



New thresholds introduced under Japanese foreign direct investment regime

As a number of countries have recently raised the regulatory hurdle and strengthen their FDI screening mechanisms, the Japanese government is no exception. The amendment of the Foreign Exchange and Foreign Trade Act was on 22 November 2019 approved by the Japanese Diet. This Forex Act stipulates the conditions for foreign investors' acquisition of Japanese companies. The Japanese government is drafting relevant supplementary regulations and ministerial ordinances. But on 14 March 2020, Japan published detailed schedules and exemption schemes for the amendments¹. The amended Forex Act is now expected to come into force in the first half of 2020.

Under the amended Forex Act, the threshold for pre-screening notification will be set at 1 per cent, much lower than the current 10 per cent of shares in Japanese listed companies engaged in 'sensitive sectors' (designated for national security reasons).

Any foreign investor contemplating an acquisition of 1 per cent or more of the shares or voting rights of Japanese listed company engaged in 'sensitive sectors' will have to notify the Bank of Japan prior to making the investment (i.e. suspensory regime) unless exemption rules are applicable.

Blanket exemptions

The expected exemption schemes are designed to minimise disruption to foreign direct investments and to minimise the burden of reviews. Investors complying with certain conditions who are acknowledged to pose relatively low risks will be exempted from the prior-notifications requirements.

For example, foreign securities houses, banks, insurance companies, asset management firms, trust companies, registered investment trusts and registered high-frequency traders who are already bound by financial regulatory laws in Japan or other jurisdictions are eligible for the "blanket exemption", provided they comply with certain conditions (see below). These exemptions for foreign financial institutions are applicable irrespective of the target business sector (i.e. including core sectors).

Regular exemptions

Other general foreign investors can also be eligible for exemption. However, core sectors are excluded (see below for a definition of 'core sectors').

In principle, state-owned enterprises (SOEs) are not eligible for the exemption from the prior-notification of stock-purchases. However, sovereign-wealth funds (SWFs) and public pension funds who are deemed to pose no risk to national security are eligible for exemption if accredited by the Japanese government. The accreditation criteria for

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¹ https://www.mof.go.jp/english/international_policy/fdi/kanrenshiryoku_20200314.pdf

SOEs are whether:

1. investment activities are only for economic returns; and
2. investment decisions are made independently of their governments.

Conditions for exemptions

Investors need to comply with three conditions to benefit from exemption:

1. investors or their closely-related persons will not become board members of the invested company;
2. investors will not propose the transfer or disposition of important business activities of the invested company to the general shareholders' meeting; and
3. investors will not access non-public information about the invested company's technology that could impact national security.

As mentioned above, foreign investments in designated core businesses (see below) cannot generally be exempted from prior-screening review. Foreign investors, including SWFs and public pension funds seeking exemption from prior-screening for up to 10 per cent of businesses in core sectors must comply with two additional conditions:

4. investors will not become members of the investee companies' committees that make important decisions in these core business activities; and
5. investors will not make proposals, in a written form, to the executive board of the investee companies or board members requiring their responses and/or actions by certain deadlines.

Designated 'sensitive sectors'

Core sectors

The Japanese Government plans to designate 12 industries as having national security concerns (i.e. being core designated business sectors). These are divided between sectors that are wholly regulated:

1. weapons;
2. aircrafts;
3. nuclear facilities;
4. space; and
5. dual-use technologies;

... and other sectors that are partially regulated, namely:

6. cybersecurity;
7. electricity;
8. gas;
9. telecommunications;
10. water supply;
11. rail; and
12. oil.

Acquisitions of 10 per cent or more shares of listed companies active in these core designated business sectors will require prior-screening and regular exemptions are not available.

Non-core sectors

The Japanese Government plans to require prior-screening for foreign direct investments in 155 business sectors (out of the total 1,465 sectors in Japan's Standard Industrial Classification). Based upon Nikkei news reports, it is expected that around 400-500 Japanese listed companies (out of in total of around 3,800) will be flagged as being engaged in these designated sectors.

Implications

The amendment of the Forex Act demonstrates Japanese government's intent to follow the recent global trend to strengthen FDI screening, particularly on national security grounds. (The US adopted the Foreign Investment Risk Review Modernization Act in August 2018 and the EU adopted a new regulation on national security in March 2019.) In fact, the Japanese amendment this time seems to follow closely the approach adopted by other overseas authorities, such as a strong focus on the investor's ability to influence the board or access to and dispose sensitive businesses.

Foreign investors initially raised concerns that the lowering of pre-screening thresholds and resulting additional burdens would negatively impact volumes of FDI into Japan.

Various exemptions as published on 14 March 2020 are designed to minimise the negative impact on the capital market. Not just a wide range of foreign financial institutions are exempt from prior-screening notifications, but other foreign investors, including SWFs and public pension funds, may also be exempt under certain conditions.

Some predict that the vast majority of foreign investments could be exempt and the amendments may not actually increase the number of pre-screening reviews.

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