



Morgan Lewis

INWARD FOREIGN DIRECT INVESTMENT REGULATIONS IN JAPAN

Motonori Araki
Narumi Ito
Nao Sato
Masaki Ichimura

Introduction

Morgan Lewis



Moto Araki

Overview of FEFTA Regulations

Morgan Lewis



Nao Sato

FEFTA Overview

- The Foreign Exchange and Foreign Trade Act (“FEFTA”) governs inward foreign direct investments in Japan.
- When a “**Foreign investor**” conducts “**Inward Direct Investments**” (e.g., acquisition of shares in a Japanese company from its parent Japanese company) in a Japanese company that engages in business in any of the “**Designated Business Sectors**”, then it is generally necessary to file a Prior Notification via the Bank of Japan.
- If the target Japanese company does not conduct any business in the Designated Business Sectors, it is sufficient to file a Post Investment Report.

Recent Amendments

- The FEFTA was significantly amended in 2019 (effective in 2020) (“2020 amendment”), aiming to promote Inward Direct Investments for sound economic growth, while still ensuring sufficient review of Inward Direct Investment activities that could pose risks to national security.
- The key components of 2020 amendments are as follows:
 - Lowering the threshold for Prior Notification (from 10% to 1%, in case of investment in listed company)
 - Introduction of exemption scheme for Prior Notification
 - Implementation of new business category (“Core Sectors”)
 - Expansion of scope of Foreign Investors
- In addition, due to several amendments to notifications and ordinances since 2019, the scope of Prior Notification requirements has been expanded.

Foreign Investors

- The scope of Foreign Investors
 - (1) Non-Japan-resident individual
 - (2) Foreign company
 - (3) Japanese company for which 50% or more of its voting rights are held by (1) or (2)
 - (4) Direct and indirect subsidiary of (3)
 - (5) Partnership for which (a) 50% or more of its total units are held by Foreign Investors, or (b) a majority of its general partners are Foreign Investors.
 - (6) Japanese company for which 50% or more of (a) its directors or executive officers or (b) representative directors or representative executive officers are (1)

Inward Direct Investment

- The Key Features of Examples of Inward Direct Investments

- (1) Acquisition of 1% or more of shares or voting rights in a listed Japanese company
- (2) Acquisition of any share in an unlisted Japanese company
- (3) A consent to substantial change in the corporate objectives of the Target company (by which a business in the Designated Business Sectors is added) (only where the Foreign Investor has one-third or more of the voting rights)
- (4) Voting at the Target Company's shareholders' meeting for appointment of the Foreign Investor him- or herself or his or her closely related person (e.g., a director or officer of the Foreign Investor) as a director or corporate auditor of the Target Company (only where the Foreign Investor has 1% or more of the voting rights) (except for the cases (i) where (a) a Prior Notification has been filed for the acquisition of the shares in the Target Company and (b) 50% of more of the voting rights in the Target Company is held by the Foreign Investor or (ii) where the Target Company is engaged only in business not falling within the Designated Business Sectors).
- (5) Proposing, and voting at a shareholders' meeting of the Target Company for, certain corporate actions, such as a transfer of all or part of the Target Company's business etc., concerning its business in a Designated Business Sector (only where the Foreign Investor has 1% or more of the voting rights)
- (6) Acquisition of business from Japan-resident company
- (7) Establishment of a Japan branch office (except for bank and certain other businesses)
- (8) Provision of over-one-year term loan exceeding certain amount

Specified Acquisition

- What is a "Specified acquisition" ?
 - The acquisition of shares in an unlisted Japanese company by a Foreign Investor from another Foreign Investor.
 - Acquisition from another Foreign Investor is not included in the definition of Inward Direct Investment.
- For a Specified Acquisition, mostly same regulations as an Inward Direct Investment apply.
 - But, the scope of Designated Business Sectors is narrower than Inward Direct Investment.
 - No Post Investment Report is required in the case where the Target Company is not engaged in any business in the Designated Business Sectors.

What Business Matters under the Regulations?

Morgan Lewis



Masaki Ichimura

Designated Business Sectors

- Designated on an industrial sector basis
- 4 types of the business
 - **national security**: e.g., manufacturing of weapon, aircraft, artificial satellites, nuclear related equipment, and certain items that may have military applications; cyber security; manufacturing of ICs, semiconductor memory devices, electronic mediums, mobile phones, personal computers; software business, telecommunications, data processing services, support services for Internet use
 - **public order**: e.g., electricity, gas, broadcasting, water, railroad
 - **public safety**: e.g., manufacturing of biological products, pharmaceutical products (for infectious illness), and special controlled medical devices
 - **smooth operation of the national economy**: e.g., agriculture, forestry, fisheries, oil, leather, air transportation, marine traffic
- Particularly related to technology
 - Goods and technology subject to export control
 - IT-related items
 - Cybersecurity
 - Manufacturing of ICs, semiconductor memory device, personal computers, telecommunications devices
 - Software business (i.e., software development)
 - Certain data processing services
 - Biotechnology
 - Biological products
 - Certain medical devices (approved as “special controlled medical devices”)

Exemption for Prior Notification - Eligibility

- Prior Notification with respect to certain Inward Investment (e.g., acquisition of shares in a listed Japanese company) may be exempted under certain requirements.
- Who is eligible?
 - Foreign financial institutions (e.g., securities firm, bank, insurance company) – “blanket” exemption
 - Other Foreign Investors (including accredited sovereign wealth funds) (“general investors”)
 - Ineligible investors: (i) an investor who was sentenced or sanctioned due to a violation of FEFTA within certain time period, (ii) foreign governments, political parties or central banks, or (iii) foreign government-owned companies.

Exemption for Prior Notification - Requirements

- What are the requirements?
 - For **general investors**
 - Making investments in a Japanese company that engages in business in non-“Core Sectors”;
 - “pure” investment
 1. Not assume the office of the director, executive officer or statutory auditor;
 2. Not propose the shareholders’ meeting to sell or cease to conduct any business in the Designated Business Sectors; and
 3. Not access non-public technical information relating to any business in the Designated Business Sectors.
 - Making investments in a Japanese company that engages in business in “Core Sectors”, but the resulting shareholding or voting right ratio in the target will be below 10%;
 - In addition to the 3 “pure” investment requirements above;
 4. Not participate in the BoD or other committee authorized to make important decision-makings of the target; and
 5. Not make any proposal in writing to the BoD or its member seeking for a response or action by a deadline.
 - For **foreign financial institutions** – making “pure” investment in a listed company
 1. Not assume the office of the director, executive officer or statutory auditor;
 2. Not propose the shareholders’ meeting to sell or cease to conduct any business in the Designated Business Sectors; and
 3. Not access non-public technical information relating to any business in the Designated Business Sectors.

“Core Sectors”

- “Core Sectors” are the business sectors closely related to national security
 - Weapons, aircraft, space, nuclear or items that may be used for military applications
 - **Cyber security (cybersecurity related services, services to provide programs particularly designed for important infrastructures)**
 - **Medical (production of pharmaceuticals for infectious disease or “specially controlled medical devices”)**
 - Water, electricity or gas providers
 - Railway
 - Certain oil businesses

Classification of Listed Companies

- Question: is the target company conducting the business in the Designated Business Sectors or “Core Sectors”?
- Ministry of Finance publicizes a list of listed companies that:
 - i. Engaging in only business outside of the Designated Business Sectors;
 - ii. Engaging in business in the Designated Business Sectors, but outside of the “Core Sectors”; and
 - iii. Engaging in business in “Core sectors”.
 - As of July 10, 2020, 3822 listed companies are in the list, and there are 1663 companies of (i), 1504 companies of (ii) and 655 companies of (iii).
- BUT, a foreign investor shall carefully examine this issue, not only relying on the list.

Investment to Listed Company vs Unlisted Company

- Investment in a **listed** company
 - Identify the numbers of shares to be acquired
 - Whether the target company conducts any business in the Designated Business Sectors or in the “Core Sectors” by checking the Ministry of Finance's list
 - Consider whether you could rely on the exemption or not
 - If a Prior Notification is needed, file it via the Bank of Japan, and file a Post Investment Report within 45 days from the closing date
 - If no Prior Notification is needed, file a Post Investment Report within 45 days from the closing date
- Investment in an **unlisted** company
 - Check whether the target company conducts a business in the Designated Business Sectors through inquiries, due diligence and public information, as needed
 - So long as the control over the target is transferred or the investor is otherwise interested in the management of the target company, the exemption will be unavailable
 - If the target's business includes the Designated Businesses, then file a Prior Notification sufficient time before the date of closing, and file a Post Investment Report within 45 days from the closing date
 - If a Prior Notification is not needed, file a Post Investment Report within 45 days from the closing date

Timelines and Procedures

Morgan Lewis



Narumi Ito

Prior Notification Procedure

- Prior Notification is reviewed by the relevant government authorities, and Ministry of Economy, Trade and Industry (METI) covers most industries, particularly technology industries
- Under the FEFTA, METI is required to complete this review within 30 days after the formal submission date
- METI shall make efforts to shorten this review period up to 5 business days unless there is any national security concern
- If METI considers that the proposed investment would pose national security concern, the review period may be extended up to 5 months, and the order to modify or discontinue the investment may be issued
- In practice, Prior Notification is reviewed by METI prior to the formal submission, and METI provides Q&As in connection with their review

Prior Notification Procedure

Action Item	Estimated Period
Prepare draft Prior Notification	1-2 weeks
Informal discussion with METI	Generally 2-3 months, but depending on the deal
Formal submission of Prior Notification to BOJ	N/A
METI's review after formal submission of Prior Notification	At least 5 business days and not more than 30 days
METI's final approval	N/A

Items Stated in Prior Notification

- Prior Notification with respect to share acquisition (Form 1) shall include, among others, the following information:
 - Information regarding the filing party (e.g., corporate name, address, nature of business conducted)
 - Information regarding the target company (e.g., corporate name, address, nature of business conducted, capital amount, foreign investment ratio)
 - Number of shares to be acquired
 - Scheduled timing of share acquisition
 - Purpose of share acquisition
 - Information of ultimate parent company of the filing party
- Information included in the Prior Notification is not disclosed to anyone other than the relevant government authorities
- METI reviews Prior Notification from the viewpoint of whether the proposed investment would impact national security, public order and/or public security, considering both nature of investors (including relationship with foreign governments) and business conducted by the target company

METI's Review – Q&As

- Prior to the formal submission of Prior Notification, METI usually provides a written questionnaire (or a series of questionnaires) including, for example, as follows:
 - Further detailed information of the filing party and its affiliates (e.g., major products and services, key customers and business partners)
 - Relationship between the filing party (including its affiliates) and government related entities
 - Information management system and data security policies of the target company
 - Detail of involvement in the target company's management after the share acquisition
- The questionnaire is usually addressed to the filing party, but sometimes the target company's cooperation is necessary in order to answer METI's questions
- METI's review period substantially differs on a case-by-case basis

METI's Review – Certifications

- METI sometimes requests to submit certain certifications together with Prior Notification
- The certifications include, for example, as follows:
 - Prohibition of transfer of shares to a third party that would pose Japan's national security concern
 - Prohibition of appointment of officers of the target company that would pose Japan's national security concern
 - Preventive measures for not being influenced by foreign governments on exercising of voting rights
 - Preventive measures for leakage of confidential information of the target company
 - Prior consultation with METI if there is any issue which may pose Japan's national security concern

Post Investment Report

- Post Investment Report with respect to share acquisition:
 - When the target company does not conduct business in “Designated Business Sectors”, a Prior Notification is not required but a Post Investment Report (Form 11) may be required
 - When the target company conducts business in “Designated Business Sectors” but a Prior Notification is exempted, a Post Investment Report (Form 11-2) may be required
 - When a Foreign Investor files a Prior Notification, a separate Post Investment Report (Form 19) needs to be filed following the share acquisition
- Post Investment Report is required to be filed within 45 days of the share acquisition.
- Filing of Post Investment Report is completed upon submission to the Bank of Japan, and there is no subsequent review by METI.

Morgan Lewis & Bockius – Tokyo Office

Please contact us if you have any questions or comments



Moto Araki (Office Managing Partner)

moto.araki@morganlewis.com

Corporate & Business Transaction Group – Japan (Bengoshi)



Mitsu Saito

mitsu.saito@morganlewis.com



Narumi Ito

narumi.ito@morganlewis.com



Nao Sato

nao.sato@morganlewis.com



Masaki Ichimura

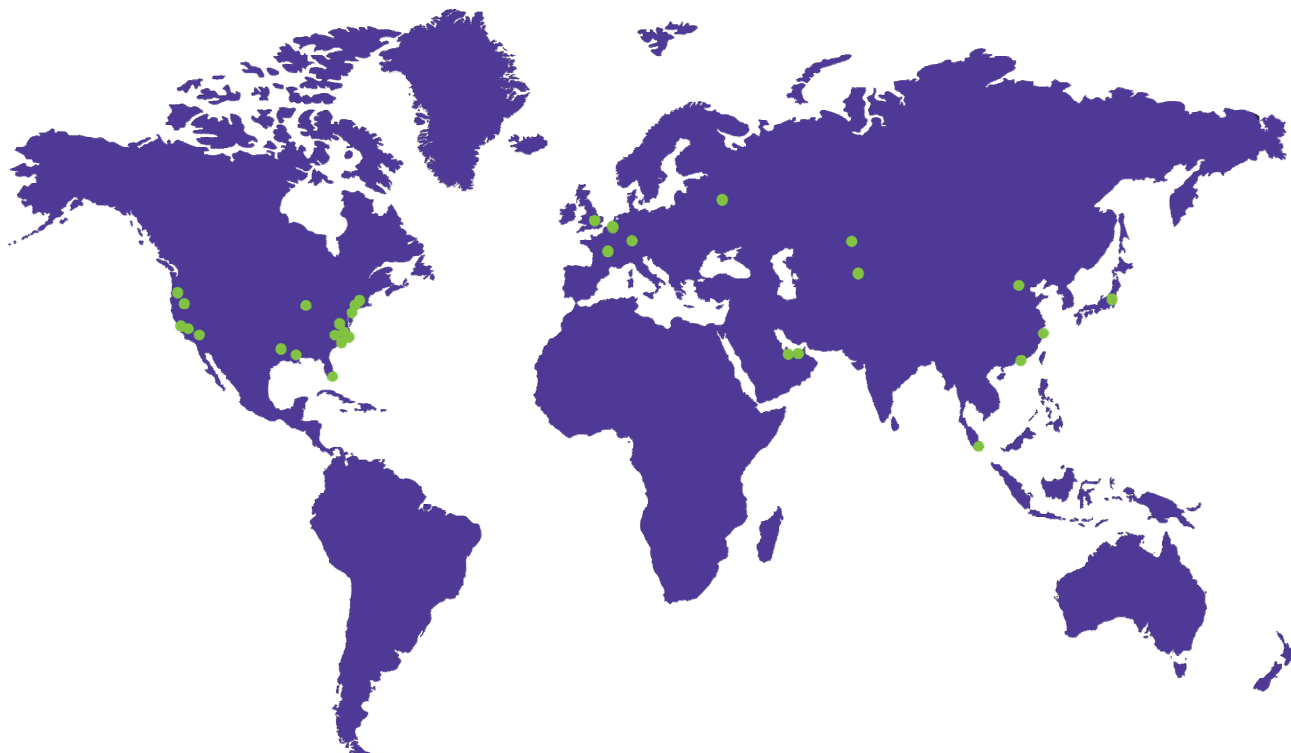
masaki.ichimura@morganlewis.com

Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

Abu Dhabi
Almaty
Beijing*
Boston
Brussels
Century City
Chicago
Dallas
Dubai
Frankfurt
Hartford
Hong Kong*
Houston
London
Los Angeles
Miami
Moscow
New York
Nur-Sultan
Orange County
Paris
Philadelphia
Pittsburgh
Princeton
San Francisco
Shanghai*
Silicon Valley
Singapore*
Tokyo
Washington, DC
Wilmington



Morgan Lewis

Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan, Lewis & Bockius is a separate Hong Kong general partnership registered with The Law Society of Hong Kong. Morgan Lewis Stamford LLC is a Singapore law corporation affiliated with Morgan, Lewis & Bockius LLP.

THANK YOU

© 2021 Morgan, Lewis & Bockius LLP
© 2021 Morgan Lewis Stamford LLC
© 2021 Morgan, Lewis & Bockius UK LLP

Morgan, Lewis & Bockius UK LLP is a limited liability partnership registered in England and Wales under number OC378797 and is a law firm authorised and regulated by the Solicitors Regulation Authority. The SRA authorisation number is 615176.

Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan, Lewis & Bockius is a separate Hong Kong general partnership registered with The Law Society of Hong Kong. Morgan Lewis Stamford LLC is a Singapore law corporation affiliated with Morgan, Lewis & Bockius LLP.

This material is provided for your convenience and does not constitute legal advice or create an attorney-client relationship. Prior results do not guarantee similar outcomes. Attorney Advertising.