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Bill on Amendment to Japanese FDI Regulations

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As we discussed in our Corporate Newsletter (October 2019, E_Vol. 1), in tune with the global trend of tightening scrutiny on foreign investments, the regulations regarding the foreign direct investments ("**FDIs**") under the Foreign Exchange and Foreign Trade Act (the "**FEFTA**" or "**Act**") have undergone a series of changes. The government was further contemplating major changes on the pre-transaction notification requirements under the FEFTA.

On October 18, 2019, the bill on the amendment to the FEFTA (the "**Bill**") was decided by the cabinet and submitted to the Diet.[1] Because the Bill includes amendments related to shareholder proposals, it is anticipated that the amended FEFTA will come into effect by such time as the amendments will be applicable to shareholder proposals to be submitted to the annual meetings to be held in June 2020.

This newsletter outlines the content of the Bill and discusses what foreign investors should pay attention to.

[1] https://www.mof.go.jp/about_mof/bills/200diet/index.htm (in Japanese)

In the Bill, the following four amendments are the most important from the perspective of foreign investors.

(1) Thresholds for acquisition of shares or voting rights of listed companies to become a covered FDI will be lowered from 10% to 1%
(2) Definition of FDIs will be expanded to include (a) giving consent to "certain matters having material impact on management of a company", and (b) acquisition of a business from a resident company
(3) Exemption to pre-transaction notification requirements will be introduced
(4) Clarification on who is obliged to make notification or reporting in the event that a fund vehicle acquires shares or voting rights

(1) Thresholds for acquisition of shares or voting rights of listed companies to become a covered FDI will be lowered from 10% to 1%

Under the current provisions of the FEFTA (following the amendment to be effective as of October 26, 2019), the thresholds for acquisition of shares or voting rights of listed companies to become a covered FDI (which is subject to either pre-transaction notification or post-transaction reporting requirement) are whether the foreign investor will hold "10% or more" after the acquisition. The Bill will lower these thresholds from 10% to 1%.

In calculating the percentage, in addition to the already existing group aggregation rules, the Bill explicitly sets forth that the number of shares or voting rights "managed" by the foreign investor under discretionary investment management agreement will be added to those "owned" by the foreign investor. With respect to financial institutions, the positions held by the sell-side and buy-side may need to be aggregated.

(2) Definition of FDIs will be expanded to include (a) giving consent to "certain matters having material impact on management of a company", and (b) acquisition of a business from a resident company

Under the current provisions of the FEFTA, if a foreign investor gives consent to any substantive change on business purposes of a company, it may become a covered FDI. The Bill adds to the definition of FDI a foreign investor's giving consent to "certain matters having material impact on management of a company", which will be enumerated in the cabinet order.

The Bill also adds a new category of the covered FDI, which is acquisition by a foreign investor of a business from a resident company. This will cover not only sale of a business, but also transfer of a business by demerger or merger.
With respect to the consent given to a listed company by a foreign investor in connection with "certain matters having material impact on management of a company" (or any substantive change on business purposes of the company), it will become a covered FDI only if the foreign investor holds 1% or more of the total voting rights of that company.
The Ministry of Finance explains that "certain matters having material impact on management of a company" (which will be enumerated in the cabinet order) will include:

- Appointment of a person affiliated with the foreign investor as director of the company, and
- Sale of material part of the business of the company.

(3) Exemption to pre-transaction notification requirements will be introduced

An FDI:

(a) by a foreign investor who is not a disqualified investor specified in the cabinet order (including an investor who in the past violated the FEFTA);
(b) which is acquisition of shares or voting rights or other specified transaction (not including the giving of consent or acquisition of a business discussed in (2) above); and
(c) which does not fall under a category of FDIs that is specified in the cabinet order as having substantial threat to the national security,

will be exempted from the pre-transaction notification requirements. In this case, however, the foreign investor must comply with certain "standards" to be specified by the Minister of Finance or other ministers having jurisdiction over the industries involved.
With respect to the requirement (a) above, it has been explained that state-owned enterprises and other entities under influence of foreign governments will be disqualified investors in addition to any investors who violated the FEFTA in the past.
The Ministry of Finance explains that the "standards" to be complied by the exempt investor will include commitments not to (i) assume the office of directors or officers, (ii) propose any sale or abolishment of a business, and (iii) access any non-public technologies or information.

Among the exemption requirements, the requirement (c) will be the critical element. The Ministry of Finance initially explained that FDIs in industries which could have substantial threat to the national security, such as arms, nuclear, electricity and telecommunication, will not be eligible for the exemption.
However, concurrently with the cabinet decision on the Bill, the Ministry of Finance clearly stated that any proprietary trading by foreign broker-dealers and any trading by foreign banks, insurance companies and asset managers (including hedges funds and other funds) will be exempt, regardless of the industries in which the portfolio companies engage. As such, it is anticipated that the cabinet order will not include such trading in the "category of FDIs having substantial threat to the national security" regardless of the industries of the portfolio companies. However, the scope of exemption cannot be clearly predicted until the draft cabinet order becomes available.

Also, even if an FDI is eligible for the exemption, the post-transaction reporting will still be required. While the Ministry of Finance has explained that the threshold for the post-transaction reporting by foreign broker-dealers, banks, insurance companies and asset managers will remain 10% even after the lowering of the threshold for the pre-transaction notification, the details of the reporting requirements are to be specified in the cabinet order and we are yet to know exactly how the reporting will be made.
The details of the exemption are to be specified in the cabinet order and public notices. Market participants and other stakeholders should pay close attention to the coming announcements of such cabinet orders and public notices.

(4) Clarification on who is obliged to make notification or reporting in the event that a fund vehicle acquires shares or voting rights

The definition of the foreign investor will be amended to include any general partnership under the Civil Code of Japan, limited partnership for investment under the Limited Partnership Act for Investment of Japan, and other similar partnership under foreign laws where (a) 50% or more of the contributions are made by non-resident, or (b) a majority of the general partners are non-residents. Such partnership will be obliged to make the notification or reporting under the name of the partnership (and individual partners will not

be required to make such notification nor reporting).

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