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Amendments to Prior Notification Exemptions under Foreign Exchange and Foreign Trade Act, Targeting Chinese Investors

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Ⅰ. Background

The amendment to the Foreign Exchange and Foreign Trade Act ("**FEFTA**"), which came into effect in 2020, expanded the scope of transactions subject to prior notification, such as by lowering the threshold for notifiable acquisition of listed shares from 10% to 1%. To strike a balance, the amendment also introduced broad exemptions from the prior notification requirement for passive investors whose sole purpose is economic return.

However, transactions that the Japanese government considered should be subject to review, such as Tencent's acquisition of a 3.65% stake in Rakuten through its subsidiary in 2021, were executed relying on the exemption, and the Japanese government did not have a chance to review these transactions because prior notifications were not made.[1] The Japanese government viewed this as a problem.

Additionally, in connection with discussions on the possible amendment to the NTT Act, the project team of the Liberal Democratic Party proposed in December 2023 to strengthen foreign investment review of

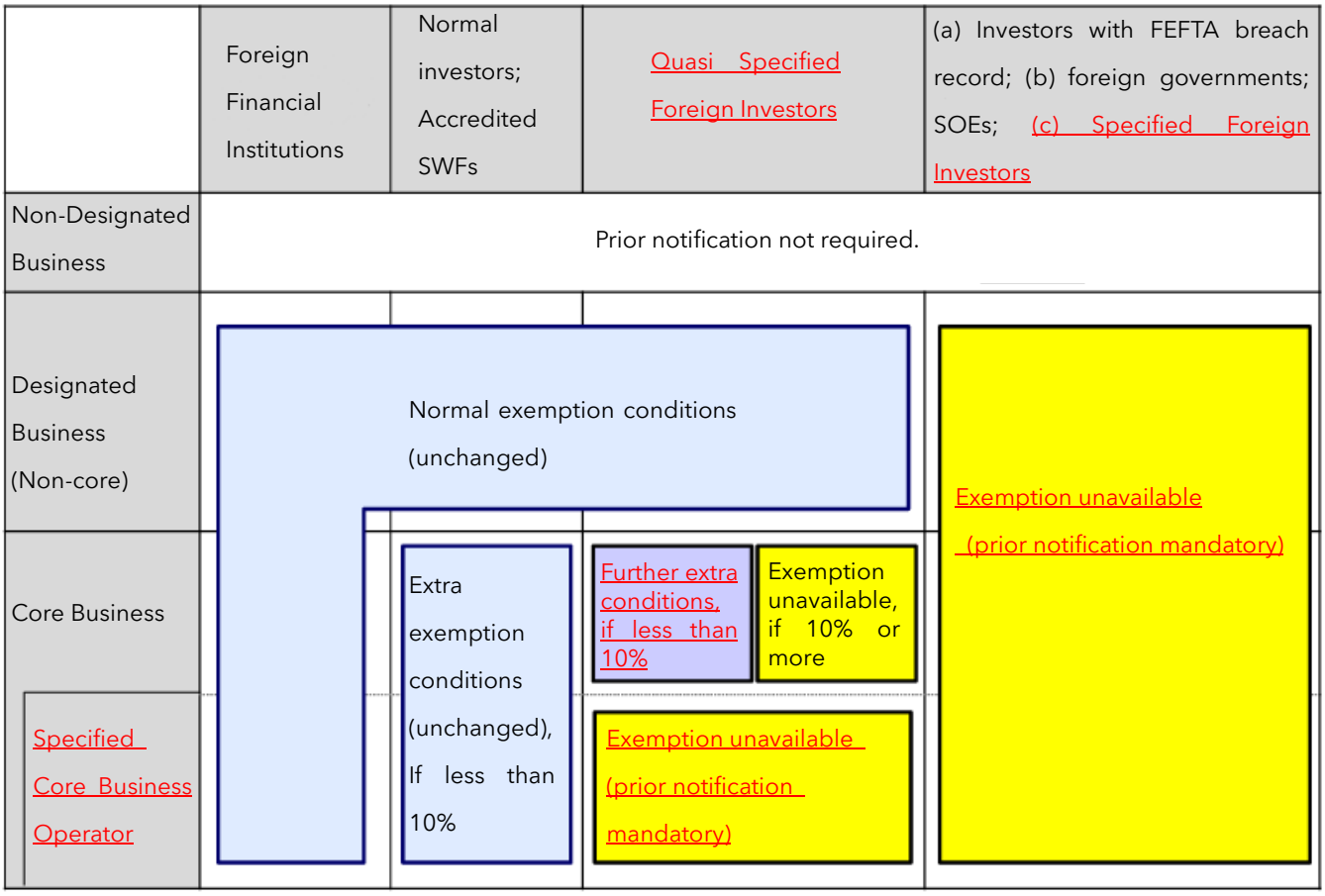
[1] *"Tencent-Rakuten deal exposes limits of Japan investment rules" (Nikkei Asia, April 20, 2021)*

certain business operators of critical infrastructures, which are particularly important for Japanese citizens, including those in the information and communications industry. This included a suggestion to make exemption under FEFTA unavailable for investment in any business operator of critical infrastructures designated pursuant to the Economic Security Promotion Act.

Against this backdrop, the Japanese government is planning to implement further amendments to the FEFTA regulations. These amendments will (a) prohibit reliance on exemptions by foreign investors who are obliged to cooperate with intelligence activities by foreign governments, which implicitly targets Chinese investors, who are under the general obligations to cooperate with the PRC government's intelligence activities under the National Intelligence Law, and (b) establish a new definition of "specific core-business operators" in addition to the existing definitions of "designated business" and "core business".[2]

Overview of contemplated amendments:

Amendments are indicated in red below.



(Prepared by author by modifying materials published by the Ministry of Finance)

[2] *Ministry of Finance, International Bureau, "Review framework of inward direct investments" (January 23, 2025)* (in Japanese)

Ⅱ. Specified Foreign Investors

Among foreign investors, those who fall under either of the following categories (1) or (2) will be classified as "Specified Foreign Investors":

(1) Organizations (corporations or other entities) or individuals who are obliged to disclose such information as acquired through inward direct investment that is likely to significantly harm national security, to foreign governments, either by foreign laws or pursuant to contracts with foreign governments, thereby cooperating with such foreign governments.

(2) Organizations, with respect to which the organization or individual falling under (1) above, or the foreign government to which the organization or individual cooperates:

  (a) holds 50% or more of the shares or voting rights or shares; or

  (b) appoints one-third or more of the directors or representative directors.

Currently, **the Japanese government seems to understand that China, which has implemented the National Intelligence Law, is the only country enforcing such a law as to broadly oblige citizens and organizations to cooperate on information collection by the government and thus falls under category (1) above**.[3] Based on this assumption, the amendment does not seem to intend to capture any conventional reporting obligations generally applicable to regulated businesses under category (1) above. However, category (1) still captures those organizations and individuals who are obliged to cooperate pursuant to "contracts with foreign governments", and thus the precise scope of information that is considered likely to significantly harm national security remains crucial.

Following the amendment, **companies incorporated in China, who are subject to obligations under the National Intelligence Law, will fall under category (1), and subsidiaries of a Chinese company will fall under category (2), making them ineligible to rely on the exemption from the prior notification requirement under FEFTA**.

As M&A transactions involving acquisition of control, or startup investments accompanied with director rights, would require a prior notification even under the current FEFTA regulations (and not only Chinese

[3] *"Screening of inbound investment by 'Companies cooperating with the PRC government', to prevent information leakage" (Nikkei, January 22, 2025)* (in Japanese)

investors, but any foreign investors cannot rely on exemption as acquisition of control or appointment of director contradicts with the exemption conditions), these transactions will not be directly affected by the amendment. However, **Chinese investors, even if they are pure passive investors, will no longer be able to rely on exemption, and, for example, must file a prior notification whenever they acquire 1% or more of the listed shares**.

Additionally, **even if a foreign investor is not a Chinese company or its subsidiary, it falls under category (2) if one-third or more of their directors or representative directors are appointed by any person falling under category (1) or the PRC government, and thus foreign investors must pay attention to their director compositions**.

Ⅲ. Quasi Specified Foreign Investors and Specified Core Business Operators

From the perspective of preventing circumvention, a foreign investor who does not fall under the definition of the Specified Foreign Investor will still be treated as a "**Quasi Specified Foreign Investor**," if it falls under any of the following. Reliance on exemption by a Quasi Specified Foreign Investor will be more restricted compared to exemption available under the current FEFTA regulations.

(1) Person whose management decisions are substantially controlled by an organization or individual falling under category (1) in Section II above.

(2) Person who has its substantial headquarters in a country or region other than their country of incorporation and is subject to the laws and regulations of that country regarding intelligence activities.

(3) Person who is obliged to disclose information to cooperate with foreign government's intelligence activities based on contracts with a person falling under category (1) or (2) in Section II above, or sub-contracts (or further sub-contracts) with entities that have entered into such contracts (or such sub-contracts).

The prongs (1) and (2) above of the definition of Quasi Specified Foreign Investors are qualitative criteria, and their respective scopes are unclear. In the materials prepared by the Ministry of Finance,[4] cases where "the decision-making process is dominated by a select few directors who are obliged to report information to a foreign government" and "the decision-making process is dominated through threats by a person who is obliged to report information to a foreign government" are presented as examples. However, the latter example seems somewhat extreme, and questions remain about whether the former refers only to exceptional cases where the board of directors is dysfunctional and only directors who owe information reporting obligations make business decisions. Clarification through public comments is desirable.

Although the regulations are somewhat complex, the exemptions on which a Quasi Specified Foreign Investor can rely following the amendment are as follows (please also refer to the diagram on page 3):

Designated Business (Non-core):	Exemption available under the same exemption conditions as now.
Core Business (other than Specified Core Business Operator):	Exemption available, but with more stringent exemption conditions.
Specified Core Business Operator:	Exemption unavailable.

A "**Specified Core Business Operator**" is defined as an operator of a critical infrastructure designated pursuant to the Economic Security Promotion Act[5] who also falls under any of the core business sectors. This approach was suggested in the proposal by the project team of the Liberal Democratic Party, as mentioned in "I. Background" above, and it reflects the view that the availability of exemption for investments in operators of critical infrastructures should be more limited among the various core business sectors in light of the particular importance of critical infrastructures to the national security.

Furthermore, when a Quasi Specified Foreign Investor relies on an exemption with respect to its investment in a core business, which is not a Specified Core Business Operator, they will be required to comply with the following additional exemption conditions, on top of the existing exemption conditions:

(A) Not accessing any non-public information relating to a core business (excluding financial information

[4] *Ministry of Finance, International Bureau, "Review framework of inward direct investments" (January 23, 2025)* (in Japanese)
[5] Such operators are designated by name by respective ministries having jurisdiction over them pursuant to the Economic Security Promotion Act. *"List of Persons Designated as Operators of Critical Infrastructures" (as of October 17, 2024)* (in Japanese)

about the company or information relating to its directors or officers).

(B) Not dispatching any employee to the company, nor soliciting directors, officers or employees of the company.

The exemption conditions under the current FEFTA regulations prohibit access to non-public information relating to technology or systems only, while condition (A) above further prohibits access to non-public information relating to a core business in general. Likewise, while the appointment of directors and attendance at board or committee meetings are already prohibited by the exemption conditions under the current FEFTA regulations, condition (B) above further prohibits a Quasi Specified Foreign Investor from dispatching any employee to the company or soliciting away any director, officer or employee of the company.

Ⅳ. Implementation schedule

The implementation date of the amendments has not yet been announced. But we expect that the draft regulations will be made available shortly and a public comment process will be conducted before the amendments are promulgated and enforced.

In particular, the definition of Quasi Specified Foreign Investors seems to involve some vagueness, we encourage those foreign investors who may be affected by the amendments to review the draft regulations and participate in the public comment process as necessary.

On a separate note, 2025 marks the fifth anniversary of the enforcement of the amended FEFTA, and the government is evaluating legislative amendments in the near future, in addition to the amendments to the regulations such as the ones we reviewed in this issue.

With the inauguration of President Trump for his second term, the global geopolitical situation will likely become even more complex, and it is essential to continue monitoring developments in Japan's foreign investment screening regime.