

## CORPORATE NEWSLETTER

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## MOF Released Draft Rules and Regulations to Implement New Japanese FDI Regulations

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The amendment bill to the Foreign Exchange and Foreign Trade Act of Japan (the “FEFTA” or “Act”), as discussed in our [Corporate Newsletter \(October 2019, E\\_Vol.2\)](#), was approved by the Diet on November 22, 2019.

On March 14, 2020, the Ministry of Finance (“MOF”) released the drafts of the new rules and regulations (including the amended cabinet orders and ministerial ordinances) which set out the details of the new framework under the amended FEFTA.<sup>1</sup> The drafts have been submitted for public comment until April 12, 2020, following which the rules and regulations will be finalized and the amended Act is expected to come into effect in May 2020. MOF provides brief explanations of the draft rules and regulations both in Japanese and English.<sup>2</sup>

In this newsletter, we will discuss some of the important aspects of the new rules and regulations from the perspectives of various stakeholders.

### I. Financial Institutions and Funds Not Regulated in Japan

Under the amended Act, prior notification and examination will be required when foreign investors acquire 1% or more of the shares or voting rights of Japanese listed companies, but passive investments will be exempted from such notification requirement.

In particular, as shown in the figure on the next page, “**Blanket exemption**”

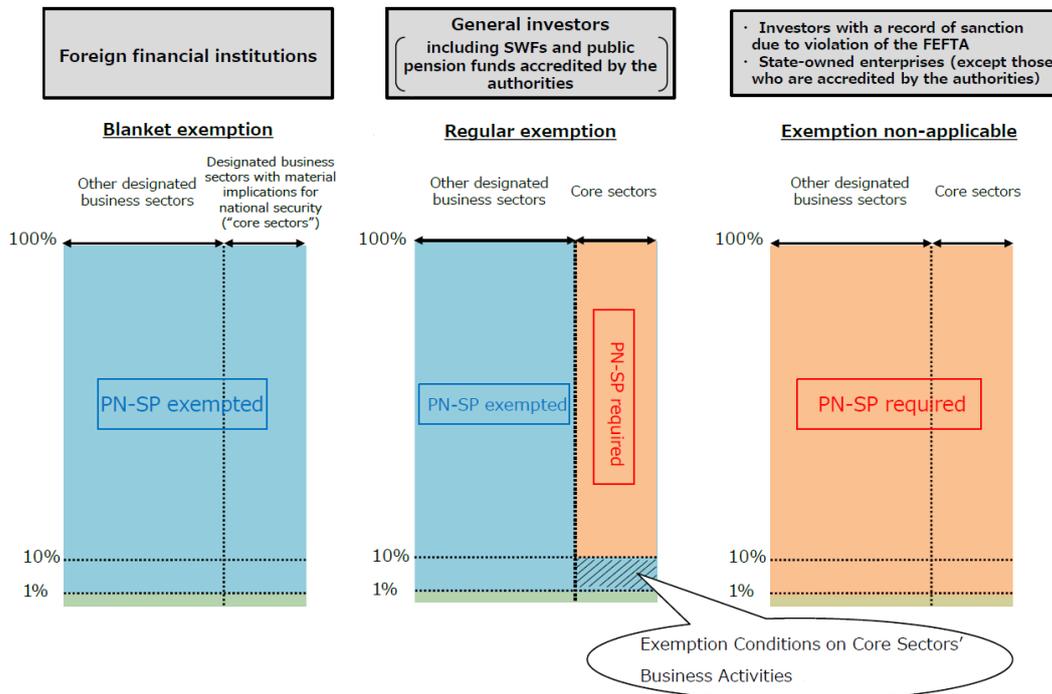
<sup>1</sup>  
<https://search.e-gov.go.jp/servlet/Public?CLASSNAME=PCMMSTDETAIL&id=395122004&Mode=0>

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[https://www.mof.go.jp/international\\_policy/gaitame\\_kawase/press\\_release/20200314.htm](https://www.mof.go.jp/international_policy/gaitame_kawase/press_release/20200314.htm)

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will be available for all the passive investments by foreign financial institutions, including investments in Japanese listed companies engaged in “**core sectors**” that are designated by the Japanese government as closely relating to Japan’s national security.

“**Foreign financial institutions**” include securities companies, banks, insurance companies and funds that are regulated by Japanese law. Among others, Japanese subsidiaries of foreign financial institutions operating under Japanese licenses, and investment funds registered under the Financial Instruments and Exchange Act of Japan fall under this category.



(Cited from the material published by MOF – partly edited by the author)

On the other hand, financial institutions and investment funds not regulated under Japanese laws and regulations can use the blanket exemption only if they are regulated by foreign laws and regulations that are “**equivalent**” to Japanese laws and regulations. There is no accreditation process by the government, and each financial institution or fund will need to make its own judgment whether it is regulated by laws and regulations “equivalent” to Japanese laws and regulations.

However, the criteria for the equivalency are currently unclear, and it could lead to confusion among foreign financial institutions and investment funds when the amended Act comes into effect. In the public comment process, MOF should provide clear guidance on the criteria for equivalency and examples with reference to specific countries and types of licenses.

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### II. SOEs and SWFs

Notwithstanding the foregoing, no exemption (neither blanket or regular) is available for (a) foreign governments (and any subdivision thereof), municipal governments, central banks, political parties and other political organizations, (b) entities 50% or more of their voting rights are held by foreign governments, (c) entities which issues shares with any veto to foreign governments, (d) entities 1/3 of whose officers are employees or designees of foreign governments, and (e) entities carrying out an FDI transaction with whom foreign governments would have the right to instruct how they exercise their voting rights.

However, sovereign wealth funds and public pension funds (“**SWFs**”) that do not pose any risk to the national security are eligible for the regular exemption if individually accredited by MOF. For the accreditation, MOF will review whether (i) investment activities of the SWFs are only for economic returns, and (ii) investment decisions of SWFs are made independently of their governments.

In order to obtain the accreditation, SWF will be required sign a memorandum of understanding with MOF, which could cover requests from MOF.

### III. Activist Investors

Foreign investors using any exemption (whether blanket or regular) are required to comply with the following three exemption conditions: (a) not to allow any of their “**closely-related persons**” to be appointed as directors or statutory auditors of the investee company; (b) not to propose to the general meeting of shareholders the transfer or disposition of a business belonging to designated business sectors; and (c) not to have access to non-public information relating to designated business sectors.

The scope of “closely-related persons” in (a) above varies depending on whether the proposal to appoint directors or statutory auditors is made by the foreign investor itself, or by the investee company or other shareholders, but in either case, it is not prohibited for the foreign investor to propose appointment of experienced businessmen (e.g., former director or officer of another company) who are neither employees of the foreign investor nor have any business with the foreign investor.

Therefore, even activist investors and other foreign investors who intend to actively exercise their voting rights may still be eligible for the exemption.

If an activist is not a financial institution regulated in Japan or elsewhere (see I. above), the blanket exemption cannot be used. However, the regular

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exemption is available for investments in the non-core sectors without any upper limit. Further, the regular exemption is also available for investments in the core sector if the acquisition is less than 10%, on the condition that, in addition to the three exemption conditions above, the company complies with additional conditions on the business activities in the core sectors, which are, with respect to business activities in core sectors, (i) not to attend any committees that make important decisions in these activities, and (ii) not to make any written proposals to the board of directors or such committees requiring their responses and/or actions by certain deadlines.

It is not clear when a foreign investor is deemed to have set such deadlines. If this only means that the foreign investor may not mention any specific date or time, then this condition could be easily circumvented. On the other hand, if the proposal such as "promptly appoint one additional independent director" in the anticipation of the annual meeting could be somehow seen as setting a virtual deadline, it could be far-reaching. MOF should provide clarifications on permitted proposals and specific examples.

### IV. VC / PE Funds

One basic, but important point is that, only the regular exemption for designated business sectors not belonging to the core sectors are available for the acquisition of shares or voting rights of "non-listed" companies. No exemption is available for a foreign investor's acquisition of shares or voting rights of a non-listed company engaged in the core sectors even if the foreign investor is willing to comply with both the exemption conditions and the additional conditions on the business activities in the core sectors.

In addition, since going private transactions by PE funds would usually involve the appointment of directors, it would be usually difficult for PE funds to comply with the exemption condition not to appoint a director in going private transactions.

On the other hand, minority investments in listed companies, such as PIPEs, may be eligible for an exemption. But when investing through an SPC, as the SPC itself may not be regulated as a fund manager under Japanese law, the blanket exemption may not be available, and only the regulation exemption may be available.

On a different, but equally or even more important topic, the scope of the software and Internet service sectors which belong to the designated business sectors have been narrowed down, and those belonging to the core sectors have

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been defined.

The software and Internet service sectors were added to the designated sectors August 2019, which especially increased the burden of VC funds.

It should be noted that the scope of the core industry is not limited to cybersecurity software services in the narrow sense, but also includes businesses that collect sensitive personal information of more than one million people and Japanese input software.

Industries	Designated Business Sectors under the current FEFTA	Designated Business Sectors under the Amended FEFTA
Software	All other than game software	Core sectors (see below)
		Software development for others
		Other businesses that are not incidental to non-designated business sectors
Information processing services	All	Core sectors (see below)
		Services dealing with data on behalf of others
		Other businesses that are not incidental to non-designated business sectors
Internet support services	All	Core sectors (see below)
		Services outsourced by others
		Other businesses that are not incidental to non-designated business sectors
Core sectors relating to cybersecurity		
Services such as monitoring, detection and log analysis to ensure cyber security		
Vulnerability diagnosis service for systems		
Digital forensics service		
Remote management of systems and terminals (including collection of information)		
Security measures to prevent unauthorized access, malware, etc.		
Japanese input software (if input is sent to an external server)		
Software and services for programs designed specifically for critical infrastructure		
Programs specifically designed to handle location information, personal identification codes, sensitive personal information or credit information of more than one million people		

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Internet support business that requires registration under the Telecommunications Business Act

(Prepared by the author based on the draft notice)

### V. Japanese Listed Companies

As for listed companies, the government plans to compile a list of three categories of companies: (a) companies subject to post-investment report only (non-designated business sectors), (b) companies conducting business activities only in the designated business sectors other than core sectors, and (c) companies conducting business activities in the core sectors. The list is expected to be released by the end of April, before the amended Act comes into effect.

As it is not part of the Act, the list will likely be published for convenience of foreign investors only, and reliance on it may not be formally protected. It remains unclear how the government will react if it later turns out such list was inaccurate.

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