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Revised Foreign Exchange Act Goes into Effect

Concerns that engagement on the part of foreign investors may be constrained

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Summary

- On April 24 the Ministry of Finance announced the final version of the amendment to Rules and Regulations regarding the revised Foreign Exchange & Foreign Trade Act. (Major changes, including the revision of the law, are scheduled to go into effect on June 7.) Revisions were made to the Foreign Exchange & Foreign Trade Act in November last year. The criterion necessitating prior notification when a foreign investor acquires the stock of a listed company in a designated business sector was lowered to 1% of the company's stock. At the same time, a system of exemption from prior notification was introduced.
- According to past explanations of the Ministry of Finance, as a general rule the following conditions must be met in order to gain exemption from prior notification: (1) foreign investors (including closely related parties) shall not be appointed as officers of a company being invested in, (2) foreign investors shall not propose to the general shareholders' meeting transfer or disposition of investee company's business activities in the designated business sectors, and (3) foreign investors shall not access non-public information about the investee company's technology in relation with business activities in the designated business sectors. (There are additional conditions in cases where a foreign investor other than a financial institution makes an investment in one of the core business sectors.)
- The final version of the Rules and Regulations also requires as a condition for gaining exemption from prior notification that investment carried out by a foreign investor shall not be "for the purpose of performing actions that make continuous and stable implementation of business operations associated with designated business sectors difficult." Cases falling under this category are expected to be rare. However, clarification of cases falling under this category would be desirable in order to avoid unnecessarily hindering engagement in investment activities on the part of foreign investors.

1. Announcement of Final Version of Amendment to Rules and Regulations Regarding Foreign Exchange & Foreign Trade Act

On April 24 the Ministry of Finance announced the final version of the amendment to Rules and Regulations regarding the revised Foreign Exchange & Foreign Trade Act (referred to hereinafter as the Foreign Exchange Act) as well as a notification revision plan and background explanation materials (available in English also). Major changes, including the revision of the law, are scheduled to go into effect on June 7. (Some aspects of the amendment went into effect by May 8.)¹

The Foreign Exchange Act stipulates regulations associated with inward direct investment. It required foreign investors to submit a prior notification in cases where they planned on obtaining 10% or more of shares of a listed company in designated business sectors, which was to be reviewed by the government. Revisions were made to the Foreign Exchange Act in November last year. The criterion necessitating prior notification when a foreign investor acquires the stock of a listed company in a designated business sector was lowered to 1% of the company's stock. At the same time, a system of exemption from prior notification was introduced. An overview of the revisions to the Foreign Exchange Act is provided in this report, as well as their influence on the stock market and corporate governance.

2. Overview of Revisions

(1) Range of exemption from prior notification

According to the law before it was revised, foreign investors were required to carry out prior notification and undergo a government examination if they planned to acquire 10% or more of shares of a listed company which is a member of one of the designated business sectors. Designated business sectors are listed below.

- (1) National safety related: weapons, aircraft, nuclear power, space industry, industries manufacturing products which can be diverted to military use, cyber security.
- (2) Public services and systems related: gas & electricity, heat, communications, broadcasting, water, railways, transportation.
- (3) Public safety related: biologics manufacturing industry, security guard industry
- (4) Industries that are fundamental to running the Japanese economy: agriculture, forestry and fisheries, oil, leather related industries, air transport, and shipping.

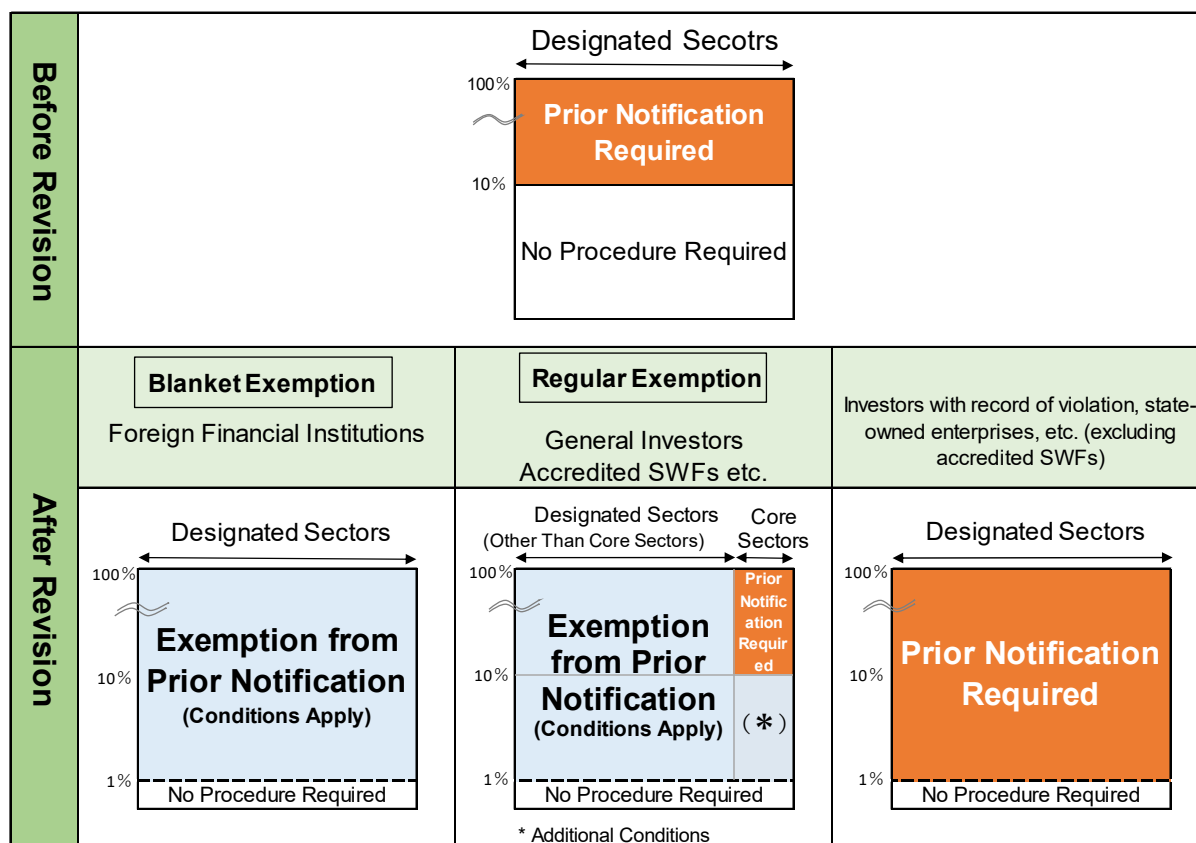
After the law has been revised, foreign investors will be required to carry out prior notification if they acquire 1% or more of shares of a listed company which is a member of one of the designated business sectors, unless said investor qualifies for an exemption. (This revision will go into effect on June 7.) The range of applicability of the system of exemption from prior notification depends on the type of foreign investor (Chart 1).

¹ Refer to the Ministry of Finance website.

https://www.mof.go.jp/english/international_policy/fdi/kanrenshiryoku01_20200424.pdf

If Prior Notification is Required

Chart 1



Source: Ministry of Finance, "Rules and Regulations of the Foreign Exchange and Foreign Trade Act" (April 2020); compiled by DIR.

Foreign financial institutions who fulfill the conditions described in (2) (a) – (c) are not required to carry out prior notification in principle (blanket exemption). Investors who have undergone sanctions in the past for violation of the Foreign Exchange Act, and state-owned enterprises are not eligible for exemption.

All others not falling under the above descriptions, such as general investors, etc. (Chart 1, lower center), are not required to carry out prior notification in acquiring 1% or more of shares of a listed company which is a member of a designated business sector other than one of the core sectors in principle if they fulfill the conditions shown below in (2) (a) – (c). On the other hand, if a general investor acquires 1% or more of shares of a listed company which is a member of one of the core sectors, they must also fulfill additional conditions as described below in (2) (d) – (e). If they can fulfill these conditions, prior notification is unnecessary up to 10% of shares in principle (regular exemption).

However, exemption from prior notification will not be granted to either foreign financial institutions or general investors if said investment is "for the purpose of performing actions that make continuous and stable implementation of business operations associated with designated business sectors difficult."

(2) Conditions which must be fulfilled in order to be eligible for exemption

(A) Standards for exemption from prior notification

Standards for exemption from prior notification are, in principle, the three items shown below. When foreign financial institutions invest in a listed company which is a member of a designated business sector or general investors invest in a listed company which is a member of a designated business sector other than one of the core sectors, exemption from the requirement to carry out prior notification is granted if they strictly uphold these three conditions.

- (a) Foreign investors or their closely-related persons (explained further below) will not become board members of the investee company;
- (b) Foreign investors will not propose to the general shareholders' meeting transfer or disposition of investee company's business activities in the designated business sectors; and
- (c) Foreign investors will not access non-public information about the investee company's technology in relation to business activities in the designated business sectors (explained further below).

However, in the case of investment in core sectors, in order for foreign investors other than financial institutions to gain eligibility for exemption from the requirement of prior notification, the additional conditions shown below must also be fulfilled.

- (d) Regarding business activities in core sectors, foreign investors will not attend the investee companies' committees that make important decisions in these activities.
- (e) Regarding business activities in core sectors, foreign 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.

Once these standards have been met and exemption from prior notification has been granted, there is no longer a way to confirm whether the foreign investor is strictly upholding said standards when acquiring stock shares, since prior notification does not take place.

When a foreign investor acquires stock shares using the exemption from prior notification, the foreign investor is required to report said transaction to the government within 45-days. This is called post-investment reporting. There is a checkbox provided on the form for post-investment reporting indicating that the foreign investor pledges to strictly uphold the above standards. Checking the box relays to the government after the investment that the investor promises to uphold the standards.

Situations in which post-investment reporting is required when a foreign investor has acquired stock shares using the exemption from prior notification are shown in Chart 2. In the case of a foreign financial institution, however, post-investment reporting is not required if the percentage of stock shares acquired is up to or within 10%, hence there is no way for the government to determine whether or not the standards are being upheld.

Cases where Post-Investment Reporting is Required when Stock Shares were Acquired Using the Exemption from Prior Notification **Chart 2**

Investors	Cases where Post-Investment Reporting is Required
Foreign Financial Institutions	If percentage of acquisition of stock shares is 10% or more. (Note 1)
Accredited SWFs, Etc.	If the percentage of acquisition of stock shares corresponds to one of the following: <ul style="list-style-type: none"> Acquisition is above a certain confidential percentage designated for said SWF etc. Acquisition is 10% or more. (Note 1)
Foreign Investors other than those Listed Above	If the percentage of acquisition of stock shares corresponds to one of the following: <ul style="list-style-type: none"> It is the first time for an acquisition by this investor to be 1% or more. (Note 2) It is the first time for an acquisition by this investor to be 3% or more. (Note 2) Acquisition is 10% or more. (Note 1)

Source: Compiled by DIR based on the amendment to Rules and Regulations regarding the revised Foreign Exchange & Foreign Trade Act.

Notes: 1) If after acquisition, the percentage of the total acquisition of stock shares is 10% or more, reporting will be required after each acquisition (for example, if percentage of shares rises from 9% to 11% reporting is required, and when acquisition of stock shares subsequently rises from 11% to 12%, reporting is again required).

2) If trading of stock shares etc. crosses the threshold once, and then the threshold is crossed again later on another acquisition, subsequent reporting is unnecessary.

(B) Investment shall not be “for the purpose of performing actions that make continuous and stable implementation of business operations associated with designated business sectors difficult.”

Summary materials provided by the Ministry of Finance regarding the revised Foreign Exchange Act specify as the condition for gaining exemption to prior notification that the foreign investor must strictly uphold the standard discussed in section (A) above. However, the Rules and Regulations have also made it a condition that investment shall not be “for the purpose of performing actions that make continuous and stable implementation of business operations associated with designated business sectors difficult².”

In applying this condition, it is stated that “decisions are made taking into consideration specific circumstances regarding the business to be invested in, and the scope of actions the investor might take, and the probability of impact on business implementation that actions which might be taken on the part of a particular investor might have.” The following is given as an example of a situation falling under the above description.

If it can be determined that an issuing company has been forced to implement the contents of the proposals of a foreign investor because the foreign investor has the influence associated with shareholdings by acquiring enough stock shares of the issuing company to make it possible for that investor to have a significant impact on financial and business policy decisions for the purpose of making proposals(*) that lead to the contraction of businesses in designated business sectors which require continuous and stable implementation from the viewpoint of national security etc.. (Underlining and note added by writer)

(*) May also apply to proposals suggested in daily communications.

If this condition were to be applied, “it is thought to be a case comparable to one in which the government will make a recommendation for change or cancellation of the investment if it is notified in advance (from the year 1991 to present, there has been only one example of a case subject to a cease and desist order)”³. Hence, its actual application is expected to be rare.

To summarize the information provided in sections (A) and (B), an overview of exemption from prior notification is shown in Chart 3.

² Cabinet Order on Inward Direct Investment, Article 3-2 Paragraph 2 Item 4. The object of establishing this condition is as follows: Investments that gain exemption from prior notification are those which “are not expected to have an impact on the survival of important business sectors from the perspective of national security, etc.” However, investments that are “for the purpose of performing actions that make continuous and stable implementation of business operations associated with designated business sectors difficult,” “do not fulfill the above premises for gaining exemption from prior notification.”

³ The case that was subject to a cease and desist order was in 2008, The Children’s Investment Master Fund (a UK corporation based in the Cayman Islands). The company submitted a prior notification for acquisition of 20% of outstanding shares of J-Power (a Japanese electrical power generation).

Type of Investor	Conditions for Exemption	
Foreign Financial Institutions	Blanket Exemption	<p>Foreign investors are exempt from prior notification if following conditions are met. (No maximum limit)</p> <ul style="list-style-type: none"> - Foreign investors strictly uphold conditions described in (2) (A) (a) – (c) above - The investment is not “for the purpose of performing actions that make continuous and stable implementation of business operations associated with designated business sectors difficult.”
General Investors (Including accredited SWFs)	Regular Exemption	<p>Designated business sectors other than core sectors</p> <p>Foreign investors are exempt from prior notification if following conditions are met. (No maximum limit)</p> <ul style="list-style-type: none"> - Foreign investors strictly uphold conditions described in (2) (A) (a) – (c) above - The investment is not “for the purpose of performing actions that make continuous and stable implementation of business operations associated with designated business sectors difficult.”
		<p>Core sectors</p> <p>Foreign investors are exempt from prior notification on up to 10% of shares if following conditions are met.</p> <ul style="list-style-type: none"> - Foreign investors who strictly uphold conditions described in (2) (A) (a) – (e) above - The investment is not “for the purpose of performing actions that make continuous and stable implementation of business operations associated with designated business sectors difficult.”
Investors who have undergone sanctions in the past for violation of the Foreign Exchange Act, and state-owned enterprises (Excluding accredited SWFs)	Not eligible for exemption from requirement to carry out prior notification.	

Source: Ministry of Finance, “Rules and Regulations of the Foreign Exchange and Foreign Trade Act” (April 2020); compiled by DIR.

(3) Treatment of SWFs, etc.

As was explained earlier, in principle, state-owned enterprises are not exempt from prior notification. However, Sovereign Wealth Funds (SWFs) and public pension funds which do not threaten to impair national security, are eligible for the exemption program (regular exemption), as long as they have been granted individual accreditation by the Ministry of Finance.

The Ministry of Finance carries out the following examination before granting accreditation (whether or not accreditation has been granted is not publicized).

- | |
|---|
| <ul style="list-style-type: none"> (1) Investment activities of the SWFs are only for economic returns; and (2) Investment decisions by the SWFs are made independently of their governments. |
|---|

(4) The scope of foreign financial institutions

As was explained previously, procedures for foreign financial institutions are simpler than they are for other foreign investors, because foreign financial institutions are not required to submit prior notification as long as they fulfill the stated conditions. For this reason many foreign investors have shown an interest in how the scope of what are called “foreign financial institutions” here is defined, in hopes that their own organization might gain recognition as a financial institution.

According to the Rules and Regulations, “foreign financial institutions,” which are eligible for blanket exemption, are defined as follows. As foreign financial institutions include asset management firms, investment funds can be also included. Foreign financial institutions are organizations which fall under the regulatory controls and supervision as financial institutions in their country of origin except high-frequency trading firms (HFT).

- ◆ Foreign financial institutions of the types listed below, and which are regulated and supervised under financial regulatory laws in Japan or other jurisdictions are defined as “foreign financial institutions.”
- (1) Securities companies
 - (2) Banks
 - (3) Insurance companies
 - (4) Asset management firms
 - (5) Trust companies
 - (6) Registered corporate-type investment trusts
 - (7) High-frequency trading firms*

* Limited to those stipulated by Japan’s Financial Instruments and Exchange Act.

(5) Definition of terms in conditions for exemption from prior notification

(A) “Closely-related persons”

As was explained earlier, it is stipulated in the conditions for exemption from prior notification that “foreign investors or their closely-related persons will not become board members of the investee company.” Since there are often cases where a foreign investor proposes the appointment of an officer to encourage more efficient management, interest has been expressed in the concrete definition of “closely-related persons” as it is used in the conditions.

The scope of “closely related persons” according to the ordinance, is established as shown in Chart 4. In the original proposal, if another company (or the issuing company itself) makes a proposal (Chart 4, (2)), persons who held the status of board member of the foreign investor or related companies during the previous year were included under the definition of “closely related persons.” However, based on the point that it can be difficult to determine, it was ultimately left out of the Rules and Regulations.

Definition of “Closely-Related Persons” (Note 1)

Chart 4

Scope of “closely-related persons” of a foreign investor	①Nomination is made by the foreign investor itself (includes nominations made by a third party on behalf of the foreign investor)			②Nomination is made by a third party (including the investee company) (Note 2)		
	Board member of the foreign investor	Employee of the foreign investor	Member of the foreign investor's committee that has authority on investment decisions	Board member of the foreign investor	Employee of the foreign investor	Member of the foreign investor's committee that has authority on investment decisions
The foreign investor (if company)	○	○	○	○	×	○
Its subsidiaries, second-generation subsidiaries, parent companies, or grandparent companies	○	○	○	○	×	○
Its other family companies such as uncle/aunt companies, cousin companies, brother/sister companies, or nephew/niece companies	○	○	○	○	×	×
The foreign investors' business partners	○	○	○	×	×	×
Persons who receive substantial amount of financial rewards and/or other assets from the foreign investor	○			×		
Persons who were in the status of the above categories in the previous one year	○			× (Note 3)		
Spouse of the foreign investor (if natural person)	○			○		
Lineal ascent or descent of the foreign investor (if natural person)	○			○		
Persons (or their closely-related persons) who have agreement with the foreign investor to jointly exercise voting rights	○			○		

Source: Ministry of Finance, “Rules and Regulations of the Foreign Exchange and Foreign Trade Act” (April 2020); compiled by DIR.

Notes: 1) The circle mark (O) means treatment as closely related person is applied, while the “X” mark does not apply. (Example: one of the board members of the foreign investor's business partners is a closely related person if ①nomination is made by the foreign investor itself, but it is not if ②nomination is made by a third party).

2) On-the-spot nomination at a shareholder's meeting is not subject to the prior-notification requirement.

3) This case was marked “O” (treatment as closely related person applied) in the original proposal.

4) If the foreign investor is a state-owned enterprise, “closely-related persons” include members of the state's central government, local governments, government agencies, central bank or political parties.

(B) “Access to Non-public Information about the Investee Company's Technology”

As was noted earlier, one of the conditions for obtaining exemption from prior notification is “Foreign investors will not access non-public information about the investee company's technology in relation to business activities in the designated business sectors”. The definition of the phrase, “access non-public information about the investee company's technology” is presented below. The scope of obtaining or requesting disclosure of confidential technology-related information is limited from the original proposal as shown in Note 3.

- ◆ Obtaining confidential technology-related information (Note 1) managed by the investee company's sections that conduct business activities in the designated business sectors (Notes 2 & 3)
- ◆ Requesting disclosure of confidential technology-related information (Note 3)
- ◆ Requesting a change in the investee company's internal rules on the treatment of confidential technology-related information.

Note 1: The followings do NOT constitute confidential technology-related information:

- Information about employment terms or remuneration of board members and employees
- Financial information

Note 2: The case where the investee company voluntarily provides such information to the foreign investor does NOT constitute a breach of this exemption condition.

Note 3: Obtaining confidential technology-related information or requesting disclosure of such information by the M&A advisory services section of a financial institution does NOT constitute a breach of this exemption condition if measures are in place in the financial institution to ensure the followings:

- (i) Confidential technology-related information is not allowed to be shared with the equity market section; and
- (ii) The M&A advisory services section is not allowed to exercise influence on the investee company taking advantage of stocks of the company held by the equity market section

(C) “Foreign investors will not attend the investee companies’ committees that make important decisions”

As was noted earlier in this report, one of the additional conditions for gaining exemption from prior notification is the stipulation that “Regarding business activities in core sectors, foreign investors will not attend the investee companies’ committees that make important decisions.” It is assumed that the foreign investor will not be in violation of this standard if “the investee company voluntarily requests the foreign investor to do so.” However, “if the foreign investor approaches the issuing company in advance in an attempt to pressure it into inviting the foreign investor to attend, and the issuing company does so as a result,” then the foreign investor will be considered to be in violation of this condition.

(D) “Foreign 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”

As was noted earlier in this report, one of the additional conditions for gaining exemption from prior notification is the stipulation that “Regarding business activities in core sectors, foreign 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.” As for the phrase “by certain deadlines,” the following is considered to be applicable: “Even if no clear date and time is specified, if it is understood that it is substantially equivalent to having a deadline.” This condition is also applicable in the following situation: “When it is understood that in actual fact, a reply by the general meeting of the shareholders is being sought.”

As for making proposals “in writing” (including electronic form), “The applicability of this condition is basically determined externally. In cases where the foreign investor, having distorted this point, is considered to have made a proposal which may be a threat to national security by virtue of actions or behaviors considered to be equivalent to putting the proposal in writing or in electronic form,” government authorities may contact the investor in order to determine whether there are any doubts regarding compliance with the conditions.

(6) *The scope of core sectors*

The scope of core sectors is stipulated as shown below.

Scope of Core Sectors		Chart 5
Areas	Scope is narrowed to those truly necessary for national security	
Weapons	All	
Aircrafts	All	
Space	All	
Nuclear facilities	All	
Dual-use technologies	All	
Cybersecurity	<ul style="list-style-type: none"> • Cybersecurity-related service (e.g. network security monitoring, software) • Service providers of the program designed for critical infrastructures 	
Electricity	<ul style="list-style-type: none"> <Electricity Business Act> • General Electricity Transmission and Distribution Utility • Electricity Transmission Utility <Armed Attack Situations Response Act> • Electricity Generation Utility companies that own a power plant with maximum generation capacity of 50,000KW or more 	
Gas	<ul style="list-style-type: none"> <Gas Business Act> • General Gas/Specified Gas Pipeline Service Providers • Gas Manufacturers <Oil Stockpiling Act> • LP Gas companies that own a storage facility or core cylinder filling station 	
Telecommunications	<ul style="list-style-type: none"> <Telecommunications Business Act> • Telecommunication carriers that provide service across multiple local municipalities 	
Water supply	<ul style="list-style-type: none"> <Water Works Law> • Water Supply companies supplying to more than 50,000 people • Bulk Water Supply companies with a capacity of supplying over 25,000 m³ per day 	
Railway services	<ul style="list-style-type: none"> <Armed Attack Situations Response Act> • Railway Service companies operating public facilities/infrastructures which are stipulated under the Armed Attack Situations Response Act 	
Oil	<ul style="list-style-type: none"> • Oil Refinery, Oil Storage Business, Crude Petroleum and Natural Gas Production 	

Source: Ministry of Finance, "Rules and Regulations of the Foreign Exchange and Foreign Trade Act" (April 2020).

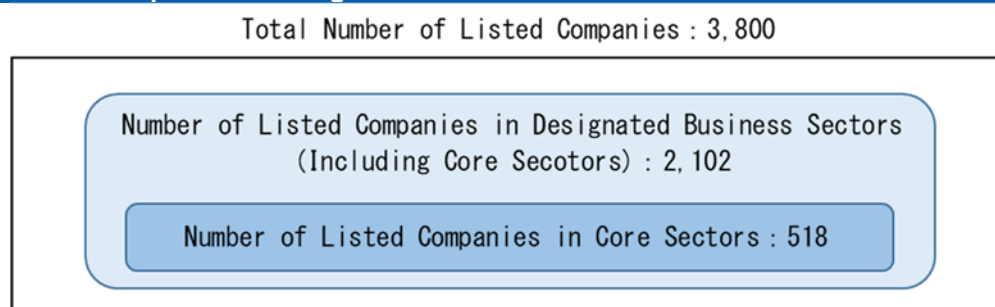
(7) *List of stock issues announced*

The Ministry of Finance also announced on May 8, separately from the Rules and Regulations, a list of stock issues⁴. The list indicates the names of the companies which are members of designated business sectors and core sectors.

The number of listed companies in designated business sectors (including core sectors), and a list of core sectors are shown in Chart 6. Of the total 3,800 listed companies included on the list of stock issues, more than half are associated with business sectors (including core sectors) (a total of 2,102 companies)⁵.

⁴ Ministry of Finance website: https://www.mof.go.jp/international_policy/gaitame_kawase/fdi/

⁵ In determining whether a listed company belongs in one of the designated business sectors, subsidiaries are also taken into consideration.



Source: Ministry of Finance materials (May 2020); compiled by DIR.

3. Influence on the Stock Market and Corporate Governance

(1) Influence on the stock market is expected to be limited

Since the number of cases requiring prior notification and examination is expected to grow due to the lowering of the criterion necessitating prior notification to 1% by the revised Foreign Exchange Act, there were concerns that investment on the part of foreign investors, who account for 70% of trading value⁶ of listed shares on the TSE and 30% in terms of ownership ratio⁷, will be hindered, potentially influencing stock prices.

According to the old explanatory materials of the Ministry of Finance, when SWFs invest in core sectors, they were assumed to be required to go through the prior notification and examination procedures. For this reason, there were concerns that if cumbersome procedures were required each time this situation occurred, SWFs and other investors might hesitate to invest in any of the core sectors, thereby negatively influencing stock prices⁸.

However, according to the final Rules and Regulations, if SWFs obtain accreditation and fulfill the conditions (including additional conditions), they will be exempt from the prior notification requirement up to an ownership level of 10%. The above concern has therefore been resolved in great part, and influence on the stock market is therefore considered to be limited.

The focus in the future will be the question of whether or not foreign investors will be able to obtain approval from the Ministry of Finance in the examination. Hypothetically speaking, if there are many cases where foreign investors are unable to obtain approval, there are concerns that they then might hesitate to invest in any of the designated business sectors, and negatively influence stock prices.

(2) Concerns regarding influence on corporate governance

(A) Standards of exemption from prior notification

One of the criticisms of the amendment is that it might reverse the current trend toward strengthening corporate governance. The reason is that in order to gain exemption from prior notification, foreign investors must fulfill the stated conditions, hence foreign investors, including related parties, cannot be

⁶ According to the Tokyo Stock Exchange report, “Trading Value of TSE 1st Section Stocks by Investor Type,” foreign investors accounted for 73.3% of annual trading value in 2019.

⁷ According to the Tokyo Stock Exchange, the Nagoya Stock Exchange, the Fukuoka Stock Exchange, and the Sapporo Securities Exchange “FY2018 Share Distribution Survey,” foreign corporations had a shareholding ratio of 29.1% as of the end of the 2018 fiscal year.

⁸ According to an article in the electronic version of the Nippon Keizai Shimbun dated May 14, 2020 (“Revised Foreign Exchange Law could Weaken Large-Cap Stocks (Market Sketch)”), it was pointed out that “with market capitalization of over 300 billion yen, percentage of change in price of issues associated with core sectors on TOPIX was down by more than 4% in the previous year.”

appointed as officers of a company being invested in, and foreign investors may not propose transfer or disposition of business activities in the designated business sectors of a company to the general shareholders' meeting.

Particularly general investors including SWFs who have gained accreditation must fulfill additional conditions in order to gain exemption from prior notification in the case of investments in core sectors. Concretely speaking, as regards business activities in core sectors, the foreign investor may not participate in committees with significant decision-making authority, or make a proposal in writing to the executive board of the investee companies or board members requiring their responses and/or actions by certain deadlines.

These are conditions for gaining exemption from prior notification, but that does not mean that foreign investors are forbidden from carrying out these actions. However, for foreign investors who manage large amounts of funds, such as SWFs and public pension funds, the requirement of undergoing the above described procedures is itself a factor hindering investment. For this reason, there may be situations in which foreign investors avoid these actions or behaviors, and in doing so place constraints on dialogue between corporations and investors.

(B) Investment shall not be “for the purpose of performing actions that make continuous and stable implementation of business operations associated with designated business sectors difficult.”

One of the conditions for gaining exemption from prior notification is that the investment shall not be “for the purpose of performing actions that make continuous and stable implementation of business operations associated with designated business sectors difficult.” As was mentioned earlier in this report, its actual application is expected to be rare. However, the question of whether a particular investment falls under the description “for the purpose of performing actions that make continuous and stable implementation of business operations associated with designated business sectors difficult” remains unclear. The example shown earlier (text appearing in box on p.5) specifies “businesses in designated business sectors which require continuous and stable implementation from the viewpoint of national security etc.” This description sounds like it is referring to infrastructure related businesses, but it does not mention in concrete terms exactly what types of businesses it is referring to, nor does it specify the number of shares that would trigger this problem other than to say “enough stock shares of the issuing company to make it possible for that investor to have a significant impact on financial and business policy decisions.”

If an investment is found to be “for the purpose of performing actions that make continuous and stable implementation of business operations associated with designated business sectors difficult,” said investment will not be exempt from prior notification. Therefore, we could imagine a situation in which a foreign investor mistakenly concludes that the investment it is about to carry out does not fall under this description, and goes ahead with the investment without carrying out prior notification even though the investment is in violation of the above condition. There are criminal penalties for violations of prior notification. Moreover, exemption from prior notification cannot be obtained for a period of five years after the date of the violation.

There are concerns that this will result in a loss of incentive on the part of foreign investors to make proposals of any kind to issuing companies in order to ensure that their investment is not interpreted as being “for the purpose of performing actions that make continuous and stable implementation of business operations associated with designated business sectors difficult.” Clarification of the scope of businesses covered by the above condition would be desirable in order to avoid unnecessarily hindering engagement in investment activities on the part of foreign investors.