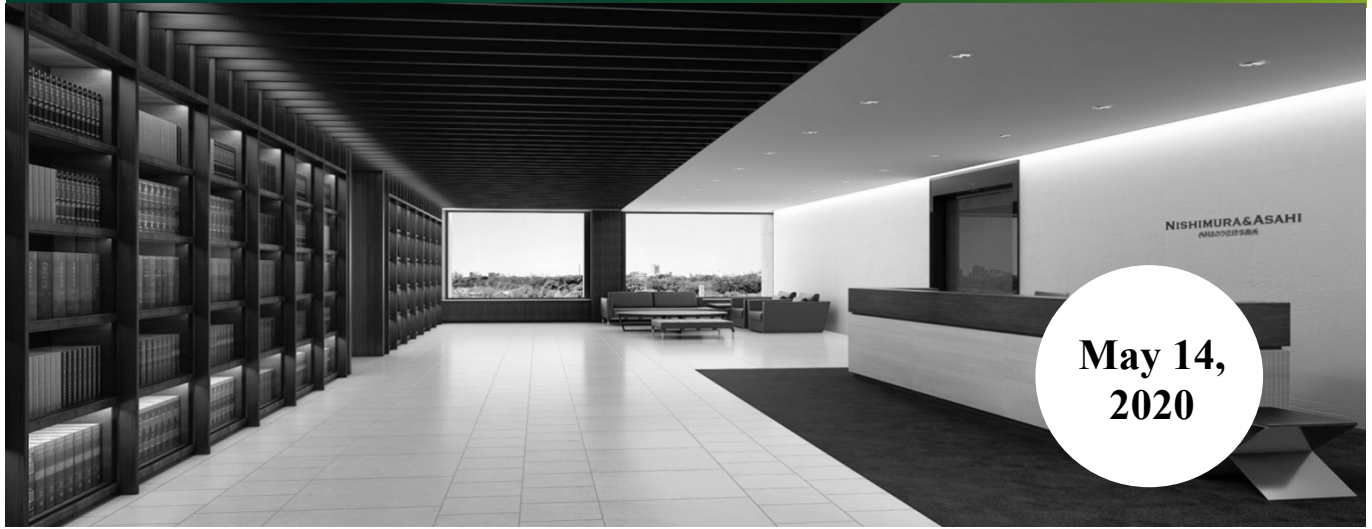


Finance Law Newsletter

May 14,
2020

Recent Amendments to Japan's Foreign Exchange and Foreign Trade Act Concerning Inward Foreign Direct Investment: Some Essential Points

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1. Introduction

In November 2019, the Foreign Exchange and Foreign Trade Act (the "FEFTA") was amended. On 30 April 2020, the amended rules and regulations were promulgated, and on 7 June 2020 the amended FEFTA, along with such rules and regulations, will be fully implemented.

Under the FEFTA, a foreign investor (*gaikoku toshika*) may be required to file a prior-notification (*jizen todokede*) or post-investment report (*jigo hokoku*) in relation to its foreign direct investments (*tainai chokusetsu toshi to*).¹ The new FEFTA amended the definitions for "foreign direct investment" and "foreign investor", and introduced new exemptions applicable to the latter under certain conditions.

We have prepared the following outline of the main points of the revisions on foreign direct investment by foreign financial investors in stocks of listed companies.^{2,3,4}

¹ *Tainai chokusetsu toshi to* is also translated as "inward direct investment, etc."

² I thank Nathan Schmidt, Hiroko Jimbo, Akihiro Shiba, Yuki Oba and Daisuke Fujisaki for comments that greatly improved this newsletter.

³ For ease of understanding, this newsletter omits detailed conditions or exemptions provided in the FEFTA and rules and regulations thereunder. Especially, foreign investors need to keep in mind there are complicated aggregation rules for stock purchase and voting rights acquisition, etc. In addition, foreign direct investments from certain countries or regions are strictly restricted.

⁴ Foreign direct investment relating to unlisted companies are regulated in many different ways.

2. Purchase of Stock and Acquisition of Voting Rights

Purchases of stock and acquisitions of voting rights are the most important categories of foreign direct investment regulated under the FEFTA. Under the new FEFTA, unless an exemption applies,⁵ a foreign investor must file a prior-notification before attempting to purchase stock or acquire voting rights in a listed company (that conducts business activities in a designated business sector; hereinafter, a "DBS listed company"⁶) if that transaction will cause it to hold one percent (1%) or more of the stock or voting rights of such company.⁷

3. Investment Funds

The definition of "foreign investors" under the FEFTA was amended, which may affect foreign investment funds.

"A corporation or other organization established pursuant to foreign laws and regulations, or a corporation or other organization with a principal office in a foreign state" is a sub-category of "foreign investor".⁸ While many foreign investment funds have fallen and will continue to fall within this category, a partnership that does not legally own property, but rather holds property co-owned by its partners, will fall within a new category called "specified partnership, etc." (*tokutei kumiai to*) if (i) 50% or more of its contributions are made by non-residents or foreign companies, or (ii) more than 50% of its general partners are non-residents or foreign companies.⁹

4. Foreign Financial Institutions

The new FEFTA introduces a blanket exemption for foreign financial institutions.¹⁰ Under this exemption, prior-notification concerning purchase of stock or acquisition of voting rights in DBS listed companies is not required if certain conditions are met.¹¹

This exemption is only available to foreign financial institutions which are subject to regulations/supervisions under financial regulatory laws in Japan or other jurisdictions. Foreign securities firms, banks, insurance companies, asset management companies, trust companies and registered investment companies are eligible for this exemption if they are licensed under financial regulatory laws in a foreign jurisdiction.^{12,13}

This blanket exemption is only available if:

- a) the foreign financial institution or any of its closely-related persons¹⁴ will not become a board member or statutory

⁵ Article 27 Paragraph 1 of the FEFTA.

⁶ Businesses are designated by a public notice issued pursuant to Article 3 Paragraph 3 of the Order on Foreign Direct Investment (the "Order"). For a list of companies that conduct business activities in DBS, see footnote #21.

⁷ Article 26 Paragraph 2 Items 3 and 4 of the FEFTA, Article 2 Paragraphs 8 and 10 of the Cabinet Order on Foreign Direct Investment (the "Cabinet Order"), Article 27 Paragraph 1 of the FEFTA, Article 3 paragraph 1 Items 9 and 10 of the Cabinet Order.

⁸ Article 26 Paragraph 1 Item 2 of the FEFTA.

⁹ Article 26 Paragraph 1 Item 4 of the FEFTA, Article 2 Paragraphs 3 through 5 of the Cabinet Order.

¹⁰ Article 27-2 Paragraph 1 of the FEFTA, Article 3-2 Paragraph 2 Item 3 (i) of the Cabinet Order, Article 3-2 Paragraph 4 of the Order.

¹¹ Article 26 Paragraph 1 Item 3 and 4 of the FEFTA, Article 2 Paragraph 16 Items 3 and 5 of the Cabinet Order.

¹² High-frequency traders are eligible only if they are registered as a high-speed trader with Japan's Financial Services Agency.

¹³ Certain foreign financial investors (e.g. investors with a record of being sanctioned due to violations of the FEFTA and state-owned enterprises) are not eligible for this exemption. Article 3-2 Paragraph 1 of the Cabinet Order.

¹⁴ Article 2 Paragraph 1 Item 2 (i) through (nu) of the Order.

auditor of such company.

- b) the foreign financial institution will not propose at such company's general shareholders' meeting to transfer or dispose of such company's business activities in the DBS;¹⁵ and
- c) the foreign financial institution will not access non-public information about such company's technology relating to the DBS.¹⁶

Foreign financial institutions that rely on this exemption need to file a post-investment report if they come to hold ten percent (10%) or more of the stock or voting rights of a DBS listed company.¹⁷

5. Other Foreign Financial Investors

The new FEFTA also introduced a general exemption for foreign investors that are not foreign financial institutions. Under this exemption, prior-notification concerning purchase of stock or acquisition of voting rights in DBS listed companies¹⁸ is not required if certain conditions are met.^{19,20}

First, where a foreign investor purchases stock or acquires voting rights of listed companies that conduct business activities in DBS with no material implications for national security ("non-core sectors"),²¹ prior-notification is not required if:

- a) the foreign investor or any of its closely-related persons²² will not become a board member or statutory auditor of such company;
- b) the foreign investor will not propose at such company's general shareholders' meeting to transfer or dispose of such company's business activities in the DBS;²³ and

¹⁵ Proposals to conduct certain other transactions (e.g. mergers and dissolution of a company) are also restricted. Article 2 Paragraph 11 of the Cabinet Order and Article 2 Paragraph 2 of the Order.

¹⁶ Article 27-2 Paragraph 1 of the FEFTA, Article 3-2 Paragraph 2 Item 5 of the Cabinet Order, Article 3-2 Paragraph 5 of the Order. After the purchasing stock or acquiring voting rights, the foreign financial institution needs to comply with the conditions similar to a) through c) pursuant to Article 27-2 Paragraph 1 of the FEFTA and the relevant public notice.

¹⁷ Article 55-5 Paragraph 1 of the FEFTA, Article 6-3 Paragraph 1 of the Cabinet Order, Article 6-2 and Schedule 3 Item 6 of the Order.

¹⁸ Article 26 Paragraph 1 Item 3 and 4 of the FEFTA, Article 2 Paragraph 16 Items 3 and 5 of the Cabinet Order.

¹⁹ Certain foreign investors (e.g. investors with a record of sanction due to violations of the FEFTA and state-owned enterprises) are not eligible for this exemption. Article 3-2 Paragraph 1 of the Cabinet Order.

²⁰ Article 27-2 Paragraph 1 of the FEFTA, Article 3-2 Paragraph 2 Item 5 of the Cabinet Order, Article 3-2 Paragraph 5 of the Order. After the purchasing stock or acquiring voting rights, the foreign investor is required to comply with conditions similar to a) through e) pursuant to Article 27-2 Paragraph 1 of the FEFTA and the relevant public notice.

²¹ The Ministry of Finance published a list that classifies each company into one of the following categories:

1. Companies subject to post-investment report only (i.e. Non-designated business sectors)
2. Companies conducting business activities only in the designated business sectors that are not core sectors
3. Companies conducting business activities in core sectors

The list are available at https://www.mof.go.jp/international_policy/gaitame_kawase/fdi/list.xlsx

²² Article 2 Paragraph 1 Item 2 (i) through (nu) of the Order.

²³ Proposals to conduct certain other transactions (e.g. mergers and dissolution of a company) are also restricted. Article 2 Paragraph 11 of the Cabinet Order and Article 2 Paragraph 2 of the Order.

- c) the foreign investor will not access non-public information about such company's technology relating to the DBS.

Second, where a foreign investor purchases stock or acquires voting rights of listed companies that conduct business activities in DBS with material implications for national security ("core sectors") and such purchase or acquisition is less than ten percent (10%)²⁴ of such company's stock or voting rights, prior-notification is not required if, in addition to the conditions a) through c) above:

- d) the foreign investor or its nominee will not join such company's board or a committee that makes important decisions in relation to businesses in core sectors; and
- e) the foreign investor will not make proposals, relating to such company's business in core sectors, in writing or by means of electromagnetic records to the board or such company's investment committee or to the members of the board or such committee, requiring their responses and/or actions by certain deadlines.

Foreign investors that rely on this exemption need to file a post-investment report if they come to hold stock or voting rights of one percent (1%) or more.²⁵

6. SWFs

Sovereign wealth funds and public pension funds ("SWFs"), as state-owned enterprises, are generally not eligible for exemptions from the prior notification requirements. However, SWFs that are deemed to pose no significant risk to national security are eligible for the regular exemption if they have been accredited by the Minister of Finance.²⁶

When considering accreditation, the Ministry of Finance will review, among other factors, whether:

- (i) the investment activities of the SWFs are only for economic returns; and
- (ii) the investment decisions by the SWFs are made independently of their governments.

The Ministry of Finance will execute a Memorandum of Understanding (MOU) with an SWF to grant accreditation. The decision to grant accreditation and the execution of the MOU will not be made public.

7. Custodians

Under the new FEFTA, a foreign investor is not subject to the prior-notification filing requirement where it purchases stock or acquires voting rights after fully entrusting such investment decisions to a third party.²⁷ Custodians may be exempted from filing a prior-notification for purchasing stock or acquiring voting rights of listed companies if they have no authority to make decisions to exercise voting and other shareholder rights.

8. Investment Advisors

Under the new FEFTA, acquisition of a right to exercise, or instruct the exercise, of one percent (1%) or more of a company's voting rights are noted as new categories of foreign direct investment, while investments by discretionary

²⁴ Article 27-2 Paragraph 1 of the FEFTA, Article 3-2 Paragraph 2 Item 3 (*ro*) of the Cabinet Order.

²⁵ Article 55-5 Paragraph 1 of the FEFTA, Article 6-3 Paragraph 1 of the Cabinet Order, Article 6-2 and Schedule 3 Items 3, 4 and 6 of the Order.

²⁶ Article 3-2 paragraph 1 of the Cabinet Order.

²⁷ Article 3 Paragraph 1 Item 8 of the Cabinet Order.

investment advisors has been and remains a category of foreign direct investment.^{28,29} Therefore, if an investment advisor that does not have discretion to make investment decisions acquires the right to exercise, or instruct the exercise, of voting rights, such acquisition is treated as a direct foreign investment, which may trigger a prior notification requirement.

In addition to purchasing stock and acquiring voting rights, prior-notification is required for certain other actions, including:

- (i) voting at a shareholders' meeting for the nomination of the foreign investor itself, or a person that is closely related to it, as a board member or statutory auditor of a company that conducts business activities in DBS,³⁰ and
- (ii) voting at a shareholders' meeting for a proposal, made by the foreign investor, to transfer or dispose of a company's business activities in a DBS,³¹

where the foreign investor holds one percent (1%) or more of voting rights of such company.³²

End.



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²⁸ Article 26 Paragraph 2 Item 9 of the FEFTA, Article 2 Paragraph 16 Item 5 of the Cabinet Order.

²⁹ Article 26 Paragraph 2 Item 9 of the FEFTA, Article 2 Paragraph 16 Item 3 of the Cabinet Order.

³⁰ Article 26 Paragraph 2 Item 5 of the FEFTA, Article 2 Paragraph 11 Item 1 of the Cabinet Order, Article 2 Paragraph 1, Article 3 Paragraph 2 Item 8 of the Order.

³¹ Article 26 Paragraph 2 Item 5 of the FEFTA, Article 2 Paragraph 11 Item 5 of the Cabinet Order, Article 2 Paragraph 2, Article 3 Paragraph 2 Items 9 and 10 of the Order.

³² Article 26 Paragraph 2 Item 5 of the FEFTA, Article 2 Paragraph 12 of the Cabinet Order, Article 27 Paragraph 1 of the FEFTA, Article 3 Paragraph 1 Items 11 of the Cabinet Order.

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