AMT/NEWSLETTER

Economic Security & International Trade

March 31, 2025

Revision to the Exemption Scheme for Prior Notification in the Foreign Direct Investment Screening System under the FEFTA

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1. Introduction

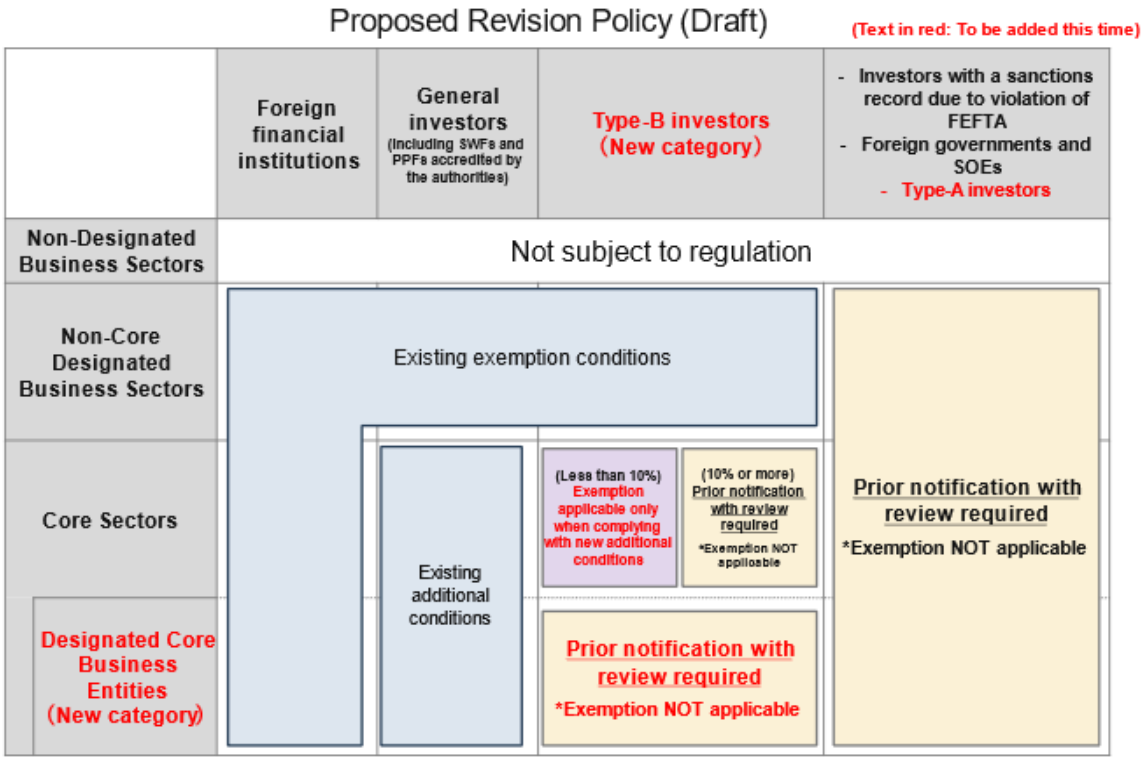
On February 10, 2025, the Ministry of Finance publicized its proposed revisions to the ancillary rules and regulations concerning the revision of the exemption scheme for prior notification in the foreign direct investment screening system under the *Foreign Exchange and Foreign Trade Act* (the "FEFTA"). The revision primarily restricts the use of the exemption scheme for prior-notification in the context of: (1) investments made by investors who are obliged to cooperate with foreign governments in collecting information based on agreements with foreign governments or foreign laws and regulations ("Type-A Investors") or the equivalent, and (2) certain investments in the business entities which are among the business entities designated as Specified Essential Infrastructure Service providers under the *Act on the Promotion of Ensuring National Security Through Integrated Implementation of Economic Measures* (the "Economic Security Promotion Act"), and which require screening with particular attention (the "Designated Core Business Entities"). This article outlines

the details of the revision based on the "Overview of System Revision" published by the International Bureau of the Ministry of Finance and the draft Cabinet Order, Ministerial Order, and Public Notice[1].

2. Background to the Revision

The recent decision of the Ministry of Finance to revise the exemption scheme for prior notification is apparently based on the view that investors who are obliged to cooperate with foreign governments in collecting information (so-called intelligence activities) should, in principle, be subject to the same prior notification screening requirements as foreign governments. Until now, there have been growing concerns about foreign investors making extensive use of the exemption scheme for prior notification and acquiring shares in Japanese listed companies. It is assumed that the Ministry of Finance has taken these concerns into account and now aims to prevent investments in Japan from being used for intelligence activities of foreign governments, thereby preventing the risks of undermining Japan's national security or equivalent values (See Diagram 1).

<Diagram 1>



Source: Ministry of Finance, International Bureau, "About the Foreign Direct Investment Screening System" (Ministry of Finance, January 23, 2025)[2], p.3

1 Ministry of Finance, Draft Rules and Regulations of the Foreign Exchange and Foreign Trade Act, February 10, 2025 〈 https://www.mof.go.jp/english/policy/international_policy/fdi/News_and_Communications/20250207110525.html〉
Ministry of Finance, International Bureau, "About the Foreign Direct Investment Screening System" (Ministry of Finance, January 23, 2025) 〈 https://www.mof.go.jp/english/policy/international_policy/fdi/News_and_Communications/relateddocument_20250210.pdf〉

2 Same as note 1 above

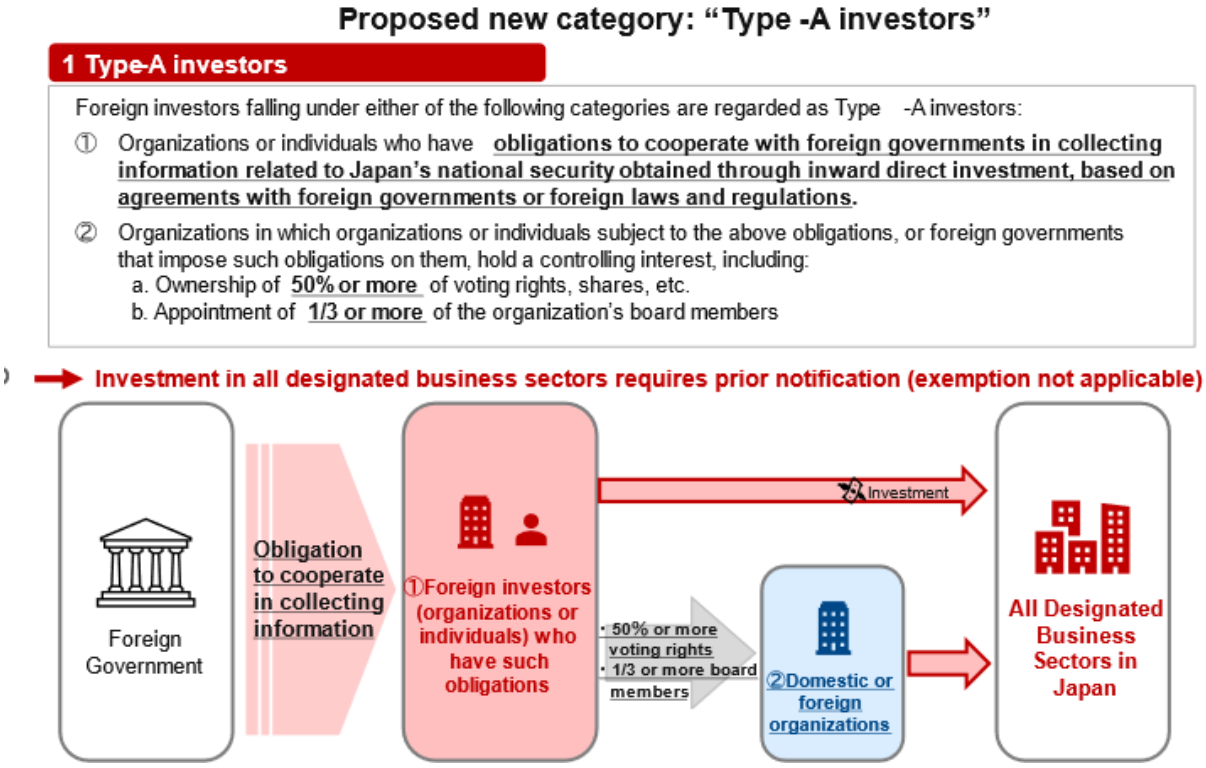
3. Type-A Investors

The newly added category of "Type-A Investors" is defined as falling under either of the following ① or ② (See Diagram 2):

① Organizations (corporations and other entities) or individuals who have obligations to cooperate with foreign governments by disclosing information related to Japan's national security based on agreements with foreign governments or foreign laws and regulations; or

② Organizations in which a controlling interest is held by either (i) or (ii) below:
(i) organizations or individuals subject to the obligations mentioned in ① above, or
(ii) foreign governments that impose such obligations on such organizations or individuals.
Here the term "controlling interest" includes:
a. Ownership of 50% or more of voting rights, shares, etc.
b. Appointment of one-third or more of the organization's board members

<Diagram 2>



Source: Same as above, p.4

If the investor falls under the category of a Type-A investor, they will not be able to use the exemption scheme for prior notification, and prior notification will always be required upon the acquisition of 1% or more of the shares of a listed company operating in a Designated Business Sector.

It is assumed that the category of ① primarily targets Chinese investors. Chinese investors (strictly speaking, "organizations and citizens") are obliged to cooperate with the Chinese government's information collecting activities under Article 7 of the National Intelligence Law of the People's Republic of China, which came into effect on June 28, 2017. As a result, it is understood that Chinese investors broadly fall under the category of ①, with subsidiaries of ① falling under

the category of ②, and that even if the purpose of the investment is purely one of investment, they will not be able to use the exemption scheme for prior-notification.

However, a closer examination of the category of ① reveals that there are several countries that mandate an obligation to report to the government or to respond to investigations based on laws and regulations (for example, the United States has the CLOUD Act, which provides for the government's request for data disclosure from companies). In addition, according to research being undertaken by the Personal Information Protection Commission, there are a number of systems in other countries that impose obligations on business entities to cooperate with the government's information collection activities[3]. The scope of such research is being limited to systems related to "personal information held by business entities." It is expected that some countries have systems that, in addition to those mentioned above, impose cooperation obligations on individuals or with regard to targeting information other than personal information (e.g. technical information) and, thus, the range of investors that fall under the scope of the category of ① could be broad. The impact of the revision under consideration is likely to be far-reaching, beyond China. We must pay close attention to official answers to public comments and other announcements to see what specific laws and regulations or which types of cooperation obligations will meet the requirements of ①.

4. Type-B Investors

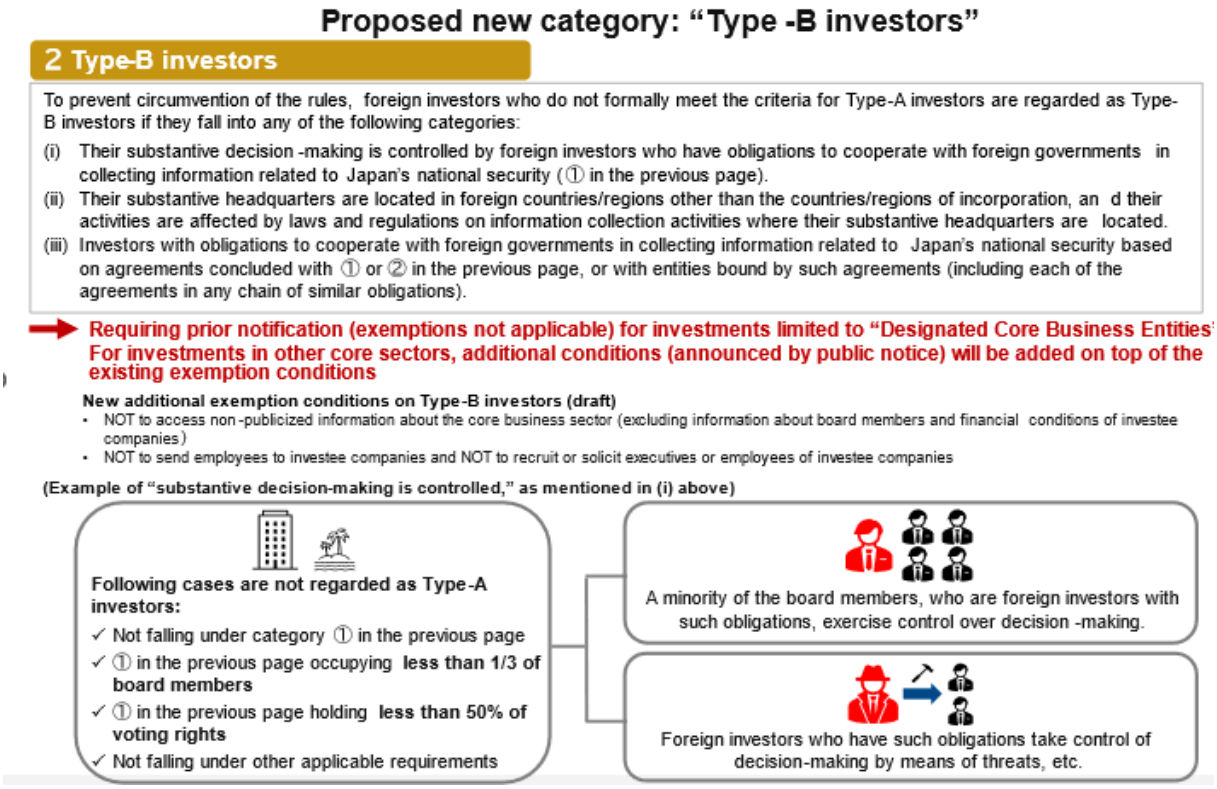
To prevent circumvention of the rules, investors who do not formally meet the requirements of "Type-A Investors" but who meet the following requirements will be regarded as "Type-B Investors." Items (i) to (iii), below, show the requirements for becoming a Type-B Investor. As mentioned at item "5. Designated Core Business Entities" below, if investors fall under the category of "Type-B Investors", for acquisitions of shares of 1% or more in a listed company that is a Designated Core Business Entity, a prior notification will be required. For acquisitions between 1% or more and less than 10% of shares of a listed company that is not a Designated Core Business Entity but operates business in a Core Business Sector, additional conditions[4] will be imposed on top of the existing conditions.

(i) Investors whose substantive decision-making is controlled by investors who have obligations to cooperate with foreign governments in collecting information related to Japan's national security (aforementioned ①);
(ii) Investors whose substantive headquarters are located in foreign countries/regions other than the countries/regions of incorporation, where their activities are affected by laws and regulations on information collection activities related to Japan's national security where their substantive headquarters are located; or
(iii) Investors with obligations to cooperate with foreign governments in collecting information related to Japan's national security based on agreements concluded with investors falling

3 https://www.amt-law.com/asset/pdf/bulletins5_pdf/250331_01.pdf
4 Additional exemption conditions are the following: (a) NOT having access non-publicized information about the business belonging to the core business sector (excluding information about board members and financial conditions of investee companies); and (b) NOT sending employees to investee companies and NOT recruiting or soliciting executives or employees of investee companies.

under the category of aforementioned ① or ② (including each of the agreements in any chain of similar obligations).

<Diagram 3>



Source: Same as above, p5

Clarification is awaited as to which investors fall under the categories of (i), (ii), and (iii) above. For example, the "Overview of System Revision" issued by the International Bureau of the Ministry of Finance seems to understand that sovereign wealth funds (SWFs) accredited by the authorities do not fall under the category of "Type-B Investors." In addition, the document also raises, as examples of the condition that "substantive decision-making is controlled" at (i), cases (x) where a minority of the board members, who are foreign investors with obligations to cooperate with foreign governments in collecting information related to Japan's national security, control the decision-making, or (y) where foreign investors who have such obligations take control of the decision-making by threatening or other equivalent means. As the exemption scheme has been used among a wide range of so-called general investors, it is desired that clarification on which foreign investors fall under the category of "Type-B Investors" will be provided through the responses to the public consultations beyond such examples. If the use of the exemption scheme for prior-notification will be restricted for even a part of general investors on the grounds of falling under the category of "Type-B Investors," it cannot be denied that this may affect the investment appetite of general investors. It is thus important to be attentive to future announcements on this issue, including the responses of participants in the public consultations.

5. Designated Core Business Entities

Further to the above, the Core Business Sectors were segmented in the latest revision by adding a new category of "Designated Core Business Entities." As a result, as mentioned above, when Type-A Investors or Type-B Investors invest in "Designated Core Business Entities," they will not be able to use the exemption scheme for prior-notification. The term "Designated Core Business Entities" refers to business entities that meet certain standards among "Specified Essential Infrastructure Service Providers" conducting specified essential infrastructure business, such as electricity, gas, communications, and railway projects, as defined in Chapter III (*Ensuring the Stable Provision of Specified Essential Infrastructure Services*) of the Economic Security Promotion Act, and at the same time belonging to Core Business Sectors. The Cabinet Office publishes a list of business entities that are designated as "Specified Essential Infrastructure Service Providers."[5]

6. Summary

Against the backdrop of the recent global rise in awareness of economic security issues, regulations in Japan have also been tightened, with the enactment of the Economic Security Promotion Act to prevent information leakage and other risks. It has not yet been specified when the revised cabinet order will come into effect, but it is expected to be enforced soon. We will continue to closely monitor the future developments on how the Ministry of Finance will balance the further promotion of foreign direct investment into Japan while mitigating the risks to Japan's economic security.

5 Cabinet Office, Designation of Specified Essential Infrastructure Service Providers, March 11, 2025, 〈 https://www.cao.go.jp/keizai_anzen_hosho/suishinhou/infra/doc/infra_jigyousya.pdf 〉(in Japanese only)

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