

# Revision of Regulations of Foreign Investments in Japan under the Foreign Exchange and Foreign Trade Law

In recent years, cross-border M&A activities have been increasing. In addition, the full enactment of the Corporate Law in May 2007 added flexibility as to the type of consideration to be paid in corporate re-organisations leading to a lifting of the ban on triangular mergers. In this sense, the acquisition of Japanese companies by foreign investors has become easier. On the other hand, with an increasingly liberal and open investment environment, the political task of avoiding an outflow of technology, which is important for Japan's national security, due to the acquisition of Japanese companies by foreign investors, has been increasingly recognised. Under these circumstances, the regulations relating to foreign investments in Japan based on the Foreign Exchange and Foreign Trade Law (the "**Regulations**") have been reviewed and relevant governmental and ministerial ordinances have been revised. These revisions became effective on 28 September 2007.

In this Client Briefing, we will discuss the contents of these revisions.

## Outline of Revisions

The new revisions can be divided into (i) the scope of industries requiring prior notification, (ii) the scope of restricted transactions, and (iii) administrative procedures.

To begin with, the Regulations prescribe that in cases where a "foreign investor"<sup>1</sup> conducts a "direct investment in a Japanese company"<sup>2</sup> with the risk of compromising Japan's national security, disturbing public order, or interfering with the protection of public security, prior notification must be made to the competent authorities. In the case of direct investments in a Japanese company not requiring prior notification, a post-acquisition report following the acquisition must be filed.

## Key Issues

### Outline of Revisions

Revision of Scope of Industries Requiring Prior Notification

Revision of Scope of Covered Transactions

Revision of Administrative Procedures

Practical Considerations

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<sup>1</sup> E.g., non-resident individuals, foreign legal entities, Japanese legal entities where foreign legal entities directly or indirectly hold more than 50% of the entity's voting rights.

<sup>2</sup> E.g., purchase of shares in a non-listed Japanese company from investors other than foreign investors and purchase of shares in listed companies resulting in a holding more than 10% after adding the holdings of related parties.

## Revision of Scope of Industries Requiring Prior Notification

In order to prevent the illegal export of important technology which can be potentially used for the production of weapons of mass destruction, direct investments by a foreign investor in Japanese manufacturers of specific items of universal use which can be applied to weapons of mass destruction and items of universal use which can be applied to conventional weapons and are of particularly sensitive nature, are now subject to prior notification. In addition to the already existing regulations for manufacturers of weapons and planes, prior notification is now also required for direct investments in manufacturers of materials, parts, manufacturing system specifically designed for the production of weapons and planes and software manufacturers of programs specifically designed for the use in space satellites, in order to prevent the destruction of defence-related production and technological platforms.

## Revision of Scope of Covered Transactions

### *Transaction types newly added to revised regulatory scope*

In cases where consolidated subsidiaries of the acquired companies are engaged in regulated businesses or new shares in the acquired companies are being acquired in overseas stock markets, prior notification is now required, even if the consolidating entity which is subject to investment does not engage in regulated activities. Investing parties will be seen as “related parties” if they agree on exercising their respective voting rights together and their percentage holdings will be added, even in the absence of capital participations between such parties.

### *Transaction types outside the regulatory scope*

Several listed Japanese companies have a high ratio of foreign investors. Since there is no significant need to regulate these companies as foreign investors, companies where foreign investors hold more than 50% of voting rights but no single investor holds more than 10% of outstanding stock have been exempt from regulation.

With certain exemptions, the granting of loans and the acquisition of privately placed securities has been subject to the Regulations. In order to remove restriction on loans or securities which are not related to the acquisition of control of management, the granting of such is now subject to the Regulations only when the aggregate balance of such loans and securities exceeds 50% of the total liabilities owed by the company to which the loans or securities are provided.

## Revision of Administrative Procedures

As part of the supervising authorities' review of individual cases, procedures to obtain reports from foreign investors and their respective affiliates have been newly introduced. These procedures are aimed at enabling the supervising authorities to gather a wide spectrum of information regarding the financial and operating situation of the company to be invested in, detailed information about the products it manufactures, and the affiliations of the foreign investor.

## Practical Considerations

The expansion of the scope of industries and covered transactions requiring prior notification will cause increase in the number of prior notifications. The obligation to find out whether the company to be invested in or to be acquired conducts a regulated business requiring prior notification rests with the respective foreign investor in the same way as before the amendment.

Given that, it is necessary to apply additional prudence when confirming the business objectives of the company to be invested in. While this would normally include gathering information from the company's Certified Copy of Register, Annual Securities Report, and website to the extent possible, it is often difficult to make adequate judgements based on this information alone. This will remain a difficult task.

*Where Japanese legal concepts have been expressed in the English language, the concepts concerned may not be identical to the concepts described by the equivalent English terminology as they may be interpreted under the laws of other jurisdictions.*

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