

Japan's revisions to the Foreign Exchange and Foreign Trade Act mark a significant shift in Japan's oversight of foreign investment

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On 7 June 2020 revisions to the Foreign Exchange and Foreign Trade Act (the Forex Act) that tighten the regulatory requirements for foreign direct investment in Japan came into full effect (a 30-day grace period was provided from the amendment's 8 May 2020 effective date).

Amendments to the Forex Act

Under the amendments to the Forex Act, an individual or company that is a nonresident of Japan or a company organized in Japan with 50 percent or more of its voting rights directly or indirectly controlled by a nonresident of Japan (a Foreign Investor) seeking just a 1 percent interest in businesses with importance to national security, public safety, public infrastructure, or Japan's economy will be required to undergo a prior notification and approval process with the Japanese government before consummating the proposed investment. The previous version of the Forex Act requires such prior notification and approval only if foreign investors seek a 10 percent interest in the relevant Japanese companies.

Foreign Investors proposing to obtain an interest in the following designated business sectors (Designated Business Sectors) and core sectors (Core Sectors) should carefully consider the notification and approval requirements discussed in more detail below.

	General category	Designated Businesses Sectors	Core Sectors
1.	National security	Weapons	All
2.		Aircrafts	All
3.		Space	All
4.		Nuclear facilities	All
5.		Dual-use technologies (i.e., businesses subject to Japanese	All

		export control regulations including certain software, engineering, and manufacturing)	
6.		Cybersecurity	e.g., cybersecurity-related service providers and software providers for critical infrastructure protection
7.	Infrastructure	Electrical power	e.g., electricity transmission and distribution, and electricity generation utilities with a maximum generation capacity over 50,000 kilowatts
8.		Gas	e.g., gas pipeline service providers and gas manufacturers as well as liquefied petroleum gas companies that own storage facilities or core cylinder filling stations
9.		Telecommunications	e.g., carriers that provide service to multiple municipalities
10.		Water	e.g., water supply companies supplying more than 50,000 people or bulk water supply companies with capacity to supply over 25,000 cubic meters per day
11.		Railway	e.g., railway service companies operating public facilities and infrastructure
12.		Oil	e.g., oil refineries, storage businesses, or crude oil or natural gas production businesses
13.	Public safety	Heating supply	N/A
14.		Broadcasting	N/A
15.		Public transportation	N/A
16.		Biological products (pharmaceuticals)	N/A

17.		Security services	N/A
18.	Smooth management of the Japanese economy	Agriculture	N/A
19.		Leather	N/A
20.		Air transportation	N/A
21.		Marine transportation	N/A

The Japanese Ministry of Finance has classified Japanese publicly traded companies into the following three categories (the full list can be found [here](#)):

1. Companies conducting business activities only in non-Designated Business Sectors (subject to post-investment notification only).
2. Companies conducting business activities in Designated Business Sectors other than Core Sectors.
3. Companies conducting business activities in Core Sectors.

Foreign Investors investing in companies conducting business in Core Sectors or Designated Business Sectors will generally require prior notification and approval of the Japanese government for an investment over 1 percent voting interest (subject to exemptions discussed in further detail below).

Foreign Investors investing in 1,698 companies in industries not directly related to the Designated Businesses Sectors or Core Sectors are generally exempt from the prior approval requirements, including firms in retailing, food, and finance, for example.

Importantly, this list is not static and is subject to change, so Foreign Investors seeking to invest in Japan will need to work with legal counsel and the target company's management early on to carefully determine whether current business activities could be classified as Designated Business Sectors or Core Sectors, even if the target company is not specifically included in the Ministry of Finance's list as such.

Further, the definition of Foreign Investors extends quite broadly to subsidiaries and "closely related persons" of Foreign Investors, including affiliates and other group companies, so structuring an investment from an overseas parent company through a local Japanese entity will still be considered an investment by a Foreign Investor.

The amendment also requires Foreign Investors to undergo the prior notification and approval process before making changes in management, such as nominating new board members at annual shareholder meetings or proposing sales of important business lines.

Exemptions to notification and approval requirements in the Forex Act

There are two possible exemptions from the prior notification and approval process for Foreign Investors: a blanket exemption and a regular exemption. The following exemption criteria (Exemption Criteria) are relevant for both types of exemptions:

1. Neither the Foreign Investor nor a "closely related person" may be an officer or member of the board of directors.

2. The Foreign Investor must refrain from proposing the sale or abolition of important business lines related to a Designated Business Sector at annual shareholder meetings.
3. The investor must not have access to nonpublic technological information related to a Designated Business Sector

Blanket exemption

The blanket exemption is available only to "foreign financial institutions" making portfolio investments (i.e., high-frequency traders who are registered with Japan's Financial Services Agency, securities firms, banks, insurance companies, asset management companies, trust companies, and registered investment funds including mutual funds and exchange-traded funds). If the Exemption Criteria are met, such foreign financial institutions may invest in publicly traded Japanese companies with no upper limit without having completed the prior notification and approval process. A post-acquisition notification is still required for investments of over 10 percent of the voting rights of a publicly traded Japanese company operating in a Designated Business Sector, however.

A Foreign Investor proposing to invest in a *privately* owned Japanese company operating in a Core Sector will still be required to undergo the prior notification and approval process.

The blanket exemption for portfolio investments cannot be used by (i) state-owned enterprises or (ii) companies that have violated this regulation in the past.

Regular exemption

The regular exemption is available to Foreign Investors, including sovereign wealth funds and public pension funds accredited by the Ministry of Finance, that will make such investments for economic reasons and without any government intervention.

If the Exemption Criteria are met, Foreign Investors proposing to invest non-Core Sector businesses may invest without any upper limit and without having to complete the prior notification and approval process. A post-acquisition notification is still required for investments of over 1 percent of the voting rights of the target company, however.

Foreign Investors proposing to invest in Core Sector businesses under the regular exemption must meet the Exemption Criteria as well as the following additional criteria:

1. The Foreign Investor will not attend the target company's board or committee meetings where important decisions are made with respect to the Core Sector activities.
2. The Foreign Investor will not make proposals, in written form, to the board or board members of the target company that would require responses or actions within a specific deadline.

A post-acquisition notification is required for investments of over 1 percent of the voting rights of the target company.

The regular exemption cannot be used by (i) state-owned enterprises or (ii) companies that have violated this regulation in the past.

Conceptual similarity to CFIUS

The Ministry of Finance has stated that Japan's proposal follows similar steps taken by the United States, which recently strengthened the powers of the Committee on Foreign Investment

in the United States (CFIUS) by signing into law the Foreign Investment Risk Review Modernization Act (FIRRMA).

The push to adopt a CFIUS-type regulatory scheme in Japan not only steps up Japan's protection of national security interests from foreign investors, but may also help support the possibility of Japan being considered an "excepted foreign state" under the CFIUS regulatory scheme, a status that Japan does not currently enjoy. Under the new FIRRMA regulations, one of the factors to be considered in identifying "excepted foreign states" is that the foreign state has "established and is effectively utilizing a robust process to analyze foreign investments for national security risks and to facilitate coordination with the United States on matters relating to investment security." Being an "excepted foreign state" under the CFIUS regime would be beneficial to Japanese companies seeking to engage in transactions that might otherwise trigger CFIUS review, a pool of transactions that has grown significantly under CFIUS' new expanded jurisdiction.

Impact on your business

In light of the changes to the Forex Act in Japan, clients considering investments into domestic Japanese companies should work closely with legal counsel at early stages of acquisition planning. Hogan Lovells is well-prepared to advise on these matters and protect your investments here in Japan and around the world. Our global network of regulatory and transactional teams has the commercially focused insight and guidance your business needs to navigate the complexity and uncertainty that flows from regulatory schemes in flux.

Contacts



Jacky Scanlan-Dyas
Partner, Tokyo
T +81 3 5157 8214
jacky.scanlan-dyas@hoganlovells.com



Wataru Kamoto
Partner, Tokyo
T +81 3 5157 8163
wataru.kamoto@hoganlovells.com

www.hoganlovells.com

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