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Report of Working Group on Capital Market Regulations and Asset Management Task Force of the Financial System Council -“Promotion of New Entrants in the Asset Management Business and Support Program for New Entrants (Japanese EMP (Emerging Managers Program))”-

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1. Promotion of New Entrants in the Asset Management Business

(1) Deregulation of Entry Requirements for Asset Management Businesses

A) Deregulation of Entry Requirements for Asset Management Businesses, Outsourcing of Middle- and Back-office Operations

For operators who have entered the market through professional frameworks (e.g., investment management business for qualified investors and specially-permitted business for qualified institutional investors, etc.), it was expected that as their business expanded, they would transition into the general asset management business (the businesses targeting general investors). However, the number of asset management firms in Japan has not showed significant growth.

The main functions required for conducting asset management operations are as follows:

- 1. Management operations for funds and similar entities;**
- 2. Investment operations; and**
- 3. Tasks related to accounting and legal compliance (so-called "middle- and back-office operations").**

One of the reasons for the lack of growth in new entrants to the asset management business is the heavy burden of establishing systems for middle- and back-office operations to meet registration requirements.

Therefore, from the perspective of ensuring a healthy competitive environment through the promotion of new entrants, it is appropriate to consider easing some of the entry requirements for the asset management business by allowing the outsourcing of middle- and back-office operations to service providers that ensure appropriate quality.

Specifically, it is appropriate to ease the registration requirements (such as capital and system organization) for the asset management business, especially in cases where they outsource middle- and back-office operations to external service providers that ensure appropriate quality and do not directly receive deposits of money or similar assets. Additionally, to ensure that low-quality service providers who neglect investor protection do not receive such outsourcing contracts, it is appropriate to impose entry regulations and conduct regulations (such as a duty of loyalty and care) on businesses that undertake all or part of these middle- and back-office operations, and to subject them to regulatory oversight, thereby ensuring the quality of their services.



Currently, a variety of outsourcing services for middle- and back-office operations are available, and imposing uniform entry regulations on all service providers offering these services could lead to excessive regulation and potentially eliminate service providers. Therefore, rather than subjecting all businesses that offer outsourcing services for middle- and back-office operations to uniform entry regulations, a structure that relaxes the entry requirements for the asset management business when outsourcing to businesses registered with the authorities can be considered.

B) Full Outsourcing of Operational Authority

In Japan, a legal revision in 1998 introduced a basis for outsourcing of operational authority of investment trust management companies, clarifying that outsourcing is permitted. However, even after the legal revision in 1998, it was pointed out that all of the operational authority could not be outsourced. As a result, it has been pointed out that Japan lacks the specialized fund operational functions seen in European fund management companies.

If Japan sees an increase in firms specializing in fund management functions, it is conceivable that this will lead to a rise in new and distinctive asset managers utilizing such functions. Moreover, separating functions such as asset management and asset custody, and entrusting asset management to highly specialized firms, is expected to enhance overall efficiency, assuming that necessary monitoring and governance of the contracted parties are effectively implemented.

Even when the authority related to investment decisions is fully outsourced, asset management companies still have responsibility to investors for the duty of loyalty and care, as well as for the operations of the outsourced entities. They are required to monitor the operational situation of the outsourced entities as necessary. In addition, asset management companies must inform investors in advance about the outsourcing of operations, including the name of the external investment operator, through contracts or trust agreements. Based on these regulations, it is considered permissible for asset management companies to specialize in fund operation functions. Therefore, it would be appropriate to review and potentially revise regulations that prohibit the full outsourcing of operational authority.



(2) Support program for new entrants (Japanese EMP (Emerging Managers Program))

Starting a new asset management business involves significant challenges, including the heavy burden of establishing systems to meet the registration requirements for the investment management business and the difficulty in acquiring operating funds (seed money) due to the lack of a track record as a new entrant.

Therefore, to create an environment where financial institutions and asset owners can realize the best interests of beneficiaries through the investment results of new entrants, it would be appropriate to develop a program to facilitate the supply of funds to emerging managers, in collaboration between the public and private sectors. The scope of new entrants and the asset classes they target should be considered broadly, as it is important for various investment products and strategies to diversify and for competition among asset management businesses to be encouraged. For example, in terms of asset classes, this could include engagement funds for listed equities (including growth capitalists post-listing on growth markets), bond funds, as well as a diverse range of investment targets such as private equity (PE) funds, venture capital (VC) funds, and infrastructure funds.

From the perspective of ensuring the best interests of beneficiaries, financial institutions and asset owners should seek out asset managers with strong operational capabilities. Furthermore, from the perspective of discovering potential partners for future customer-oriented products, there should be active utilization of new entrants in investment operations, and these managers should not be excluded merely because of their short business history but rather should be broadly considered as options for fund management. In addition, the government should support the entry of new entrants by relaxing the entry requirements for new participants. To make such efforts more visible, it is appropriate for the government and others to publish various initiatives aimed at funding new entrants and to provide lists of new entrants to financial institutions and asset owners.

Under such initiatives facilitated by public-private partnerships, the establishment of numerous new asset management firms in Japan is expected to lead to the advancement of the asset management industry through enhanced competition, the development of skilled gatekeepers who can discern the potential of new entrants, and the transfer of skills and experience to the next generation. Through the implementation of EMP, it is crucial to broaden the talent base related to asset management for the future.



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