50 ratio. This is not the case in other jurisdictions (the report particularly notes the US case) where the fees assigned to the distributor are much lower, at around 1/3 of the total fees for passive funds and 1/4 of total fees for active funds. The FSA continues to discuss this issue with the largest IMBOs and expects these firms to provide reasonable explanations for the fee regime, or otherwise change the fee structure.

Winding Up/Liquidation of Investment Funds

52. Investment trusts can be liquidated further to the specifications in their Terms and Conditions. Liquidation can either happen after a certain period of time has elapsed (the “trust period”) or before the expiration date in certain conditions (e.g., when the number of remaining units of the trust or the size of NAV fall below a certain level), as specified. In the case of early termination of an investment trust, this generally requires the investors voting in favor of its liquidation; for this reason, there is a significant number of small funds without significant activity that remain to be liquidated due to this being perceived by both Type I FIBOs and IMBOs as a burdensome activity involving investors’ approval.

53. J-REITS will be delisted and liquidated should they fall under specific conditions. These include: the expiration of the term for which it was set up, a resolution of the investors in the REIT, a merger (should the corporation disappear as a result), a judicial decision ordering dissolution, the revocation of the registration further to FIEA.

Findings and Recommendations

54. The enhanced approach to liquidity risk management is a welcome step. The new framework significantly enhances regulation for open ended public investment trusts and fills an important gap. Further, initiatives undertaken by authorities on actively engaging with the industry to better understand the practicalities and implications of particular liquidity risk management tools have contributed to enhancing their insights on this industry.

55. The new requirements, as well as most of industry engagement initiatives focus on open-ended investment trusts. The FSA has also been engaging bilaterally with one of the top providers of ETFs to understand its approach to liquidity management. It would be advisable to expand this dialogue to a broader set of firms providing ETF services to better understand whether the arrangements they have in place with authorized participants and market makers are robust and promote the smooth functioning of the sector, including in times of stress.

56. Authorities should continue to engage with the industry on the implementation of the liquidity risk management rules. Most of the recently introduced framework appears to have been smoothly implemented by the industry, as many firms already had relatively strong liquidity risk management functions. A few items however, like the possibility to introduce variable anti-dilution levies, are still under discussion with firms, while authorities also await final FSB and IOSCO recommendations for open-end funds in this regard. As part of this engagement, the regulators should request more detailed information from IMBOs on how they have implemented the stress testing requirement to be able to understand what their frameworks look like and whether they have adequate data for these exercises. Also, regulators should monitor the data that it will receive on liquidity classification through the new fund survey and, if it finds material divergences in fund managers' approaches to similar assets, it should provide guidance to promote consistency.

57. As certain types of funds may in the future be allowed to invest in new types of assets, authorities should remain alert to the need to adapt their regulatory perimeter. This may be in the form of adapting regulation, issuing guidance or updating the relevant reporting requirements. In particular, regarding partnerships that may have the ability to invest in crypto assets (currently Silent Partnerships and potentially in the future Limited Partnerships), the FSA should make sure reporting for those vehicles fall within the current framework to be able to monitor any developments (see paragraph 89 below).

58. Authorities should monitor the MMF/MRF market for potential developments that may warrant regulatory updates in the future. Currently, the totality of MMF funds are MRFs, a highly domestic product used exclusively for settlement purposes and held entirely by retail investors. These factors reduce the risks traditionally associated with constant NAV MMFs. However, other MMF products could be introduced in the future and the authorities should therefore maintain an active monitoring of this sector to update the regulatory framework as needed to contain possible risks in the future.

B. Registration

59. The registration or licensing framework involves both the LFBs and the FSA. In general terms, the LFB is responsible for the registration of investment management companies as IMBOs (see exceptions below), although the processing of the application also involves the FSA in some cases. Some entities can provide certain investment management activities without a license, further to a notification process with the LFBs subject to several conditions (e.g. offer to only qualified institutional investors or limited number of investors). The investment corporations follow a registration process with the respective LFB.

Investment Management Business Operators

60. A firm seeking to be licensed as an IMBO generally needs to submit an application to the LFB in the geographical area where the firm is located. There is, however, one exception to this rule: applicants which have already gotten the license which is other than IMBO and been supervised by the FSA want to add the license of IMBO. Firms can choose to request licensing for

one or more of the business categories permitted for IMBOs and the application must specify the specific category that the applicant plans to carry out. For Category A or Category B IMBOs, their application reviews are conducted by not only the LFB but also the FSA, which shall supervise these IMBOs after registration.

61. The FIEA includes a number of key criteria for the consideration of prospective IMBO applicants. These criteria vary depending on the type of license required, but include at least the following:

- Minimum capital of ¥50 million (except for “investment management business for qualified investors” where this requirement is lowered to ¥10 million).
- Establishment of board of directors including statutory auditors (except for “investment management business for qualified investors” which is required to have only statutory auditors).
- Fit and proper directors and officers with no track record of misconduct or links to organized crime.
- Adequate internal controls and risk management systems.
- Establishment of an independent compliance unit (except for “investment management business for qualified investors” where outsourcing is permitted).
- Physical presence in Japan.
- Request membership with the respective SRO or establish internal rules similar to those governing members of the relevant SRO.

62. The LFBs will engage with the applicant to undertake a preliminary review of the application and assess compliance with the requirements in FIEA as per the FSA’s Supervisory Guidelines. The application will typically start with an LFB’s¹⁷ unofficial review and discussion with the applicant to ensure they are requesting the right license for their business and that they would meet the expected requirements. This requires checking the capital requirements, personnel structure, resumes and information of directors and officers, corporate governance, internal control and risk management policies and procedures as submitted. In case of IMBOs managing real estate (Category B), there are additional requirements in relation to the professional knowledge of personnel on real estate. The applicant and its staff are summoned to a hearing at the LFBs to discuss the application and answer questions as part of the vetting process and then required to submit the Summary of Applicant to the LFBs.

63. The LFB will review the final application and either grant or refuse the license. Once the consultation process and submission of the Summary of Applicant is over, applicants submit the

¹⁷ Note that for convenience, we refer to LFBs as the main regulator in charge of assessing registrations, however, the FSA is also involved throughout the process for those Category A and B IMBO applicants, as explained earlier.

formal registration request and documentation, which will be checked by LFB staff and a decision will be issued. If LFB is satisfied that the applicant complies with the necessary requirements, it will issue a notice of completion of registration, and the IMBO will be expected to start the process to join the relevant SRO before it can start operations. Due to the review and discussions carried out during the preliminary application period, refusals of licenses are very rare.

Specially Permitted Business Operators

64. SPBOQIIs can carry out certain asset management business without a license, following a notification process with the LFB. In particular, firms can notify the LFB of their intention to carry out business under the category of Specially Permitted Business for Qualified Institutional Investors (SPBQII) if they intend to be General Partner of a CIS taking the form of a partnership for (i) at least one QII, and (ii) 49 or less non-QII.

65. The relevant LFB reviews the application and notifies the applicant when the filing is completed. The applicant has to submit the notification form prior to finalizing the partnership, and include the name of the QII, as well as documentation regarding the directors and officers of the general partnership, which will vary depending on the structure of the fund. LFBs engage with the applicants as needed to discuss the applications, review that conditions are met and will communicate the finalization of the process to the applicant. In this process both the investment manager (as well as the distributor, when the vehicle is self-offered) and the vehicle (partnership) are reviewed simultaneously.

Financial Market Entry Office

66. Since January 2021, the FSA and LFBs have a special point of entry for foreign asset managers/investment advisors planning to take up business in Japan. The Financial Market Entry Office is formed as a joint team of the Securities Business Division and Strategy Development Division of the FSA as well as the relevant LFBs and its aim is to provide assistance regarding legal interpretation and business models in English to foreign firms willing to apply for a license, followed by actual licensing and supervision. All communications are done in English if requested, and most documents further to the licensing process can be presented officially in English for their processing. The initial focus is on licenses for IMBOs, Investment Advisory and Agency Business Operators (IAABOs) but the scope has recently been expanded to cover certain business of Type I FIBOs and certain business of Type II FIBOs as well.

Investment Vehicles

67. The process for registration of an investment fund varies depending on whether it takes the form of an investment trust or an investment corporation:

- **Investment trusts:** IMBOs must submit the basic Terms and Conditions of the relevant trust to the FSA, who will review them primarily for formal deficiencies (Table 3). Further, if the trust is

intended for public offering (50 or more investors to be solicited), it will have to submit a “Securities Registration Statement” to the LFBs.

- **Investment corporations:** Before an investment corporation starts the process of the registration, the investment companies are required to be registered as IMBOs (Category B).¹⁸ Once the investment company is registered as IMBO, the registration process of investment corporations can be initiated. Project planners (in most cases, the relevant IMBO), must file the Basic Terms and Conditions of the corporation with the LFBs, together with an application for registration of the corporation containing the relevant documentation to the LFBs. Due to the nature of investment corporation, which is only a vehicle for investment, it is reviewed focusing on whether it has the relevant asset management, administration and custody with its IMBO. Once the registration process is completed at the LFBs, the investment corporation will follow the relevant procedures to be listed at a stock exchange, if it chooses to list. Finally, it will submit relevant public offering documentation to the LFBs at the time of listing.
- **Foreign funds:** Before a foreign investment fund can solicit the general public in Japan, it has to notify the FSA of its Terms and Conditions, together with the identification of a Type I FIBO to carry out distribution of the relevant fund amongst Japanese investors.

FSA	Local Finance Bureaus
Investment trusts (Category A): Reviews Terms and Conditions	Investment trusts (Category A): Reviews public offering Securities Registration Statement
	Investment corporations (Category B): Reviews Terms and Conditions and public offer Securities Registration Statement
Foreign funds: Receives notification of Terms and Conditions and identification of Type I FIBO distributing fund	

¹⁸As part of the review process for registration, if the investment companies want to be registered as IMBOs (Category B) which will conduct management of a registered investment corporation investing in real estate, the LFB will also ensure they have a license as a Real Estate Broker. In addition, if the investment corporation is aimed at investing over 50 per cent of the assets under management in real estate, the LFB will ensure that they have both broker license and Entrustment-based Agency Services for Transactions as defined in Article 50-2 of the Real Estate Brokerage Act and whether it has obtained the necessary approval for real estate transactions with the Minister of Land, Infrastructure, Transport and Tourism.

C. Supervision

Institutional Arrangements for Supervision

68. The FSA, LFBs, and SROs share supervisory powers over IMBOs (Table 4). All IMBOs authorized under categories A and B (IMBOs of investment trusts and investment corporations) are supervised by the FSA (Table 5). IMBOs authorized under categories C (discretionary investment management) and D (self-managed partnerships) will be under the supervision of the LFBs, unless they have been designated by public notice to be supervised by the FSA. This is the case of larger entities, or entities that belong to a financial group that is already under FSA supervision, or are affiliates of other financial sector entity, among other. All SPBOQIIs, with the exception of 1 SPBOQII, are under direct supervision of their respective LFBs. Finally, JITA and JIAA exercise supervisory powers over their members, which are virtually all IMBOs licensed under the different categories.

69. Authorities and SROs appear to coordinate and frequently share information. Further to the information provided during the mission, it appears that the FSA and LFBs are in regular communication in relation to their respectively supervised entities and share relevant information with each other. They also regularly receive information from the JITA and JIAA and discuss any relevant information affecting their members, as well as supervisory planning and results of any inspections.

Table 4. Japan: Supervision of Entities Providing Asset Management Services	
FSA	Local Finance Bureaus
IMBO Category A (managers of investment trusts) IMBO Category B (managers of investment corporations) Other IMBOs that have been designated by public notice (e.g., an affiliate of any FIBOs supervised by the FSA, an affiliate of other financial service entities, particular large-size independent IMBO, a foreign IMBO registered through the Financial Market Entry Office)	IMBO Category C (Discretionary Investment Management) and IMBO Category D (self-managed partnerships), unless designated by public notice. SPBOQIIs SPBOOI

Table 5. Japan: Number of Firms Under Supervision by Respective Authorities					
(As of July 2023)					
Supervisory Authority	IMBO Category A	IMBO Category B	IMBO Category C	IMBO Category D	SPBOQII
FSA	111	110	181	20	1
LFB*	0	0	149	25	3,503
Total	111	110	330	45	3,504

Note: * LFB supervises one SPBOOI.

70. The FSA and SESC have implemented since 2018 a new approach to supervision, which aims to better integrate onsite and offsite monitoring. The basic supervisory approach is made public by disclosing the FSA's Supervisory Guidelines. The SESC, for its part, annually releases its statement on monitoring priorities for securities business, which sets forth its general approach to monitoring IMBOs.

71. Further to this new approach, the FSA and SESC rely on an enhanced offsite monitoring framework to assess the need for onsite inspections. Offsite monitoring of data and information from IMBOs is carried out by the FSA, who is in regular communication with the SESC in relation to the impact of findings and both engage in discussion as needed for the identification of targeted firms for onsite inspection.

Offsite Monitoring and Reporting Framework

72. The bulk of the offsite monitoring work is carried out by the FSA and LFBs, in close collaboration with the SESC. This is primarily done by the Asset Management Monitoring Office within the Securities Business Division in the Supervision Bureau for the IMBOs falling under direct supervision of the FSA. This office is in charge of reviewing the data and information reported by IMBOs, as well as carrying out the process to impose administrative actions and decide any policy needs in the investment fund sector. To carry out its mandate, it also keeps a very active engagement with firms and undertakes numerous initiatives and discussion groups for topical matters as needed. It has a headcount of around 20 staff.

73. The FSA relies on a number of different sources of information for their offsite monitoring of firms:

- Basic Terms and Conditions of investment funds filed with the FSA and LFBs, and public offering disclosure documents filed with LFBs.
- Business report prepared by IMBOs which provides information on governance and corporate structure, information of the funds they manage such as the fund type, AUM, creation and liquidation of funds and financial statements.
- Ad-hoc notifications in relations to the investment funds and IMBOs (e.g., notifications of incidents, changes to internal rules, changes to officers, capital amount, important employees etc.)
- Complaints, tips and referrals from the public and other authorities.
- Information obtained from whistleblowers.
- Results of audits by SROs.
- Data received from SROs: in particular, the JITA (for Category A and B IMBOs) provides to the FSA monthly information on high-level composition of funds' portfolios, net inflows and

outflows and NAV.¹⁹ JIAA (for Category C and D IMBOs) receives an annual company overview report as well as a quarterly report of AUM.)

- Discussions with firms.

74. The JITA also requests IMBOs to fill out a questionnaire on an annual basis. The questionnaire includes certain standard questions, regarding governance, compliance, structure, investment, etc. and the JITA also includes several questions regarding one or more topics that it decides on a yearly basis, where it understands it would be beneficial to obtain more information from the membership (e.g., liquidity risk management).

75. Another relevant source of information for the last few years has been the FSA's monitoring process for enhancing the asset management business. This initiative has since 2020 been publishing annual Progress Reports on the most relevant findings and recommendations. This initiative focuses on the 11 largest IMBOs in Japan and regularly requests data and information from them on areas of interest. Some topics are recurrent (e.g., governance), and others are included on an ad-hoc basis for each particular year (e.g., recently, ESG issues were covered). The initiative notably allows the FSA to follow up on areas of concern or for improvement (see Box 1 for Japan's new initiatives on enhancing the asset management sector). The FSA conducts a number of discussions and meetings with the firms as part of this initiative, which also allows it to collect additional information and follow up as needed.

76. The FSA is also rolling out a new survey for all fund managers that will improve its data collection on the industry. The information will be requested annually, from all IMBOs (irrespective of license type) and SPBOQIs, for all funds managed by them with more than JPY 50 billion in NAV. Managers will have to report investment strategy (in case of hedge funds), breakdown of regions, types of assets, information on counterparty risk, leverage and liquidity risk management (including their liquidity bucketing of assets further to the new JITA Rules).

77. The survey has been piloted on the 14 large IMBOs this year and will be rolled out to all entities starting January 2024. The FSA received the information from the pilot in July 2023 and plans to analyze it to identify trends and risks in the surveyed firms. The deadline for submission of the first full survey will be end of July 2024.

On-Site Inspections

78. Based on the information gathered via their offsite monitoring and discussions with the FSA, the SESC determines what firms to inspect further to several criteria. The SESC carries out an initial exercise to determine high-priority firms that meet criteria such as: (i) have had no onsite inspections in the past several years, (ii) are in the top rank of firms based on their AUMs, and (iii) could have a large impact on consumers due to its number of retail clients. It also looks at several quantitative and qualitative criteria to further narrow the identification of firms, such as:

¹⁹ JITA receives fund-by-fund NAV and net inflows/outflows on a daily basis from its members and reports it monthly at the aggregate level to the FSA.

(i) indicators like company profits, rate of change in AUM, rate of change in revenue, (ii) business characteristics like types of customers, outsourcing arrangements, related party transactions, (iii) audit framework, (iv) time elapsed since the last inspection, (v) complaints or problematic conduct reports, (vi) reports on problematic issues from SROs and other sources. There is, however, no specific weight assigned to these factors, and no standardized approach to arriving at a risk score based on the overall risk profile of firms. Inspections are mainly to be conducted in cases where the SESC/FSA need to understand further details, like whether there is a breach of laws or regulations or a deficiency in business operations that needs prompt action, there is a possible serious problem concerning investor protection or the business is not fully understood from the offsite information gathered. The SESC does not have a practice of inspecting newly established firms as part of its approach.

79. Through its onsite inspections, the SESC aims to establish the full picture of problems and investigate their root causes, focusing on prevention of recurrence. Further to the SESC's Basic Principles of Securities Business Monitoring, the SESC not only investigates causes of violations of laws and regulations but tries to understand the overall picture of identified issues, including the likelihood of non-compliance with minimum standards in the future. It focuses on the status of firms' systems for business operations, including their internal controls, compliance and legal systems, and risk management frameworks.

80. The SESC also annually publishes its Monitoring Priorities for Securities Businesses. It prioritizes based on changes in the economic environment and changes surrounding the industry, while taking into account the FSA's strategic directions and priorities. For 2022-23, for example, the SESC identified a number of industry-wide themes for their inspections (i.e., internal control environments for adequate solicitation based on the principle of suitability and customer-oriented conduct, business model changes along with digitalization, sufficiency of cybersecurity measures, internal controls for AML/CFT, and implementation of measures to prevent recurrence of problems identified via internal audits or SRO examinations). The document also identified priorities for the different types of FIBOs. For IMBOs, focus is on their actual investment practices and control environment for managing investment (including outsourcing practices) and management of conflicts of interest.

81. The SESC has a dedicated team for the inspection of IMBOs. It has a total of 78 staff for both offsite monitoring and onsite inspections for all FIBOs, including two teams (12 staff), dedicated to IMBOs. LFB staff also conducts inspections for FIBOs as discussed in paragraph 85 below. The average team for an onsite inspection consists of 8 people and the inspection lasts for about 6 months. Staff follow the FSA Guidelines for Supervision and SESC's Basic Guidelines on Securities Business Monitoring to guide their approach, including the planning of the visit and the focus of the team's work.

82. Each inspection concludes with an Inspection Report to the SESC Chair and Commissioners. The report contains the main findings of the inspection, as well as whether the SESC should recommend the Prime Minister and the FSA to take administrative action. If there was

no problem found during the inspection, there is no more communication with the firm, other than to notify the conclusion of the inspection.

83. Should the SESC team find any potential issues, it can take two alternative options, depending on the severity of the findings:

- It can either send a notification to the firm identifying the issues to be addressed, which would imply that the case is then transferred to the FSA for follow-up; or
- Recommend that the FSA take administrative disciplinary action (see the Enforcement section below).

84. The FSA will issue an Order for Production of Report to firms that have been notified of issues to be addressed. The firm is then expected to produce a report explaining how they are addressing any problematic issues found during the inspection and submit to the FSA for review. The FSA will also conduct interviews and discussions with firms until it is satisfied that adequate action has been taken.

85. While the SESC/LFBs have no set target of yearly inspections, the average number of inspections has remained stable for the past five years. The SESC/LFBs have carried out a total of 24 firm inspections since 2018, averaging about five IMBO onsite inspections per year (Table 6). However, only four of the top 11 IMBOs have been subject to an onsite inspection in the last ten years. The SESC/LFBs have also carried out a total of 6 inspections of SPBOQIIs since 2018.

Type of entity	2018	2019	2020	2021	2022	5-year total
IMBOs	4	5	4	4	7	24
Of which, concluded in administrative action	0	1	1	1	1	4
SPBOQII	2	2	0	0	2	6
Of which, concluded in administrative action	0	2	0	0	1	3

86. The SESC engages closely with Local Finance Bureaus to ensure adequate coverage of their inspection program. The SESC supports the individual LFBs in planning and implementing their firms' monitoring. If the monitoring suggests that an IMBO's operational risk is significant or if it falls under the jurisdiction of multiple bureaus, the SESC may take over the onsite monitoring of such an IMBO or carry out a joint inspection with the relevant LFB. The LFBs have approximately 300 staff members, 200 of whom are assigned to inspection, not only for IMBOs but for FIBOs as a whole.

87. The JITA also carries out onsite inspections of its members and follows a similar approach to that of the SESC when selecting firms. The SESC also works closely with the JITA, including by sharing perspectives to raise the efficiency of the monitoring program. In practice, the JITA focuses on medium and smaller firms in terms of inspection and uses a similar set of criteria to the SESC in determining which firms it will inspect each year. The JITA has a total headcount of 50 people, with 10 assigned to onsite inspections. It conducts about 10 to 12 inspections annually.

88. As a Self-Regulatory Organization, The JITA is also under the supervision of the FSA. The FSA is in continuous contact with the JITA and interacts regularly with its staff regarding the offsite monitoring and inspections of JITA's members, as well as for the drafting and approval of sectoral rules. The JITA reports once per year to the SESC and provides information regarding its operations. FSA senior representatives hold semi-annual meetings with JITA's management to discuss priorities and areas of focus. The supervisory program, however, does not include onsite inspections of the SROs; the last onsite inspection of the JITA was carried out in 2007 and there are no plans to carry out an inspection in the near term.

Findings and Recommendations

89. Authorities should continue to strengthen their collaboration and ensure adequate resource allocation for the FSA to carry out its coordination role. The Japanese regulatory and supervisory structure is complex, but the authorities and SROs' responsibilities appear to sufficiently cover the supervision of IMBOs. The complexity applies both to the allocation of responsibilities between the FSA, SESC and Local Finance Bureaus and the role the SROs play in the regulation and supervision of the sector. Despite these complexities, the authorities and SROs strive to work in a coordinated manner to achieve their common objectives, while trying to reduce overlaps. While a simpler structure could potentially be more efficient (e.g., by simplifying and centralizing the reporting by entities to a single authority), the current structure does not seem to lead to any significant gaps of coverage, driven by the FSA's leading role in defining the regulatory and supervisory strategy for the entire financial sector. Authorities are encouraged to continue the efforts to cooperate and regularly communicate among them for the purposes of regulating and supervising the sector. As the investment fund sector continues to grow, authorities should ensure the FSA asset management team has adequate resources to continue to strengthen the above-mentioned leading role in a way that is commensurate with any potential risks.

90. The offsite monitoring framework for fund management activities has been significantly enhanced, but authorities should consider whether its coverage and frequency are sufficient. The new fund survey is a very welcome development, and it is expected to provide authorities with a more comprehensive view of the sector, as all Types of IMBOs will need to report information on their most significant funds. Also, the Asset Management Monitoring Office undertakes a significant number of initiatives that have provided very valuable information on how firms carry out their businesses and deal with some topical issues. However, authorities don't have an overall view of the investment funds sector, with only partial visibility over the SPQOII sector and

of those trusts and corporations with less than JPY 50 billion.²⁰ Once the FSA has rolled out the survey, it should consider either expanding its coverage or supplementing it with targeted data collection for those entities outside of the Survey. Additionally, the annual frequency of the Fund Survey will be useful in building a retrospective view of the industry, but it is unlikely to help the FSA identify risks and trends in time to address them in its ongoing supervision or for systemic risk monitoring purposes. Collecting such data semi-annually or even quarterly would be more appropriate, at least as a medium-term goal once the survey is up and running.

91. Offsite monitoring provides certain insight into the business of large IMBOs, but this should be supplemented with more frequent onsite visits. The engagement with the top IMBOs that the Asset Management Monitoring Office carries out in specific areas of interest goes beyond traditional offsite activities and provides more insight into some of their practices (e.g., corporate governance). However, there are certain overall functions like risk management and governance that are unlikely to be assessed adequately without an in-person inspection of firms and detailed interviews with staff and management. The SESC should consider adapting its onsite approach to ensure that a more frequent cycle of inspections can be delivered to the largest IMBOs. This can also be done by carrying out more targeted onsite thematic inspections focusing on areas where there has not been recent focus through offsite firm engagement, or where the offsite monitoring is more reactive (e.g., outsourcing arrangements, etc.)

92. Authorities should broaden their onsite supervisory approach to allow for a larger coverage of firms. While the SESC has managed to maintain a certain number of routine inspections (i.e., where there is no suspicion of wrongdoing), the overall number is low. Out of 422 IMBOs, only an average of five are inspected onsite per year. As the SESC resources continue to be stretched in a growing market, this approach risks translating into teams conducting inspections to address the most imminent issues, targeted to obtaining further details on situations where a relevant law or regulation could be potentially breached, or where there are signs that there could be a serious problem regarding the protection of investors. This implies that the supervision program relies heavily on findings from offsite monitoring and self-reporting by firms. A broader onsite supervisory approach could be gradually implemented based on the availability of resources (see below), for example, by re-introducing the onsite inspection of newly licensed firms. Beyond identifying potential problematic areas for improvement, a broader onsite supervisory approach would also facilitate a more dynamic integration of findings from onsite inspections into the overall risk assessment of firms. It will also provide FSA and SESC staff with an opportunity to better understand the business and practices of different types of IMBOs and have a better insight into the industry, which will become even more relevant as the sector continues to grow.

93. The supervisory program of the FSA should also include a more structured approach to onsite inspection of SROs, particularly the JITA. Although the FSA appears to have a relatively good insight on the activities of the JITA through regular official and unofficial discussions and

²⁰ This is also coupled with very limited onsite coverage of SPQOIs (only 6 inspections in the last 5 years), which adds to the limitations of the authorities in adequately monitoring this sector.

exchanges of information, it could be beneficial to have a more programmatic approach to their onsite supervision to ensure that it is inspected more frequently. This would provide the FSA and SESC with an opportunity to better understand the SRO's supervisory and enforcement capacity, which will be crucial to continue to strengthen the overall approach to supervising the sector, as well as to identify and address any potential weaknesses.

94. Authorities should continue to closely monitor the relationships between IMBOs and trust banks. Further to the work carried out as part of the progress report for enhancing asset management business regarding conflict-of-interest rules, the FSA and SESC should ensure that they follow up on any relevant findings from that work. They should also continue to engage with the banking supervision team to ensure relevant trust bank activities and, particularly, potential areas of concern are looked into via the banks' onsite supervision activities, as needed.

95. Authorities are under resource constraints to carry out a truly comprehensive supervisory program of an industry which is growing steadily. While the FSA, SESC and LFBs appear to smoothly coordinate their supervisory efforts and efficiently use the resources available to them, the available resources do not appear sufficient to comprehensively oversee the investment fund management sector in Japan. In the absence of adequate resources, the supervisory approach risks becoming more reactive rather than proactive, or focused on firms with apparent compliance issues, thereby potentially missing emerging risks and vulnerabilities in the sector.

96. More resources need to be assigned to enhance the supervision of the asset management sector as it continues to grow. The supervisory approach relies heavily in offsite monitoring, which is carried out by the FSA and SESC through a very limited number of staff. Likewise, limited resources of the SESC onsite team are likely impacting the breadth of its onsite supervision program. The FSA and SESC are encouraged to undertake an in-depth analysis of their available resources and identify their needs. This should take into account the need to more frequently and routinely supervise firms and SROs, the resources in the LFBs, as well as the expected growth of the sector in the coming years.

D. Enforcement

97. Once the SESC has made a recommendation to the FSA or the LFB to take administrative action, the FSA or the LFB initiates the process and summons the relevant entity to a hearing. This aims to provide an opportunity for the entity to be heard, beyond the discussions and communications held during the inspection process. Hearings are intended to be public further to FIEA, but IMBOs usually request a closed hearing. In most instances, firms accept the facts and recommendation for administrative order.

98. Based on the circumstances of the case, the FSA or the LFB determines what type of action to impose. Further to FIEA, the FSA or the LFB can decide whether to (i) issue a Business Improvement Order, requiring IMBOs to undertake relevant measures and submit business improvement reports to the FSA or the LFB to attest progress, (ii) issue a Business Suspension Order, instructing firms to stop a particular practice or suspend part of its business for a maximum of six

months, or (iii) cancel the IMBO's registration. The FSA or the LFB cannot impose administrative monetary penalties to IMBOs. To determine the best measure for each particular case, the FSA or the LFB takes into consideration factors like seriousness of the conduct, awareness by IMBOs' management and boards of compliance and risk functions and whether there are any other mitigation factors such as the IMBO proactively taking action to correct the conduct. The administrative order is published on the FSA's website as well as LFB's website if the IMBO is supervised by the LFB.

99. The FSA or the LFB then follows up on actions taken by the firms to comply with the administrative order. The IMBOs need to file an Improvement Report with the FSA or the LFB, which the latter will review and ask for hearings or discussions as needed until it is satisfied that the measures taken by the sanctioned firm are appropriate. Once that is the case, a cancellation of the order is published on the FSA's website. The website also contains a database of administrative actions taken on FIBOs, providing information on whether they have been cancelled or not.

100. Along with recommendation for administrative actions, the SESC can also file criminal charges for serious and malicious cases with public prosecutors' offices. The SESC investigates violations of applicable laws, such as insider trading, market manipulation and submission of false securities reports. The SESC has powers to question and obtain information from any witness, as well as to request that a judge issues a search warrant to seize documents relevant to an investigation. The SESC then files criminal charges with public prosecutors' offices based on the results of their investigation.

E. International Cooperation

101. International supervisory cooperation takes place as required, on a bilateral basis. The FSA and SESC maintain contact as needed with foreign counterparts for supervisory processes. For some of those relationships and based on supervisory needs, they have entered into formal arrangements, like the Memorandum of Cooperation with National Securities Regulators in the European Union that allows the FSA and supervisory authorities in Europe to exchange information regarding supervision of their respective investment funds sectors. Other bilateral cooperation happens ad-hoc as needed, including for the consultation of foreign authorities' examinations towards their supervised entities located in Japan.

102. For cooperation in relation to enforcement matters, the FSA is a signatory to the IOSCO Multilateral Memorandum of Understanding (MMoU). The FSA uses the IOSCO MMoU actively both to respond to requests from foreign regulatory authorities, as well as to obtain any needed information and documents for its own enforcement investigations.

F. Systemic Risk Monitoring

103. The FSA has a broad responsibility to contribute to the identification, monitoring and appropriate management of systemic risk in the Japanese financial markets. To meet this

responsibility, the Risk Analysis Division is in charge of the coordination of research and analysis concerning the condition and trends of risks common to multiple financial institutions and the broader financial system, and conducts comprehensive or particularly specialized research and analysis. This Division can also carry out inspections with the purpose of understanding the risk management situation of financial institutions, under the coordination with the SESC where necessary.

104. The Asset Management Monitoring Office and the Risk Analysis Division collaborate to exchange information on the sector and improve data collection efforts. Due to the smaller size of the sector relative to the securities market industry, the importance of the investment funds sector in the overall systemic risk monitoring framework of the FSA has up until now been more limited. However, this focus has already started to change, and a good example of this is the collaboration between the Asset Management Monitoring Office and the Risk Analysis Division for the purposes of designing the new investment fund survey and initially identifying data points that were relevant beyond micro prudential supervision (e.g., derivatives and counterparty exposures).

105. The FSA also coordinates with the Bank of Japan (BOJ) for the purposes of assessing systemic risk. Biannual meetings are held with the BOJ senior officials at the Council for Cooperation on Financial Stability and Financial Monitoring Council, and the two institutions also hold more frequent working-level liaison meetings, as well as informal information sharing. Moreover, the FSA and BOJ also collaborate on data collection efforts through the “Common Data Platform” that is expected to be operational later this year.

Findings and Recommendations

106. The authorities should continue their efforts to incorporate the investment funds sector as part of their systemic risk analysis framework. Both the Asset Management Monitoring Office and Risk Analysis Division should continue to be actively engaged in reviewing the data obtained from the new survey and other relevant information that the FSA collects as part of its enhanced offsite monitoring. Going forward, the FSA should also consider whether the reporting framework provides sufficient data for efficient systemic risk monitoring, or whether more granularity or new data points need to be requested from firms. Also, as mentioned earlier, authorities could consider expanding their data collection effort to include all funds in the future for a more comprehensive view of the sector. While this may be a too burdensome exercise for IMBOs at this point given the large number of very small inactive funds, it could be more feasible if they restructure their products to focus on providing larger sized, longer-term vehicles, thereby reducing the number of small inactive funds.

107. As the investment fund sector continues to grow, the FSA should consider stress testing of funds as a component of the systemic risk analysis approach. This would not only serve as a monitoring tool to better understand any systemic risk implications of the sector, but it could also provide the FSA with the expertise needed for its supervisory activities when monitoring the implementation of the new requirement for IMBOs to carry out their own stress tests.