

Key Amendments to FEFTA Tighten Foreign Investment Regulations in Japan

The amendments expand the industries covered by the prior notification and waiting period requirement, and broaden covered foreign investment-related activities.

In 2019, the Japanese government announced three key amendments to the Foreign Exchange and Foreign Trade Act and related regulations (collectively, FEFTA), two of which have since taken effect. Collectively, these regulations will impose more rigorous regulation of foreign investment in Japan. Foreign investors considering investing in Japan should be aware of these changes and the impact on potential investments.

General Overview of FEFTA Notification / Waiting Period Requirements

FEFTA requires a “foreign investor”¹ who acquires shares of a Japanese company² — whether through a stock purchase, new share subscription, or certain other forms of business combination — to submit post-closing notice of the acquisition to the Ministry of Finance and other relevant regulatory authorities through a filing with the Bank of Japan (BOJ).

If the Japanese target company, or any of its direct or indirect subsidiaries or certain of its joint ventures, is engaged in a specified regulated business industry deemed relevant to the public safety or economic stability of Japan, FEFTA requires:

- Each foreign investor to submit prior notification³ to the Ministry of Finance and other regulatory authorities through a filing with the BOJ, which must include detailed information about the foreign investor, the seller, the proposed transaction, and the target Japanese company and its business activities.
- Parties to observe a mandatory 30-day waiting period after the notification before completing the transaction, which, in practice, the BOJ typically shortens to 14 days.

The FEFTA pre-closing filing requirement applies to any acquisition of shares in a private company, even a single share. In the case of a public company, at present, only acquisitions of 10% or more (measured both by equity ownership and, after the Second Amendment discussed below, by voting interests) trigger the filing requirement. As covered in additional detail below, the Third Amendment proposes to lower the threshold for public company share acquisitions from 10% to 1%.

If a foreign investor fails to submit the prior notification or completes the transaction without complying with the mandatory waiting period, the investor and its management (in the case of a corporate investor) may be subject to imprisonment for up to three years and/or fines of up to three times the transaction value.⁴ In addition to these penalties, the transaction may also be rescinded.

The First Amendment — Newly Added Industries

On May 27, 2019, Japan's Ministry of Finance, Ministry of Economy, Trade, and Industry and Ministry of Internal Affairs and Communications jointly announced an amendment to FEFTA expanding the scope of the regulated industries that trigger the prior notification requirement and mandatory waiting period. This amendment became effective on August 1, 2019.

The newly added industries are broadly drawn and would appear to cover most technology transactions. While the industry terminology used in FEFTA is pegged to defined terms under the Japan Standard Industrial Classification (JSIC),⁵ the vast majority of the JSIC definitions lack the clarity and detail necessary to facilitate application to real-world situations. Further, no guidance has been issued by the BOJ to clarify the scope of the newly added regulated industries. Future transactions involving these industries may therefore require prior consultation with the BOJ.

The newly regulated industries include dozens of specific JSIC terms that generally fall within the following broad categories:

- Manufacturing of computers and components, including integrated circuits, semiconductor memory, optical disks, and circuit mounting
- Manufacturing of mobile phones and other communications equipment and components
- Manufacturing of external memory and storage devices
- Commissioned software development and other software businesses
- Data processing services
- Expanded telecommunications businesses, including local, long-distance, fixed, and mobile telecommunications⁶

The Second Amendment — Expansion of Regulated Investment Activities

An additional amendment to FEFTA, effective as of October 26, 2019, expanded the types of foreign investment-related activities subject to FEFTA's notification requirement:

- **Filing Threshold:** The 10% filing threshold, applicable in the case of acquisitions by a foreign investor of a listed Japanese company's shares, is no longer measured solely by the foreign investor's equity ownership, but also by the investor's voting rights (if greater). This change is primarily intended to address the disproportionate voting rights a shareholder may possess when a listed Japanese company issues non-voting preferred stock. Prior to the Second Amendment, a foreign investor would not have to file any prior notification under FEFTA even if the investor controlled 10% or more of the listed Japanese company's voting interests, so long as it held less than 10% of its outstanding shares.
- **Public Company Proxy:** The prior notification requirement applies when a foreign investor is granted a proxy from one or more other shareholders, in respect of a listed Japanese company, and (i) the proxy confers upon the foreign investor the right to vote on material shareholder matters (such as director elections, certain amendments to the Articles of Incorporation, and acquisition activities) and

(ii) taking the proxy and the foreign investor's own shares into consideration, the foreign investor has the right to exercise 10% or more of the listed Japanese company's total voting rights.

- **Private Company Proxy:** The prior notification requirement applies when a Japanese shareholder grants a proxy to a foreign investor, in respect of an unlisted Japanese company, which confers upon the foreign investor the right to vote on material shareholder matters in line with the examples provided above.
- **Multiple Investor Filing Threshold:** The Second Amendment is far-reaching and requires prior notification if (i) two or more foreign investors, who collectively own 10% or more of a listed Japanese company's equity ownership or total voting rights, enter into any form of shareholders agreement relating to the exercise of their rights as shareholders, including voting rights and (ii) the listed Japanese company is engaged in one of FEFTA's regulated industries.

The Third Amendment — Lowering the Threshold for Listed Company Share Acquisitions

On November 22, 2019, the legislature adopted a draft amendment to FEFTA that would authorize the government to lower the notification threshold for the acquisition of shares in a public company operating within a specified regulated business industry from 10% to as low as 1%.

In parallel, to avoid disproportionately disincentivizing lower-risk inbound investment, the Ministry of Finance has announced that:

- While it intends to lower the prior notification threshold for acquisitions of shares in a public company operating within one of FEFTA's specified regulated industries, it will not lower the current 10% post-closing notification threshold applicable to investments in businesses outside FEFTA's specified regulated business industries.
- It will adopt a number of general exemptions from the prior notification requirement for portfolio investments and certain other investment types, which will apply even when the listed company operates within one of FEFTA's specified regulated industries. A foreign investor's eligibility to rely on these exemptions will be conditioned on its compliance with covenants prohibiting it and its affiliates from (i) acting as an officer (*yakuin*) of the listed company, (ii) proposing the sale or abolishment of certain material businesses of the listed company, and (iii) accessing any of the listed company's non-public technical information relevant to public safety in Japan.

Notably, the Third Amendment is also expected to change the party or parties responsible for filing prior notification and post-closing notification in the partnership context. Currently, all foreign GPs and LPs must file an individual prior notification or post-closing notification (as the case may be) when their partnership acquires a qualifying equity or voting stake in a Japanese company. After the Third Amendment, however, this filing obligation will generally be shifted from the individual foreign GPs and LPs to the partnership itself.

The Third Amendment is expected to take effect in late spring 2020, and draft enforcement regulations clarifying the Third Amendment likely will be promulgated shortly before it takes effect.

Looking Forward

Though all three FEFTA amendments may affect a wide range of cross-border transactions involving Japan, the Third Amendment in particular has drawn significant attention for its potentially far-reaching implications. Foreign investors should consider the impact of the recent FEFTA amendments on current and future investments in Japan.

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Endnotes

- ¹ This requirement applies to (i) non-Japanese residents (typically foreign nationals), (ii) legal entities organized outside of Japan and (iii) legal entities organized in Japan directly or indirectly controlled by (i) or (ii).
- ² While FEFTA post-closing report requirements generally apply to the acquisition of any number of shares of a Japanese company, they only apply to Inward Direct Investment involving a listed Japanese target company's shares that would result in the foreign investor owning 10% or more of (i) the total listed shares or (ii) the total voting rights (since October 26, 2019). Also, when the investment structure is stock purchase, the target company is a private company, and the seller also falls within "foreign investor," the post-closing report by the purchasing foreign investor is not required.
- ³ Sufficient notice must be given such that the mandatory waiting period ends before consummation of the transaction. What constitutes the "consummation" of the transaction varies depending on its structure. Please consult with legal counsel on any questions about a particular transaction.
- ⁴ If the product of three times the transaction value is equal to or less than ¥1 million, the maximum fine will be ¥1 million.
- ⁵ Available in English at: http://www.soumu.go.jp/english/dgpp_ss/seido/sangyo/san13-3a.htm#b.
- ⁶ Previously, prior notification was necessary only if (i) the Japanese target company owned a physical telecommunication network exceeding a certain size and (ii) its business required registration under the Telecommunications Business Act. Following the recent amendment to FEFTA, telecommunications businesses of listed types (which were expanded by the First Amendment) are subject to the notification/waiting period requirements regardless of whether registration is required under the Telecommunications Business Act.