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Overview

2016 has been an encouraging year for private equity in Japan. On the fundraising front, it is expected to be one of the best years in a decade. Advantage Partners, Ant Capital, CLSA, Integral, J-Star, Polaris and Tokio Marine Capital, together with newcomers such as NSSK and Yukon Capital, are among the sponsors who, according to Reuters, could help Japan-based private equity firms raise as much as US$4bn during the year, a solid increase from the US$2.6bn reported by PEI Research & Analytics to have been raised in 2015 and a far cry from the lean years following the Global Financial Crisis ("GFC"), when total fundraising reportedly averaged less than US$500,000 a year. On the deal-making front, announced M&A deal volume in Japan in the first half of 2016 totalled approximately US$30.7bn, representing a 68% increase as compared to the first half of 2015, according to Mergermarket. In addition, in November 2016, KKR & Co. announced its largest buy-out to date in Asia, a US$4.5bn acquisition of Calsonic Kansei Corporation, an auto parts maker listed on the Tokyo Stock Exchange and affiliated with Nissan Motors.

The resurgence of private equity fundraising in Japan comes after a long period of minimal activity and represents the fruition of significant shifts that began with the election of Shinzo Abe as Prime Minister in December 2012. As the after-effects of the GFC receded and investors were encouraged by signs of success of Prime Minister Abe's economic policies, known as "Abenomics", both Japanese and foreign investors began to find Japanese private equity attractive again. Despite the lack of sustained growth in GDP, the doubling of Japanese equity markets between 2013 and mid-2015 was viewed as possibly signalling that the stimulus and reform policies of Abenomics might be working and that long-entrenched impediments to M&A might be breaking down. This led to a modest rebound in fundraising activity in late 2014 and 2015, with Carlyle closing their third Japan buyout fund with over ¥100bn (US$825m) in commitments and Unison closing their fourth at their cap of ¥70bn (US$578m). That trend accelerated through 2016. As both Japanese investors and sponsors, including Yasufumi Hirao of Alternative Investment Capital and Ryuosuke Iinuma of Ant Capital, remarked to Reuters and PEI, it is a good time to be raising funds in Japan.

Abenomics has represented a shot in the arm for private equity fundraising on multiple levels. The Bank of Japan (BOJ)'s monetary easing and lowering of interest rates, ultimately below zero, stoked inflation and boosted equity markets, at least in the beginning, but its more lasting effect may have been to make Japanese private equity funds more attractive to investors. At the same time that the BOJ was cutting rates, the world's largest pension investor, Japan's Government Pension Investment Fund (GPIF), with approximately ¥132trn (US$1.3trn) AUM (as of Sep. 2016), announced that it was shifting its target allocations from predominantly government bonds to a more growth-oriented strategy, with significantly higher allocations to equities (both foreign and domestic), as well as alternative asset classes including private equity. According to Bloomberg, GPIF is targeting an allocation of up to 5% of its assets (i.e. ¥6.6trn (US$55.8bn)) in alternative investments including private equity. The new allocations made GPIF one of the largest potential alternative asset investors in the world overnight.

Following GPIF, the recently privatised Japan Post Bank, with approximately ¥207trn (US$1.8trn) AUM, and Japan Post Insurance, with approximately ¥80trn (US$676.9bn) AUM (as of Sep. 2016), each announced that they would start allocating similar percentages to alternative investments. PEI reports that together, GPIF, Japan Post Bank and Japan Post Insurance potentially stand to mobilise over US$3trn towards private equity investments.

The benefits to the private equity industry of the wave of capital brought by these three giants are magnified by the fact that these institutions cannot make direct investments by themselves. Rather, they are required by law or policy to invest through third-party asset managers, such as Nissay Asset Management, which in many cases must agree to invest according to a strict set of fiduciary rules not unlike those applicable to ERISA fiduciaries. These shifts have also necessitated the rapid build-up of private equity skills and knowhow at these institutions. GPIF, for example, hired former Coller Capital partner Hiromichi Mizuno in 2015, who now serves as Executive Managing Director and Chief Investment Officer, while Japan Post Bank hired Hideya Sadanaga to be their head of private equity. This new sophistication, knowledge and familiarity is another positive for the industry.

The Japanese pension and savings giants are not the only movers in the market, either. Reuters and FinanceAsia.com report that regional banks, including the likes of Yokohama Bank, Shizuoka Bank and Fukuoka Bank, have also begun investing in private equity, seeking returns as a means to help their local and regional economies. And Japanese mega-banks, who played a central role in the emergence of the home-grown Japanese private equity industry, have begun returning to the market, for somewhat different reasons. In March 2015, after years of uncertainty as to whether foreign banking institutions would be permitted to invest in private funds that were open to U.S. investors,[1] during which time Japanese banks had largely scaled back their investment in, and sponsorship of, private equity funds, the U.S. Federal Reserve Board and other agencies provided an important clarification that effectively made it easier for non-U.S. banks to rely on an exemption to the so-called "Volcker Rule". With that, Japanese banks began reversing course and resuming their private equity programs. As PEI notes, the participation of Japanese banks is particularly significant for the Japanese private equity industry, as they play a unique role in the pipeline of investment opportunities for some Japanese GPs. For some sponsors, the mega-banks account for very substantial portions of their capital. Added to this mix, corporate pensions have also become increasingly active investors in Japanese buyout funds, contributing to a substantial new pool of capital for private equity fund sponsors.

Despite the apparent flood of capital back into the market, these changes represent something other than a return to the domestic Japanese private equity industry's pre-GFC trajectory. The market and the industry have shifted fundamentally since the shock, internalising, rightly or wrongly, lessons of the perceived excesses of the pre-GFC days. The private equity landscape that is now emerging is characterised by a larger number of sponsors raising comparatively smaller funds, generally in the ¥30bn to ¥60bn (US$253.8m to US$507.7m) range, with only one predominantly Japan-focused non-captive fund (Carlyle Japan Partners III, which closed with ¥119bn (US$1.0bn) in commitments in 2015) having closed with more than ¥70bn (US$592.3m) in commitments over the past few years. Even Japan's largest buyout fund sponsors, Unison and Advantage Partners, which each raised over US$1bn in their last pre-Lehman vintages (AP's 2007 Fund IV fund series, with the equivalent of approximately US$2bn in commitments, remains the largest non-captive Japan buyout fund to date), have set their sights in the ¥70bn (US$592.3m) range for their most recent vintages. (The exception that proves the rule may be Japan Industrial Solutions, a mostly captive large-cap sponsor funded by the Japanese mega-banks that held a special closing of their 2010 vintage turn-around fund in 2013 to bring total commitments to ¥100bn (US$1.0bn) and is now reported by Nikkei to be forming a ¥200bn (US$ 1.7bn) Fund II.)

On the regulatory side, amendments to the Japanese Financial Instruments and Exchange Act (the "FIEA")[2] took effect in March, imposing additional restrictions and requirements for fund operators relying on the QII-targeted business exemption (the "QII Exemption"), which has been a popular exemption for non-Japanese general partners placing limited partnership interests with investors in Japan. Additionally, the industry continued adapting to the July 2015 Japan Supreme Court decision holding that Delaware limited partnerships should be considered foreign corporations under Japanese tax law, and thereby putting into question the pass-through tax treatment of interests in Delaware limited partnerships.

On the financing side, Japan's established banking sector, record-low negative interest rates, recent legislative and structural reforms, and improved perception towards private equity investors, have created an attractive market for private equity funds in Japan. In the current environment, with plentiful long-term, low-interest credit, some, including Megumi Kiyozuka of CLSA Capital Partners (quoted by PEI) now boast that the leveraged buyout market in Japan may be "the best in the world". The market's development has also led to Japanese private equity sponsors' increasing interest in entering into fund-level borrowing through capital call facilities (also known as subscription facilities), a type of credit facility made available to a fund typically secured by: (i) the unfunded capital commitments of the fund's investors; (ii) the fund's rights to call capital and receive capital contributions; and (iii) the fund's bank account in which capital contributions are made. Given the relatively small size and number of funds compared to the U.S. and Europe, the Japanese fund finance market remains in a relatively early stage of development.

Fund formation and finance

As the Japanese private equity market has evolved, managers of Japanese private equity funds have shown increasing interest in entering into capital call facilities for their funds. Some of the key reasons for this interest include: (i) the attractiveness of borrowing terms, with effective interest rates hovering just above zero per cent; (ii) the ability to bridge the gap between the investment date and the typical 10–12 business days normally required by a fund to call capital from its limited partners; (iii) the ability to improve the fund's internal rate of return by using low-cost interim financing; (iv) the ability to reduce the spread between gross and net performance metrics with low-cost financing; (v) the ability to more flexibly support obligations of portfolio companies at more attractive rates than those available to the portfolio companies themselves; and (vi) improved competitiveness *vis-à-vis* strategic buyers.

Many Japanese private equity funds have not been able to execute on capital call facilities, however, due in part to the tension between the stringent requirements of the capital call lenders and the resistance by the limited partners to accommodate additional obligations. Also, there are practical challenges imposed by Japanese tax considerations, including the need to avoid causing offshore limited partners to be deemed to have a permanent establishment ("PE") in Japan or increasing their risk of exposure to local taxation under the so-called "25/5 Rule".

Permanent Establishment

Japanese tax advisors commonly advise sponsors of Japan-focused funds that accept both Japanese and non-Japanese investors to structure the funds in a manner that minimises potential PE risk in Japan for non-Japanese LPs. The rules are complex and beyond the scope of this article, but broadly there are several avenues through which a non-Japanese investor in a Japanese private equity fund may be deemed to have a PE in Japan, including by virtue of the general partner conducting its business in Japan, having a Japan-based advisory entity that manages (or appears to manage) the fund (e.g., where the general partner is merely a "rubber stamp" for the Japan-based sponsor) or by having Japanese investors invest in the same vehicles alongside non-Japanese investors.

To help reduce these risks, Japanese buyout funds are sometimes structured as two or more independently managed parallel funds, i.e. one exclusively for Japanese investors and one (or more) exclusively for non-Japanese Investors. In order to minimise the risk of any non-Japanese limited partner being deemed to have a PE in Japan through the general partner, the general partner of each parallel vehicle for non-Japanese investors is typically organised in a jurisdiction outside of Japan and conducts the business of managing the fund outside of Japan. Additionally, local tax counsel often advise the sponsor to ensure that any Japan-based advisor or sub-advisor entity (i.e., typically the sponsor) does not hold itself out to investors or third parties as actually carrying out the business of the general partner, so as to avoid the risk of offshore investors being deemed to have a PE through the Japanese advisor. Direct agreements between the non-Japanese limited partners and any Japanese entities in the fund structure (e.g., a clawback guarantee agreement by a Japanese advisor and the offshore limited partners) may also be seen to create risk that the non-Japanese limited partners may be deemed to have a PE in Japan. The consequences to non-Japanese investors of having a deemed PE in Japan are significant, with potential exposure to the top applicable effective Japanese tax rates for corporations or individuals in Japan, plus penalties and interest.

25/5 Rule

Non-Japanese limited partners in Japanese buyout funds may also risk being subject to Japanese tax with respect to investments in Japanese portfolio companies through the 25/5 Rule if such limited partner, together with "special related parties" (i.e. typically including all the other limited partners in the fund vehicle in which such limited partner invests) owns 25% or more of the shares of any Japanese portfolio company.[3] Some Japan-focused buyout funds that have commercial substance in multiple locations may structure multiple independent fund vehicles that co-invest the fund, with each fund owning less than 25% of any particular underlying investment. Such a structure, if respected, could avoid exposure to Japanese taxation under the 25/5 Rule.

Additional measures may also be used from time to time in order to minimise such exposure, including decoupling of any linked voting among the parallel funds (e.g., voting as "combined limited partners" with respect to general partner removal, exceeding the fund's investment limitations, extending the term of the fund, incurrence of debt obligations). Moreover, local tax advisors often advise against permitting direct agreements between the general partners of the independent parallel funds to act in concert, e.g., with respect to caps on fund size or organisational expenses.[4]

Implications for capital call facilities

Consequently, any capital call facility arrangements between lenders and such private equity funds need to take into consideration the finely tuned tax structure of the funds, so as to avoid increasing the risk that offshore investors might be deemed to have a PE in Japan or become subject to the 25/5 Rule. In other words, a single agreement among the lenders and all of the general partners/managers of the multiple independent parallel funds in the fund structure may materially increase these risks. Further, such an agreement among a lender, a non-Japanese general partner of the parallel fund for non-Japanese investors, and the Japanese general partner of the parallel fund for Japanese investors, could potentially give rise to PE risk for the non-Japanese investors in the offshore parallel fund.

A further consequence of these tax risks is that joint and several liability among borrowers in the various parallel funds of the fund series with respect to obligations under the same credit facility or cross-collateralisation within a credit facility (where the borrowers are liable on a several basis, but the obligations under the credit facility are secured by the uncalled capital of the parallel funds in the fund series) raise the same PE and 25/5 Rule aggregation concerns, effectively limiting the inclusion of cross-defaults among parallel funds in such a fund series in any capital call facility or similar lending arrangement.[5]

Given the complexities of the Japanese tax considerations for private equity buyout funds, it is essential that any sponsor or lender with an interest in entering into lending arrangements with Japanese private equity buyout funds consult their respective tax advisors and weigh their options to determine the optimal capital call facility structure.

"Bankable" limited partnership agreement

Lenders of capital call facilities diligence the limited partnership agreement of the fund borrower to ensure that the partnership agreement permits borrowings, and the pledge by the borrower to the lenders of its right to call capital from the investors. The permission to incur indebtedness could be a highly negotiated provision in the limited partnership agreement between the private equity sponsor and the limited partners. Certain limited partners investing in Japanese funds still frown upon the ability of the fund to incur indebtedness and negotiate to minimise the amount of permitted debt as well as the duration for which such debt can be outstanding, for example, by requiring indebtedness to be repaid within 30 days of borrowing. Realising the utility of capital call facilities, the private equity sponsor and the general partner tend to desire a more flexible borrowing provision where indebtedness may be outstanding up to 180 days or longer. Capital call facilities are considered to be a low-risk credit instrument as lenders are typically over-collateralised, and the availability of borrowing under the credit facility is based on the quality of the investors, each thoroughly vetted by the lenders prior to and during the course of the credit facility.

Lenders also sometimes request investor consent letters in which each limited partner provides a direct confirmation to the lenders that such limited partner agrees for the fund to enter into the capital call facility and to pledge the uncalled capital to the lenders, and that if there is a default under the credit facility and the lenders exercise remedies and make a capital call, such limited partner will fund the capital call. Limited partners typically do not want to be in direct privity with the lenders. Therefore, obtaining investor consent letters from each limited partner requires prolonged negotiation and is very time-consuming and expensive. Funds in the U.S. have managed to avoid investor consent letters, mainly because limited partnership agreements now include many of the same acknowledgments and representations that would otherwise be included in investor consent letters, and the limited partnership agreements provide for third party beneficiary rights to the lenders.

Lenders in the Japanese fund finance market, which is dominated by Japanese financial institutions such as Mizuho Bank, Sumitomo Mitsui Trust Bank and The Bank of Tokyo Mitsubishi UFJ, have generally accepted that investor consent letters are cumbersome for fund sponsors; however, in lieu thereof, they may demand that no amendment, modification or waiver of any partner's obligation under the limited partnership agreement is permitted without the prior written consent of the lenders. Such restriction essentially constrains the fund borrower from negotiating side letters with the limited partners which is an essential component of fundraising, especially disadvantaging funds trying to court non-Japanese investors. For example, certain sovereign wealth fund investors require their investments to remain confidential, and may not agree to provide any information to the lenders. Such arrangement would be included in a side letter between the specific investor and the fund borrower. In the U.S. market, lenders do not have a consent right over side letters, but rather the lenders diligence these side letters and exclude certain investors from the borrowing base. Ineligibility of specific investors in the borrowing base is more favourable than a covenant outright-prohibiting the fund borrowers' or the general partners' ability to accommodate flexibility essential to certain investors. The fund borrowers must ensure, however, that these ineligible investors are limited compared to the overall investor pool supporting the capital call facility, as significant exclusions from the borrowing base would affect the viability of the capital call facility.

It is not unusual for a fund borrower to share, subject to confidentiality, drafts of its limited partnership agreement to potential lenders, in order to ensure that the limited partnership agreement is "bankable" from a fund financing perspective. Understanding what a "bankable" limited partnership agreement needs to look like prior to, or at the early stages of, the fundraising efforts is critical in navigating successful negotiations with the limited partners as well as the lenders, as there is still a gap between what the Japanese lenders consider "bankable" versus the flexibility required by fund borrowers, especially for funds with both Japanese and non-Japanese investors.

Realising that the U.S. and European fund financing markets have adopted a more flexible approach, certain sponsors have started to reach out to non-Japanese financial institutions in hopes of securing financing on terms that would be more acceptable to limited partners in their funds. These non-Japanese financial institutions, however, cannot offer the same low interest rate product as their Japanese competitors. In addition, interest on loans by non-Japanese financial institutions is generally subject to a 20% Japanese withholding tax, further disadvantaging the non-Japanese lenders.

Key developments

Increased receptivity to private equity investment

A subtle but key development in Japan has been the increasing receptivity of the public generally, and the owners and founders of private companies specifically, to investment by private equity firms. Cultural resistance to selling a business to outsiders, and the prevalence of cross-shareholdings among corporate conglomerates, have long been a target of critics lamenting the failure of M&A and private equity to penetrate Japan. But recently, private equity investors including Carlyle's Tamotsu Adachi (quoted by PEI) have touted Japanese small and medium enterprises' desire to partner with firms that have the skills, experience and capabilities to help them expand internationally. Megumi Kiyozuka, managing partner of CLSA Capital Partners, credits intermediaries like investment banks for helping sellers become better informed about the advantages and disadvantages of potential private equity partners, noting for PEI, "[p]reviously they hated seeing us private equity firms, but that negative perception is decreasing."

Differences in domestic and offshore LP investment strategies

One of the interesting aspects shaping development in the Japanese private equity industry has been the different approach to private equity investing taken by Japanese and offshore investors. Non-Japanese investors, particularly those with a long history of investing with private equity general partners, often look at their investments as the establishment of long-term relationships, and therefore tend to be highly selective in choosing the managers with whom they will entrust their money. After conducting broad diligence, they may select their partners from among a basket of many options, and then look to work closely with that partner to help it grow and succeed. Japanese investors, on the other hand, outside of the GPIFs and the Japan Post Banks of the world, seem to be taking a more risk-diversification portfolio approach to investing, choosing to divide their allocations across many sponsors rather than betting on just one or two that they find to be more promising.

The results have been significant in helping to shape the industry. Many domestic sponsors find that they can raise sufficient capital for their funds' investment programs mainly, or even solely, on the basis of commitments from Japanese investors. Although there is a desire to tap into overseas capital, they don't need to do so. Moreover, a strong domestic sponsor that wins commitments from both limited partners with their diversified portfolio approach and the larger, selective domestic investors, finds itself in a strong position *vis-à-vis* offshore investors, with little need to make concessions on terms. Another result has been that a number of sponsors have seen the portion of aggregate commitments to their funds accepted by Japanese investors increase significantly relative to those of non-Japanese investors.

Recent FIEA amendments

As mentioned above, amendments to the FIEA took effect in March, imposing additional regulatory restrictions and requirements for fund operators relying on the QII-targeted business exemption. Under the March amendments, satisfying the QII Exemption has become more difficult and compliance burdens have increased substantially. The new requirements have also made it more difficult for Japanese domestic investors to structure offshore investment vehicles that are outside the application of the FIEA (or that at least do not impose compliance burdens for general partners), while on the off-shore side, what had been a relatively straightforward notification process to accept Japanese investors has become more complex, with compliance requirements that are potentially burdensome and intrusive from the sponsor's perspective.

Impacts of AIFMD for Japanese fundraising

The effects of the implementation of the Alternative Investment Fund Managers Directive (the "AIFMD") in the European Union ("EU") have been felt globally, but particularly in Japan, where funds tend to be smaller and have fewer investors than in the United States and some other jurisdictions. Consequently, the burdens and costs may disproportionately impact Japanese sponsors more than in some other jurisdictions where the fund sizes are large enough to support full compliance efforts, or are small enough that they do not frequently have EU investors. As one might imagine, sponsors therefore seek to rely on reverse solicitation whenever possible, and only infrequently seek to use the national private placement regime route, other than in administratively "easy" jurisdictions such as the United Kingdom and the Netherlands.

The European Securities and Markets Authority ("ESMA") publication in July of its advice on the application of the AIFMD "passport" to several non-EU Alternative Investment Fund Managers ("AIFMs") established in 12 countries, including Japan, was encouraging. The passport refers to the process by which the AIFMD can be extended to non-EU AIFMs in these countries – by choosing to comply fully with the AIFMD, a non-EU AIFM would become authorised, and thus permitted to market alternative investment funds in all member states of the EU under the marketing passport. ESMA's advice with respect to Japan was positive, concluding that there are no significant obstacles impeding the application of the AIFMD passport to Japan. This does not guarantee that the passport will ultimately be extended to Japan, and realistically the next steps in the process are likely to take time, particularly in the wake of Brexit. Challenges remain, but this is an encouraging step that leaves Japan one step closer to becoming a passport country, with the potential for an easier road to reaching EU investors.

Corporate governance reforms under Abenomics

Two key initiatives of the Abe administration have had particularly positive impacts on private equity and investing in Japan: the amendment of the Companies Act, and the introduction of the new Stewardship Code.

The Companies Act amendments, effective May 1, 2015, have effectively put pressure on companies to break with the traditional practice of keeping directorships limited to former senior executives, and instead make increased use of outside independent directors. The notion is that independence would help Japanese companies avoid the strong temptation of "group-think", make them more responsive to outside shareholders, and improve performance. The same amendments also streamlined the process by which minority shareholders can be squeezed out after a successful tender offer, making it easier for buyers which have acquired at least 90% of the total voting rights of the target to then make such target a wholly-owned subsidiary. While the effectiveness of these reforms in improving corporate governance is a matter of some debate, it appears they have in fact made it easier to take Japanese public companies private.

The introduction of the Stewardship Code provides institutional investors with greater opportunities for constructive engagement with management in determining the medium- to long-term growth of the companies in which they invest. The institutional investors are required to disclose their votes at shareholders' meetings, as motivation to end the traditional passivity of Japanese shareholders. A new index, JPX-Nikkei 400, was also launched in the beginning of 2014, comprised of companies which meet global investment standard criteria. Selection criteria include factors such as disclosure of earnings in English and three-year average return on equity. These reforms and initiatives have arguably forced greater accountability on large public companies and encouraged investors to become more active, in an effort to kick-start value creation and improve shareholder return. These changes are driving an uptick in carve-out transactions (i.e., partial divestitures of non-core businesses of larger conglomerates), creating more opportunity for private equity firms. As seen in the ¥665.5bn (US$5.9bn) acquisition of Toshiba Corp's medical equipment unit by Canon in early 2016, multiple challenges remain for private equity firms, including cash-rich strategic bidders whose valuations of target companies are often significantly higher than what private equity investors find reasonable, as well as the pervasive challenge of changing entrenched corporate cultures in which resistance to change is part of their DNA.

The year ahead

While the impact on Japan of certain global events such as the withdrawal of the United Kingdom from the European Union and the new U.S. presidency remain uncertain, interest rates are expected to remain low, and the long-term shifts that have been making private equity attractive to investors are expected to continue. As some observe, the next few years look to be a good time to be a private equity investor in Japan.

Overseas investors' appetite towards Japan should remain steady; however, they may be more susceptible to currency fluctuation. The Japanese yen has fluctuated between US$1 = ¥135 and US$1 = ¥76 since 2001 and if it were to significantly strengthen against the US dollar, Japanese investments would become more expensive for overseas investors and hence less attractive. Recent signs since the U.S. presidential elections, however, point to the yen weakening, which seems to be an encouraging sign for investors and the economy.

On the deal-making front, there is no reason to believe that additional carve-out transactions of non-core assets by large Japanese corporations and other divestitures will cease. Partnership between small to medium-sized companies and private equity firms should continue as the aging and declining Japanese population is not an easily reversible phenomenon.

From the fund financing perspective, it is important to increase awareness among the limited partners, the sponsors and the lenders regarding the benefits of the capital call facilities and the limited risk associated therewith. The tax implication on these capital call facilities will need to continue to be assessed. A better understanding of the flexibility needed by the fund borrowers, and of the protection provided to the lenders, will hopefully lead to more competition, sophistication of the market and expansion of capital call facilities in Japan.

* * *

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* * *

Endnotes

1. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("*Dodd-Frank*"), enacted in response to the financial crisis, ushered in a new wave of financial and regulatory reform that, among other things, heightened regulation of the private funds industry. A key component of Dodd-Frank was the so-called "Volcker Rule" which, subject to certain limited exceptions, prohibits banking organisations from sponsoring or investing in most private equity funds. Defining and clarifying those exceptions took a period of several years, during which non-U.S. banks with U.S. branches or subsidiaries were left in limbo, not knowing whether they would be required to withdraw from their private fund investments and, if so, how quickly.
2. Kinyu Shōhin Torihiki-hō, Act No. 25 of April 13, 1948.
3. Technically the 25/5 Rule applies where a non-Japanese limited partner without a PE in Japan (i) together with its "specially related parties" sells 5% or more of the shares in a

Japanese company in a fiscal year and (ii) together with specially related parties owns, or has owned, 25% or more of the shares in such Japanese company at any time during the prior three 12-month periods from the last day of the fiscal year of sale. Note that limited partners of a private equity fund are generally, absent an applicable exemption, deemed to be aggregated with each other for purposes of the 25/5 Rule.

4. This does not necessarily mean that fund size and organisational expenses cannot be capped, just that it has to be done in a manner that does not constitute a direct agreement among the general partners of the parallel funds.
5. It should be noted that there are other potential structuring alternatives which could, in theory, make it possible to have cross-default type arrangements and agreements by and among the parallel funds. For example, each of the non-Japanese limited partners could be required to rely on making a so-called "25/5 Rule Exemption" filing. However, there are significant limitations with such an approach (e.g., a minimum one-year holding period for investments does not apply to distressed financial institutions; the limited partners shall not be involved in the management or operation of the fund negating any consent rights and increased regulatory oversight in Japan), which are commercially challenging in most cases.

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