

JAPAN'S NEW FOREIGN DIRECT INVESTMENT (FDI) REGULATIONS ENTER INTO FORCE

Last autumn Japan reported it would tighten its foreign direct investment (FDI) regulations and lower the threshold for pre-transaction approval for acquisitions by foreign investors of shares in Japanese listed companies from 10% to 1%. The Ministry of Finance (MOF) published the final version of the implementing ordinances on 30 April 2020. The new FDI regulations enter into force on 8 May 2020 and apply to investments which close or complete on or after 7 June 2020. In this briefing, we outline the practical impact on the activities of foreign investors and shareholders in Japanese listed companies and the conditions for relying on exemptions from the pre-transaction approval requirement.

MAJOR CHANGES

The threshold for pre-transaction approval is lowered from 10% to 1% in relation to acquisitions of shares in Japanese listed companies operating in designated business sectors although several exemptions are available.

The designated business sectors that require pre-transaction approval are divided into core business sectors and non-core business sectors. The conditions for availing of the exemptions differ depending on which of these sectors the listed company is in. On 8 May 2020 the MOF will publish a list identifying the sector categorisation of each listed company.

Separately, the filing process for investment through partnership funds is simplified.

For an overview of the background to these changes, please see our earlier briefing: [Reform of Foreign Direct Investment Regulations in Japan: Expansion of Pre-Transaction Approval Regime](#).

PRE-TRANSACTION APPROVAL REQUIREMENT AND EXEMPTIONS

If a foreign investor intends to acquire shares in a Japanese listed company, after which the number of shares or voting rights held by the foreign investor and certain persons related to it will constitute 1% or more of the total shares or voting rights in that company, a notification for pre-transaction approval must be filed. In the event that a foreign investor already holds 1% or more of

Key issues

- Japan tightens FDI regulations and lowers from 10% to 1% the threshold for pre-transaction approval for acquisitions by foreign investors of shares in certain Japanese listed companies.
- Several exemptions from the pre-transaction approval requirement are available.
- MOF will publish a list identifying the sector categorisation of each listed company, to facilitate investment by foreign investors.
- Filing process for investment through partnership funds is simplified, however the foreign contribution ratio of the partnership needs to be carefully calculated.

the shares of a Japanese listed company, prior notification for pre-transaction approval is required for any additional purchases of shares in such company.

However, several exemptions are available.

Financial firms

Financial firms including securities firms, banks, insurance companies, asset managers, trust companies and registered corporate-type investment trust asset managers which are subject to regulation or supervision under financial regulatory laws in any jurisdiction are exempted from the pre-transaction approval requirement entirely (i.e. without any threshold applying, even if its shareholding would exceed 10% as a result of the transaction) if all of the following **portfolio investment conditions** are satisfied:

- they or their closely-related persons¹ will not become board members of the investee company;
- they will not propose in a general shareholders' meeting the sale of the investee company's business in any of the designated business sectors; and
- they will not have access to non-public information about the investee company's technology relevant to business activities in any of the designated business sectors.

The exemption is available for investments in any listed company, whether or not it operates in **core business sectors** (such as arms, aircraft, space, nuclear or cybersecurity).

Further, the post-transaction reporting requirement will apply only if the shareholding of the foreign investor is, or will be following the purchase, 10% or more.

General investors

General investors (excluding the financial firms mentioned above), sovereign wealth funds and public pension funds accredited by the MOF are exempted in the following circumstances:

- when investing in a company operating in non-core business sectors: if the portfolio investment conditions listed above are satisfied.
- when investing in a company operating in core business sectors, if:
 - the portfolio investment conditions above are satisfied;
 - the total shareholding is less than 10%; and
 - the additional portfolio investment conditions below are satisfied.

The **additional portfolio investment conditions** are:

- the investor will not participate in the investee company's committees that make important decisions regarding activities in core business sectors; and
- the investor will not make proposals, in written form, to the executive team or the board of directors of the investee company requiring responses by certain deadlines set by the investor.

¹ Defining the scope of 'closely related persons' is fairly complex, but would generally include a wide range of corporate group members, business partners, those with joint voting rights and those deriving substantial revenue from a company, as well as family members in an individual context.

Notwithstanding these exemptions from the requirement for pre-transaction approval, a post-transaction reporting requirement continues to apply if the shareholding of the foreign investor is, or will be following the purchase, 1% or more.

Who is not exempted?

The following persons will not be exempted:

- foreign government owned funds that are not accredited by the MOF;
- activist foreign investors who cannot comply with the portfolio investment conditions or additional portfolio investment conditions; and
- foreign investors who change their policy after acquiring shares and seek to be appointed as a board member of the investee company or propose the sale or disposition of the investee company's business in any of the designated business sectors. In such case, the foreign investor is required to obtain approval before taking such action by filing a prior notification.

The above persons must file a notification for pre-transaction approval prior to acquiring shares in a Japanese listed company constituting 1% or more of such company's total shares.

MOF'S CATEGORISATION OF LISTED COMPANIES

Whether or not the investee company operates in any of the designated business sectors is essential to determining what kind of filing is required with respect to investments in its shares.

On 8 May 2020, the MOF will publish lists of companies which (i) do not operate in any of the designated business sectors, (ii) operate only in designated business sectors that are not core business sectors (**non-core business sectors**), and (iii) operate in core business sectors. This should assist foreign investors in determining whether pre-transaction approval is required for a particular share transaction. It is likely that the MOF will review and update the lists from time to time and a company's categorisation could therefore change.

INVESTMENT THROUGH PARTNERSHIP FUNDS

Currently, a foreign investor investing any amount in an investment limited partnership (*toshi jigyo yugen sekinin kumiai*, or LPS), a general partnership (*nin-i kumiai*, or NK) or a similar investment limited partnership governed by the laws of a jurisdiction other than Japan (in each case, which invests in shares in Japanese listed companies), is subject to the notification obligations under the FDI regulations as they are deemed to be a co-owner of the fund assets. Under the new FDI regulations, a foreign limited partner in such a partnership is not required to file notifications or reports. Instead, one of the general partners of the partnership fund is required to make filings on behalf of the partnership fund if either (i) 50% or more of the investment in the partnership fund is held by non-Japanese investors or (ii) 50% or more of the general partners in the partnership fund are non-Japanese. In such cases, pre-transaction approval will be required and the completion of an investment by a foreign investor in the partnership fund would need to be suspended until pre-transaction approval is granted.

CONTACTS

Tatsuhiko Kamiyama
Partner

T +81 3 6632 6395
E tatsuhiko.kamiyama
@cliffordchance.com

Natsuko Sugihara
Partner

T +81 3 6632 6681
E natsuko.sugihara
@cliffordchance.com

Michihiro Nishi
Partner

T +81 3 6632 6622
E michihiro.nishi
@cliffordchance.com

Masafumi Shikakura
Counsel

T +81 3 6632 6323
E masafumi.shikakura
@cliffordchance.com

Timothy Merchant
Senior Associate

T +81 3 6632 6631
E timothy.merchant
@cliffordchance.com

Leng-Fong Lai
Partner

T +81 3 6632 6625
E leng-fong.lai
@cliffordchance.com

Yusuke Abe
Partner

T +81 3 6632 6332
E yusuke.abe
@cliffordchance.com

Chihiro Ashizawa
Counsel

T +81 3 6632 6414
E chihiro.ashizawa
@cliffordchance.com

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www.cliffordchance.com

Clifford Chance (Gaikokuho Kyodo Jigyo)
Palace Building, 3rd floor
1-1, Marunouchi 1-chome, Chiyoda-ku,
Tokyo 100-0005, Japan

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