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# Q&A Regarding Share Ownership Restrictions on Foreign Investors

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## Summary

- This report answers basic questions about share ownership restrictions on foreign investors imposed by laws that govern individual industries (e.g., Civil Aeronautics Law, Broadcast Law).
- Topics covered include an overview of share ownership restrictions imposed on foreign investors by such industry-specific laws, the significance of denial of registration to foreign investors, and dividend payouts to shareholders denied registration. (All references are to listed companies and stocks unless otherwise indicated.)

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## Introduction

Share ownership restrictions on foreign investors imposed by laws that govern individual industries (e.g., Civil Aeronautics Law, Broadcast Law) have lately attracted renewed interest due to recent IPOs and the increased presence of foreign investors in the stock market. This report answers basic questions about such restrictions, including inquiries we have actually received. All references are to listed companies and stocks unless otherwise indicated.

**Q1: What ownership restrictions are imposed on foreign investors by industry-specific laws?**

**A1: Laws that govern individual industries place a restriction on the proportion of voting rights that can be held by foreign investors (see Chart 1 for definition), such as the Civil Aeronautics Law (one-third of voting rights) and Broadcast Law (20%).**

Certain laws place limitations on foreign investor acquisition and ownership of the voting rights of companies in certain industries due to economic, industrial, and security considerations.

For example, the Foreign Exchange and Foreign Trade Law requires foreign investors to submit an advance application for review before making direct investments in certain industries (i.e., to acquire 10% or more of shares in a listed company).

In addition, some laws that govern specific industries restrict the proportion of voting rights that can be held by foreign investors as a whole, as opposed to a single foreign investor.

The definition of foreign investor and voting right ceiling differs among individual laws. Chart 1 shows the outline of the laws encountered most often in dealing with listed companies: Civil Aeronautics Law, Broadcast Law (and Radio Law), and the Law Concerning Nippon Telegraph and Telephone Corporation, etc. (NTT Law).

None of these laws prohibit the acquisition of shares by foreign investors. Instead, they allow issuers to deny registration of foreign investors as shareholders for the portion of foreign ownership at or exceeding the ceilings shown in Chart 1 (see Q2 and 3). Note that the voting right stakes under the ceiling are allowed, while those at the ceiling or above are unacceptable under these laws.

**Industry-specific Laws Restricting Shareholdings by Foreign Investors** **Chart 1**

	Companies subject to law	Voting right ceiling	Definition of "foreign investor"
Civil Aeronautics Law	Domestic air carriers, their holding companies	1/3	(1) Any person who is not of Japanese nationality (2) Any foreign state, foreign public entity, or its equivalent (3) Any juridical person or body established in accordance with the laws and ordinances of any foreign state
Broadcast Law Radio Law	Broadcasters using spectrum assigned exclusively or with priority for broadcasting  Licensed provider of broadcast station infrastructure  Certified broadcasting holding companies	20%	(1) Any person who is not of Japanese nationality (2) Any foreign government or its representatives (3) Any foreign juridical person or association (4) Any juridical person or association which (A) 10% or more of whose voting rights are directly owned by a single person or body listed under (1) through (3) above, and (B) owns 10% or more of voting rights in companies subject to the pertinent laws.
NTT Law	NTT	1/3	(1) Any person who is not of Japanese nationality (2) Any foreign government or its representatives (3) Any foreign juridical person or association (4) Any juridical person or association which (A) 10% or more of whose voting rights are directly owned by a single person or body listed under (1) through (3) above, and (B) owns 10% or more of NTT's voting rights.

Source: DIR.

Notes: 1) Regulations applied to listed companies only.

2) Ceiling of one-third for licensed provider of broadcast infrastructure also licensed for satellite broadcasting or multimedia broadcasting (for mobile devices).

3) Under Broadcast Law and Radio Law, proportion of voting rights held by foreign investors under definition (4) calculated in principle as follows: % of voting rights in the person or association held by single foreign investor x % of voting rights in companies subject to the pertinent laws held by the person or association.

4) Under Broadcast Law and Radio Law, definition (4) applied only to broadcasters and holding companies engaged in terrestrial broadcasting.

Q2: If foreign ownership in a company exceeds the limit stipulated by industry-specific regulations, does this mean that foreign investors lose their rights to the portion exceeding the ownership limit?

A2: Even if foreign ownership exceeds the stipulated limit, foreign investors should be able to retain their ownership of the shares as assets, and the share transaction itself should be considered valid. However, listed companies have the right to deny registration for the portion exceeding the limit.

The trading of listed stocks under the electronic trading system is governed by the Act on Book-Entry Transfer of Company Bonds, Shares, etc. (Transfer Act). The ownership and transfer of rights pertaining to shares are effected as follows:

- 1) The ownership of rights is established by book-entry transfer.
- 2) The transfer of rights is effected by book-entry transfers between accounts.
- 3) The person who opened the account is presumed to be the lawful owner of the rights to the shares recorded in the account.
- 4) As of the record date, listed companies are provided notification of shareholder information in the transfer account book by the Japan Securities Depository Center (known as general shareholder notification).
- 5) Upon receipt of such notice, listed companies must update their shareholder registers accordingly.

Industry-specific laws that impose share ownership restrictions on foreign investors (e.g., Civil Aeronautics Law, Broadcast Law) establish exceptions to the Transfer Act for the industries that they govern.

The exceptions occur at the point of rule (5) above: whereas listed companies are required to update their shareholder registers upon receiving general shareholder notification from the Japan Securities Depository Center, listed companies governed under these industry-specific laws are allowed to deny registration to foreign investors if the proportion of voting rights held by foreign investors exceeds the ownership limit (see Q1).

In such case, foreign investors are not registered for the portion exceeding the limit despite having acquired the shares.

Meanwhile, none of the industry-specific laws provides any exception to the definitions of the ownership and transfer of rights as described in rules (1)-(4) above.

With this in mind, we can summarize the treatment of shares held by foreign investors exceeding the ownership limit as follows: in general, it is possible for foreign investors to validly acquire and own shares if they establish accounts in accordance with the Transfer Act in terms of their relationship with third parties other than the listed companies. Also, even if the total proportion of voting rights held by foreign investors exceeds the ownership limit, they are still entitled to retain their ownership of the shares as assets.

However, in terms of their relationship with listed firms, foreign investors cannot be recorded as shareholders for the portion exceeding the ownership limit. This inability leads to certain restrictions in the exercise of their rights as shareholders (see Q3).

Q3: What is the significance of the denial of registered ownership in listed companies?

A3: In principle, listed companies do not have to treat those not registered in their books as shareholders; in other words, they can deny the exercise of their rights as shareholders. However, it is generally considered that they are allowed to use their discretion to let such shareholders exercise rights.

With respect to shares in listed companies, which are subject to electronic registration, the law stipulates that a transfer of ownership in such shares can only be perfected against issuing companies by registration. That is, unless holders of listed shares are registered, they cannot claim their status as shareholders of the listed companies concerned. Conversely, listed companies in principle do not have to recognize any transfer of shares unless they are registered—even if they actually know of the existence of any transfer, the general interpretation of the law is that they only have to treat shareholders of record as shareholders<sup>1 2</sup>.

Therefore, listed companies have no legal obligation to treat as shareholders those foreign investors that are denied registration due to a voting right ceiling. They can also reject exercise of the shareholder rights of such investors.

That said, entry in the shareholder register is only a requirement to perfect ownership and is not required for rights to arise. According to academic opinion, the objective of the law is just to allow companies to conduct collective legal activities in a consistent and convenient manner<sup>3</sup>. Therefore, based on both precedent and theory, it is generally considered acceptable for companies to recognize those not recorded on the shareholder register as shareholders according to their own responsibility, judgment, and discretion.

Based on this reasoning, listed companies have discretion in allowing foreign investors denied registration to exercise rights to a certain extent (see Q5).

In addition, entry in the shareholder register is not a perfection requirement for third parties other than the listed companies that issued the shares. That is, while foreign investors denied registration are unable to claim their status as shareholders vis-à-vis those listed companies, they should be able to claim their legal ownership to other third parties (see Q2).

Q4: Does a denial of registration automatically mean that voting rights at general shareholders' meetings would also be denied?

A4: Based on the objective of the law, we believe voting rights would also be denied.

With respect to shares in listed companies, which are subject to electronic registration, the law stipulates that a transfer of ownership in such shares can only be perfected against issuing companies by registration.

<sup>1</sup> Kenjiro Egashira, *Law of Stock Corporations*, 3<sup>rd</sup> edition (Yuhikaku, 2009) p. 196.

<sup>2</sup> An exception is made in the case of individual shareholder notification, which allows for the exercise of minority shareholder rights under the Transfer Act.

<sup>3</sup> Ibid. p. 203.

Therefore, listed companies have no legal obligation to treat as shareholders those foreign investors that are denied registration due to a voting right ceiling. They can also reject the exercise of such investors' rights as shareholders.

That said, entry in the shareholder register is strictly a perfection requirement and is not required for rights to arise. Therefore, it is understood that companies can recognize those not recorded on the shareholders register as shareholders at their own discretion. Based on this, the denial of registration should not automatically mean that voting rights are denied.

However, it should be noted that the denial of registration means that foreign ownership would otherwise exceed the legal limit. If a company should permit the exercise of voting rights by investors denied registration under these circumstances, the proportion of voting rights owned by foreign shareholders would exceed the limit, meaning the company could be subject to penalties such as the cancellation or revocation of permits/licenses. Therefore, it should generally be impossible for foreign investors denied registration to be allowed the exercise of voting rights at the company's discretion.

**Q5: Does the denial of registration automatically mean that dividends are not paid?**

**A5: The payment of dividends varies by company.**

The decision on whether to pay dividends to foreign investors denied ownership registration differs by company. The reasons for this are as follows:

### **(1) Regulatory issues**

With respect to shares in listed companies, which are subject to electronic registration, the law stipulates that transfer of ownership in such shares can only be perfected against issuing companies by registration.

Therefore, listed companies have no legal obligation to treat as shareholders those foreign investors that are denied ownership registration due to a voting right ceiling. They can also reject exercise of the shareholder rights of such investors.

That said, entry in the shareholders register is only a requirement to perfect ownership and is not required for rights to arise. Therefore, it is understood that companies are allowed to recognize those not on record as shareholders at their own discretion. From this perspective, the denial of registration should not automatically mean that foreign investors lose their right to claim dividends.

However, unlike voting rights, the payment of dividends to foreign investors denied registration does not infringe upon any industry-specific laws, which are only concerned with voting rights held by foreign investors.

In our view, it seems reasonable to limit participation in corporate management by foreign investors in light of the industry-specific laws that place ceilings on voting rights. Nonetheless, we see no solid basis for restricting economic interests such as the right to claim dividends.

In fact, there have been past cases where foreign investors denied ownership registration were deprived of voting rights, but who nevertheless still received dividends.

## (2) Issues pertaining to articles of incorporation

Some listed companies state in their articles of incorporation that dividends are to be paid to shareholders of record as of the end of a certain date. In such case, payment of dividends to foreign investors not on the register would likely be deemed a violation of its articles of incorporation. These companies will need to amend their articles of incorporation to justify making dividend payments to such investors.

Technically, such a move would likely require a review of not only the articles of incorporation, but also by-laws including those regarding shareholder rights.

## (3) Technological issues

In order to make dividend payments to foreign investors denied registration, companies need a list of persons and entities actually holding the shares as well as other relevant data as of the record date. Prior to the start of electronic registration of listed shares in 2009, difficulty identifying holders of paper stock certificates made it virtually impossible for companies to make dividend payments to foreign investors not on record.

However, since the launch of electronic registration, all shareholders are required to open an account at securities companies or other financial institutions directly or indirectly participating in the book-entry transfer system of the Japan Securities Depository Center. As of the record date, securities companies and other financial institutions transmit information regarding the balance of listed shares to the Japan Securities Depository Center, which then consolidates accounts by name and sends the information to listed companies (general shareholder notifications; see Q2). Therefore, listed companies are now able to identify all actual shareholders as of the record date, including foreign investors denied entry in the shareholders register.

As such, there are no longer technological impediments to making dividend payments to foreign investors not registered for ownership, although costs and other issues still remain.

Q6: If the proportion of voting rights owned by foreigners exceeds the limit as a result of share transactions, how will registered ownership be allocated among such investors?

A6: The Civil Aeronautics Law, for example, stipulates that (1) existing registered shareholders are given priority up to their number of shareholdings of record, and (2) any remaining amount will be divided according to shares actually held. If (2) results in any odd shares, allocation of the remaining amount is decided by draw.

## (1) How this has become a problem

Before electronic registration replaced paper stock certificates, any changes in registered ownership were based on application by new owners which required presentation of paper certificates (first-come first-served basis). Applications by foreigners were accepted (they were registered by the company as shareholders) in principle until total voting rights owned by such investors reached the limit<sup>4</sup>, and were refused in principle once the limit<sup>5</sup> had been hit.

<sup>4</sup> If a change in registered ownership for all shares under application would cause the proportion of foreigners' voting rights to exceed the limit, part of such application could be declined.

<sup>5</sup> As an exception, if shares were transferred from one foreigner to another, application by the latter was sometimes accepted on the ground that the change in registered ownership did not cause a change to the proportion of foreigners' voting rights.

When electronic shareholder registration was introduced, however, any changes in registered ownership became based on general shareholder notification from the Japan Securities Depository Center (details in Q2) instead of shareholder application. As a result, it became impossible for companies to judge whether a foreigner could obtain registered ownership or not based on timing of application. This called for rules regarding how to decide allocation of registered ownership in cases where the proportion of foreigners' voting rights would exceed the limit stipulated by individual industry laws if registered ownership was changed according to general shareholder notification—specifically, who would be given priority and registered ownership of how many shares allowed to be changed.

In the following section, we outline rules regarding registered ownership allocation applied to listed companies (which are subject to the Transfer Act) under enforcement regulations of the Civil Aeronautics Law, Broadcast Law, and NTT Law. It should be noted that details of practice (such as actual method of dividing the remaining amount after priority allocation to existing holders of record and method of draw) are also important.

## **(2) Enforcement regulations of the Civil Aeronautics Law**

The Civil Aeronautics Law stipulates that existing registered shareholders should be given priority up to their number of shareholdings of record. If the proportion of foreigners' voting rights is still below the limit at this point, the remaining amount will be allocated according to shares actually held, and then based on a draw.

- 1) To holders of record at the point of general shareholder notification, the smaller of the number notified and registered number is allocated.
- 2) If the proportion of foreigners' voting rights is still below the limit after the first allocation, the remaining amount is allocated according to number of shares actually held but not included in the first allocation.
- 3) If (2) results in any odd shares, allocation of the remaining amount is decided by draw.

## **(3) Enforcement regulations of the Broadcast Law**

In order to prevent indirect control of companies, the Broadcast Law restricts ownership not only by foreign investors but also by companies/entities at least 10% of which is owned by a single foreign investor (so-called foreign-capital firms; Chart 1). However, such companies/entities are not subject to regulation if their voting rights are less than 10% of total, and are given priority regarding registration.

Apart from this, rules regarding allocation of registered ownership are basically the same as under the Civil Aeronautics Law.

- 1) Registered ownership is first allocated to companies/entities in which a foreigner has a 10% or higher stake but which has less than 10% voting rights.
- 2) To holders of record at the point of general shareholder notification, the smaller of the number notified and registered number is allocated.
- 3) If the proportion of foreigners' voting rights is still below the limit after the second allocation, the remaining amount is allocated according to number of shares actually held but not included in the first or second allocation.
- 4) If (3) results in any odd shares, allocation of the remaining amount is decided by draw.

## **(4) Enforcement regulations of the NTT Law**

The rules are basically the same as under the Broadcast Law.



- 1) Registered ownership is first allocated to companies/entities in which a foreigner has a 10% or more stake but which has less than 10% voting rights.
- 2) To holders of record at the point of general shareholder notification, the smaller of the number notified and registered number is allocated.
- 3) If the proportion of foreigners' voting rights is still below the limit after the second allocation, the remaining amount is allocated according to number of shares actually held but not included in the first or second allocation.
- 4) If (3) results in any odd shares, allocation of the remaining amount is decided by draw.

**Q7: Is there any way to learn the number/proportion of shares held by foreign investors in individual listed companies?**

**A7:** It is difficult to grasp an accurate number/proportion of shares held by foreign investors in individual listed companies for a specific point in time. However, the Japan Securities Depository Center's (JASDEC) website discloses the number of shares held directly by foreigners in companies subject to foreign investor share ownership regulations on a daily (working day) basis. In addition, share-issuing companies also disclose information regarding voting rights held by foreigners based on industry-specific laws.

It is difficult to grasp an accurate number/proportion of shares held by foreign investors for a specific point in time. However, similar information is available as described below.

#### **(1) JASDEC's website**

JASDEC discloses the number of shares directly held by foreigners for the previous working day based on reports from account management bodies such as securities brokers ([http://www.jasdec.com/en/reading\\_e/for\\_pubinfo.php](http://www.jasdec.com/en/reading_e/for_pubinfo.php)).

The figures disclosed on the website do not necessarily match those calculated based on the methods defined by industry specific laws. According to the JASDEC website, the figures are disclosed as a reference for foreign investors to judge the probability of being denied registered ownership. Since the data is updated on a daily basis, we think it plays an important role in providing information regarding the trend of foreign ownership of voting rights in individual firms.

#### **(2) Compulsory disclosure by individual firms**

The Civil Aeronautics Law, Broadcast Law, and other industry specific laws oblige companies subject to them to regularly disclose the proportion of voting rights held by foreign investors. The timing and frequency of disclosure varies by industry law as below.

Legally Required Disclosure of Proportion of Foreigners' Voting Rights		Chart 2
Civil Aeronautics Law	Disclosure at every regular general shareholders' meeting if the proportion is a quarter or more	
Broadcast Law	Disclosure every six months if the proportion is 15% or more	
NTT Law	Until 14 days before the record date (for voting rights, dividends, etc.)	

Source: DIR.

Following are our views regarding the disclosure of information regarding foreign ownership.

Although individual companies do not have a legal obligation to disclose more information than required by law, we believe whether registered ownership has been denied or is likely to be denied to a

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foreign investor is an important piece of information not only for specific investors concerned but also for foreign investors overall.

Given this, we hope disclosure will be improved, by, for example, stock exchanges voluntarily starting to timely provide relevant information. And, providing information in English as well as in Japanese would help enhance evaluation of Japanese firms and the Japanese market.

As for the timing of disclosure, we think it would be ideal from the viewpoint of investors to have disclosure on a record date basis.