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## METI's Guidance Clarifying the Eligibility for Investment in Securities Tokens by an Investment Limited Partnership

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### I. Introduction

On April 19, 2023, the Japanese Ministry of Economy, Trade and Industry (METI) issued its guidance clarifying that an investment limited partnership (*toushi jigyou yuugen sekinin kumiai*) ("ILP") established under the Act on Investment Limited Partnership Agreements (the "ILPA Act"), one of the most popular private equity and venture capital fund vehicles in Japan, is allowed to invest in security tokens pursuant to the ILPA Act.

METI's guidance can be seen in the context of the Kishida administration's 2022 "Five-Year Plan for Nurturing Startups", which includes several plans for enhancing the investment environment for Web3.0 business, including clarifying the eligibility for investment by ILPs of security tokens that tokenize securities.

While the guidance is not a regulatory amendment per se, rather a clarification of the regulatory interpretation of the purport of the ILPA Act, it is an important first step in diversifying the fund vehicles used for investing in blockchain-related business and for securing an investment environment that supports opportunities for ILPs to access and invest in innovative projects that use security tokens as a fundraising method. It also benefits security token issuers who can tap into a new source of capital.

## II. Background

### 1. Recent developments in regulation of security tokens

Under the amended Financial Instruments and Exchange Act (the FIEA), which came into effect on May 31, 2020, security tokens are regulated as “rights or interests characterized as securities that are represented by tokens by leveraging distributed ledger technology (DLT)<sup>1</sup>.” Security tokens themselves are defined as “Electronically Recorded Transfer Rights to be Indicated on Securities, etc.” (*denshi kiroku iten yuuka shouken hyouji kenri tou*). The scope of the security tokens subject to METI’s guidance corresponds to those falling within this definition.

### 2. Restriction on investment by Investment Limited Partnerships

An ILP is similar to a limited partnership in other jurisdictions and must be formed by at least one general partner, who is subject to unlimited liability to third parties, and one limited partner. A general partner is responsible for operating the fund’s business, while limited partners are not involved in the day-to-day operations of the fund. A limited partner’s liability is limited to the amount of their capital contribution to the fund. The scope of investments permitted by an ILP (“Permitted Investments”) is restricted under the ILPA Act, which exhaustively lists the categories of Permitted Investments.

While the purpose of the ILPA Act is to promote access to capital by businesses through investment by ILPs, ambiguity in the question of whether investment in security tokens and other assets whose transfers are handled by leveraging blockchain technology fall within the scope of Permitted Investments has frustrated the full attainment of this goal in the context of increased opportunities for digitized investments.

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<sup>1</sup> The FIEA takes a neutral position as to which technology should be used for tokenization.

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### III. METI's Interpretation of Permitted Investments

1. Clarification that securities under the FIEA that are already included in the scope of Permitted Investments under the ILPA Act remain Permitted Investments even if those securities are tokenized.

In coming to its interpretation that security tokens fall under the scope of Permitted Investments under the ILPA Act, METI took the position that securities that are already included in the scope of Permitted Investments still remain within existing specified categories of Permitted Investments even if those securities are tokenized. The rationale behind the interpretation is simple, but METI presented a meticulous explanation in order to align the attributes of the following three categories of securities, which are Permitted Investments under the ILPA Act, with defined categories of securities regulated under the FIEA.

- (i) Securities that fall under the category of securities set forth in Article 1(i) to (xi) of the Order for Enforcement of the ILPA Act (the "Order") ("Category 1 Securities").

Category 1 Securities are specified in Article 1(i) to (xi) of the Order as follows:

- (a) Special corporation bonds
- (b) Specific bond certificates under the Asset Securitization Act
- (c) Debenture certificates
- (d) Special corporation investment securities
- (e) Preferred equity securities or deeds indicating preferred equity subscription rights
- (f) Preferred equity investment certificates or securities indicating preferred equity subscription rights under the Asset Securitization Act
- (g) Beneficiary certificates of investment trusts or foreign investment trusts
- (h) Investment securities, investment equity subscription rights securities or investment corporation bonds under the Investment Trust Act
- (i) Beneficiary certificates of loan trusts
- (j) Beneficiary certificates of specific purpose trusts under the Asset

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## Securitization Act

## (k) Commercial paper

Article 1(xiii) of the Order provides that rights that must be indicated on Category 1 Securities according to the provision of Article 2(2) of the FIEA (*yuuka shouken hyouji kenri* – i.e. securities that are supposed to be indicated by physical instruments, which are not actually issued) are also Permitted Investments. By this logic, rights corresponding to Category 1 Securities (*yuuka shouken hyouji kenri*) that are represented by tokens (i.e. Electronically Recorded Transfer Rights to be Indicated on Securities, etc.) naturally fall within the scope of Article 1(xiii) of the Order and are, accordingly, to be considered Permitted Investments for purposes of the ILPA Act.

- (ii) Rights that must be indicated on shares, stock acquisition rights, etc. as physical instruments (“Category 2 Securities”).

The definition of “shares” set forth in Articles 3(1)(i) and (ii) of the ILPA Act can be interpreted as including rights that must be indicated on “share certificates” under the FIEA (*yuuka shouken hyouji kenri*). While the logic behind the interpretation is not supported by an explicit provision such as Article 1(xiii) of the Order discussed above, METI’s guidance has clarified that such rights (*yuuka shouken hyouji kenri*), if they are represented by tokens, naturally fall within the definition of “shares” set forth in Articles 3(1)(i) and (ii) of the ILPA Act and are, accordingly, to be considered Permitted Investments.

For purposes of Category 2 Securities, similar to the aforementioned interpretation regarding “shares”, the guidance has clarified that, since certain securities specified in the ILPA Act such as stock acquisition rights can be interpreted as including rights that must be indicated on physical instruments, those rights, if they are represented by tokens, naturally fall within the definition of each Category 2 Security under the ILPA Act and are, accordingly, to be considered Permitted Investments.

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- (iii) Securities corresponding to beneficial interest in trusts, silent partnership interests, etc. (“Category 3 Securities”).

The definition of “beneficial interest in trusts” set forth in Article 3(1)(vi) of the ILPA Act can be interpreted as including rights that must be indicated on beneficial certificates of trusts as set forth in Article 2(1)(xiv) of the FIEA (*yuuka shouken hyouji kenri*) and beneficial interest in trusts under Article 2(2)(i) of the FIEA. Based on the interpretation, the guidance has clarified that such rights regarding beneficial interest in trusts, if they are represented by tokens, naturally fall within the definition of “beneficial interest in trusts” set forth in Articles 3(1)(vi) of the ILPA Act and are, accordingly, to be considered Permitted Investments.

For purposes of Category 3 Securities, a similar analysis is available to interests in silent partnerships (also permitted under Article 3(1)(vi) of the ILPA Act) and investments in ILPs and certain other partnerships established under the Civil Code (permitted under Article 3(1)(ix) of the ILPA Act).

## 2. Investments other than security tokens

With respect to investment in the following assets that do not fall to be considered securities, METI has also clarified that an ILP may handle transfers and manage ownership records by leveraging blockchain technology:

- (a) Shares of a joint enterprise cooperative (Article 3(1)(i) and (ii) of the ILPA Act)
- (b) Monetary claims (Article 3(1)(iv) of the ILPA Act)
- (c) Industrial property rights and copyrights (Article 3(1)(vii) of the ILPA Act)
- (d) Promissory notes (Article 2(1)(i) of the Order)
- (e) Negotiable certificates of deposit (Article 2(1)(ii) of the Order)

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### 3. Other considerations

#### (i) Act of unauthorized agency by the general partner

The ILPA Act does not permit the ratification by limited partners of investments made by the general partner that are not permitted under the ILPA Act and limited partnership agreements. The general partner may thus be liable for such acts accordingly under Article 117 of the Civil Code. General partners will therefore need to make careful consideration, including the taking of legal advice, before making an investment decision to invest in security tokens based on METI's new interpretation.

#### (ii) Treatment of Stablecoins and Crypto-assets

METI confirmed that investment in stablecoins or crypto-assets would not constitute Permitted Investments under the ILPA Act. It has thus been clarified that ILPs are not fund vehicles that are allowed to directly invest in stablecoins or crypto-assets under current Japanese regulation. There is, however, an ongoing debate over expanding the scope of Permitted Investments under the ILPA Act to cover digital assets, especially crypto-assets, and developments regarding the potential for ILPs to invest in such assets will continue to be closely monitored.

## IV. Conclusion

While METI's guidance is intended to provide clarity and certainty to investors and their targets that investment in security tokens is permitted under the ILPA Act, it is not intended to represent that tokenization or transfer of rights using blockchain technology is feasible with respect to each type of security mentioned in the guidance and it remains to be seen how issuers will be able to structure security tokens meeting statutory requirements for being considered to fall under the definition of "Electronically Recorded Transfer Rights to be Indicated on Securities, etc." under the FIEA.

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## PUBLICATIONS

- Article "Corporate Legal Affairs Frontier (No.248): metaverse"  
Publication Monthly Audit & Supervisory Board Member No.749  
Author Masafumi Masuda
  
- Article "Non-Japanese Alternative Investment Funds offered in Japan"  
Publication Chambers Expert Focus  
Author [Co-Author] Nobuharu Onishi and Keita Nakano
  
- Book "Legal and Tax Affairs for Limited Liability Companies"  
Publication Chuokeizai-sha, Inc.  
Author Yoshihiko Abe
  
- Article "(Editorial) Scheme Design and Structure for Granting Incentives in  
Venture Capital Funds (VC)/Private Equity Funds (PE) - In  
Association with the Revisions to the Registration Regulations, Etc.  
for Limited Partnerships (LPS)"  
Publication Kinyu Homu Jijo No.2211  
Author Keita Nakano
  
- Article "Private Equity in Japan: Overview"  
Publication [Thomson Reuters Practical Law](#)  
Author [Co-Author] Hajime Tanahashi, Shuhei Uchida, Makoto Sakai and  
Mitsue Tanaka

## NEWS

- [The Best Lawyers in Japan™ and Best Lawyers: Ones to Watch in Japan™ \(2024 edition\)](#)

In the 2024 edition of The Best Lawyers in Japan™ by Best Lawyers®, MHM received the "Law Firm of the Year" award in the categories of Banking and Finance Law and Insolvency and Reorganization Law.

Furthermore, 152 lawyers from our firm have been included in The Best Lawyers in Japan™, and 55 lawyers from our firm have been included in Best Lawyers: Ones to Watch in Japan™.

Best Lawyers

• Financial Institution Regulatory Law

Hideki Matsui, Daisuke Oda, Akira Ehira, Takane Hori, Takanori Ishikawa,

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Tsuyoshi Shirakawa and Takanori Shinohara

- Private Equity, Private Funds and Venture Capital Law

Yasuzo Takeno, Ken Miura, Soichiro Fujiwara, Hajime Tanahashi, Gaku Ishiwata, Atsushi Oishi, Mitsue Tanaka, Takayuki Kihira, Rintaro Shinohara, Masakazu Masujima, Shuhei Kubota, Shuhei Uchida, Hirokazu Hayashi, Kenichi Sekiguchi, Shimpei Ochi and Takeshi Fukuda

### Ones to Watch

- Financial Institution Regulatory Law

Kazuyo Ikeda, Chiho Zen and Ryo Yoshino

### ➤ Firm receives awards at ALB Japan Law Awards 2023

Mori Hamada & Matsumoto earned the prestigious awards listed below at the ALB Japan Law Awards 2023 organized by Asian Legal Business (ALB), an internationally-recognized legal journal and a part of the Thomson Reuters Group.

### LAW FIRM CATEGORIES

Japan Law Firm of the Year

Japan Deal Firm of the Year

Banking and Financial Services Law Firm of the Year

Capital Markets Law Firm of the Year

Investment Fund Law Firm of the Year

Regulatory and Compliance Law Firm of the Year

Restructuring and Insolvency Law Firm of the Year

Technology, Media and Telecommunications Law Firm of the Year

### DEAL CATEGORIES

Debt Market Deal of the Year

- Bain Capital's Tender Offer for Hitachi Metals

Equity Market Deal of the Year

- SBI Sumishin Net Bank's Global IPO

M&A Deal of the Year (Premium)

- KKR Acquisition of Mitsubishi Corp UBS Realty

Technology, Media and Telecommunications Deal of the Year

- Hitachi Disposition of Hitachi Metals



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## ➤ Opening of Sapporo Office

Mori Hamada & Matsumoto is pleased to announce the planned opening of an office in Sapporo, Japan.

To date the firm has been providing legal support for matters in Hokkaido through its offices in Tokyo and other locations in Japan. However, clients have expressed their desire for support closer to where they do business, particularly in the field of corporate law. By opening an office in Sapporo, Hokkaido, the firm hopes to respond to such needs and expectations, and provide services specifically tailored to the needs of clients in that region.

The Sapporo Office will be staffed by Mitsuhiro Tateishi, who is a partner of the firm and has extensive experience in areas including M&A, corporate law-related services, and startups, and other associates of the firm. The Sapporo Office will endeavor to contribute to the economic development of Hokkaido by providing cutting-edge legal support in a wide range of areas including M&A, startups, business succession, crisis management, finance, litigation, restructuring, and cross-border transactions while working in close coordination with the firm's lawyers not only within Japan (Tokyo, Osaka, Nagoya, Fukuoka, and Takamatsu), but also at our overseas offices (those in Beijing, Shanghai, Singapore, Bangkok, Yangon, HCMC, Hanoi, and Jakarta, and an office in New York that is scheduled to commence operations in the autumn of 2023) as well as with other overseas law firms, etc. we have alliances with.

The Sapporo Office is scheduled to open in September or October 2023, after the necessary procedures have been completed. Further details about the office, including the date of opening and the location, will be announced at a later date.

\* The Sapporo Office will be established as a branch office of Mori Hamada & Matsumoto LPC.

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