Newsletter

ATSUMI & SAKAI
TOKYO | LONDON | FRANKFURT
www.aplaw.jp

Abe administration signs off on the bill to lower the threshold for prior notification of inward investments by foreign investors in sensitive industries

October 2019 No.AS_008

1. The bill to implement the new prior notification rule was submitted to the Diet

On October 18, the Abe administration submitted to the Diet a draft bill that amends the prior notification rules under the Foreign Exchange and Foreign Trade Act (the "FEFTA") applicable to inward investments by foreign investors in listed corporations of sensitive industries.

According to the Ministry of Finance (the "MOF"), which is the government agency in charge of these amendments, the amendments contemplated in the bill would require foreign investors to file a prior notification if they plan to buy 1 percent or more of the shares in companies engaging in sensitive businesses, compared with the current threshold of 10 percent.

The framework of such amendments is substantially similar to the proposed amendments announced by the MOF earlier on October 8.

We have reported on the proposed amendments in our earlier A&S Newsletter released on October 10, 2019 (URL: *https://www.aplaw.jp/Newsletter_AS_007.pdf*).

Overseas investors negatively reacted to the proposed amendments warning that the amendments would discourage foreign investments into the Japanese capital markets impeding Japanese companies' ability to raise capital and also undermine the positive momentum in market reforms.

In response to the criticism from the overseas investors, the MOF announced its intention to exempt investment managers and other "portfolio investors" from the new prior notification rule in the bill.

However, the Ministry's recent discussion paper summarizing the framework of the bill makes it clear that the exemption is NOT available to investors which make proposals regarding important management matters of issuer corporations in sensitive industries (URL: *https://www.mof.go.jp/english/international_policy/fdi/20191021.html*). The Ministry distinguishes them from "portfolio investors" that are eligible for the exemption.

In the following, we summarize the key points of the bill and clarify that only a little of the new prior notification rule is incorporated in the bill as a "done deal" and a substantial portion of the rule is yet to be specified in the Cabinet Order, Ministerial Ordinance and Official Public Notice to implement the amended FEFTA (collectively, the "Orders"). The drafts of the Orders will be made public only after the bill is approved by the Diet, with changes if any.

2. Outline of the bill

(1) The framework of the bill

The framework of the bill is substantially similar to that of the amendments announced by the MOF on October 8.
According to the MOF, the bill is intended to achieve two different objectives.

One is to facilitate portfolio investments of foreign investors by exempting them from the prior notification requirement.
The other objective is to tighten review of foreign investments in sensitive industries that are important for the protection of the national security (e.g. nuclear power, weapons, and cyber security), public order (e.g. utilities, transportation and broad casting), public security (e.g. manufacturing biological preparations and security services) or the smooth operation of economy (e.g. agriculture, forestry and fishery, petroleum, air transport). To these ends, the bill contemplates to (A) reduce the threshold for prior notification from the current 10% to "no less than 1%" which threshold shall be specified in the Cabinet Order ; but (B) introduces exemptions from the prior notification requirement as specified in the Cabinet Order (see our discussion in 2. (2) below) whilst (C) clarifying that the exemption is not available if the investor (i) has a previous record of offence of the FEFTA or otherwise falls in a "watch" list category as specified under the Cabinet Order (according to the MOF, state-owned enterprises would be included in this category); (ii) intends to invest in the industries that are important for the national security as specified in the Cabinet Order (according to the MOF, such industries would include nuclear power, weapons, electricity and telecoms OR (iii) does not agree to abide by certain conditions as specified in the Cabinet Order (according to the MOF, such conditions would include agreement to refrain from assuming a director position, making a proposal to dispose or close a part of the business or having access to confidential information.).

The amendment (B) will facilitate portfolio investments of foreign investors that do not intend to engage in the activities that may influence management of the issuer companies.

The amendment (A) and (C) will enable the government to scrutinize the proposed investments in smaller proportions and, in an extreme case, suspend the investment if the issues identified during the review process are not resolved.

(2) Notable exemptions and another prior notification requirement applicable to "consent" to important management matters

Regarding the exemption (B) mentioned in (1) above, the MOF has announced that under the Cabinet Order, portfolio investors that do not fall within any of the disqualifying categories (C) (i) through (iii) above will be eligible for exemption from a prior notification requirement that otherwise applies to them if they hold no less than 1% in a company within sensitive industries.

The MOF has also announced that the Cabinet Order would grant special exemption available to investments by investment managers and certain other financial institutions and investments for proprietary trading by securities companies. Those investments, according to the MOF, would be exempt from the prior notification requirement regardless of the industries in which their investments are made.

On the other hand, it is notable that the bill tightens current prior notification requirement applicable to a foreign investor that (a) has no less than 1/3 of the voting shares of an issuer corporation and (b) grants its consent to a change in the business objective of the issuer corporation.

The bill contemplates to (A) lower the current threshold of a holding ratio from 1/3 to "no less than 1%" which will be specified in the Cabinet Order and also (B) expand the scope of the activities subject to the prior notification to include granting consent to a proposal on matters that have material impact on the management of the business of the issuer corporation as specified in the Cabinet Order as well as the consent to a change in the business objective of the issuer corporation as stipulated in the current FEFTA. According to the MOF, the Cabinet Order would cover consent to a proposal on assumption of a director position and assignment of an important business.

Given the wide scope of the matters that trigger a prior notification, if the Japanese government intends to reduce the threshold from 1/3 to 1% in the Cabinet Order, it appears to be an aggressive change. It is unlikely that the broad exemption like (B) above is made available to this prior notification requirement under the Orders.

(3) Deregulations relating to investments by a fund formed as a partnership

Under the current FEFTA, each of the General Partner and limited partners of a fund is deemed to hold shares of a Japanese listed company held in the portfolio of the fund in proportion to its equity interest in the fund and is obligated to file prior notification if its deemed shareholding reaches the 10% threshold. The bill releases them from their filing obligations and, instead, obligates a foreign fund to file prior notification if the foreign fund's shareholding as a whole reaches the threshold which will be no less than 1% as specified under the Cabinet Order. A fund formed as a partnership is regarded as a foreign fund and will be subjected to such new filing requirement if no less than a half of its equity interests are owned by foreign investors or its General Partner is a foreign investor.

3. Next Steps

As briefly discussed in 2. above, only a little of the new prior notification rule is incorporated in the bill as a "done deal" and a substantial portion of the rule is yet to be specified in the Orders.

Foreign investors that engage or may engage in activities to make proposals to issuer corporations should follow the discussion in the Diet of the bill.

If they wish to engage in a dialogue with the MOF, METI and other government agencies to discuss the contents of the bill and Orders, we believe that key subject matters would include, among other things, (a) the scope of the conditions to the exemption available to portfolio investors from the prior notification rule discussed in 2. (1) (C) (iii), (b) the scope of matters and threshold of a holding ratio that triggers a prior notification requirement in case a foreign investor grants a consent to matters that have material impact on the management of the business of the issuer corporation (see our discussion 2.(2) above) and (c) the request for a list of listed corporations in sensitive industries that are protected under the bill and daily updating of the list (currently, there is no such list).

Akio Kawamura > *View profile*
Attorney (Bengoshi), Japan
Partner
E: akio.kawamura@aplaw.jp

Ryuichi Nozaki > *View profile*
Attorney (Bengoshi), Japan
Partner
E: ryuichi.nozaki@aplaw.jp