

# Amendments to Japan's Foreign Exchange and Foreign Trade Act - Should we be worried?

November 2019

Readers of the Financial Times will be aware of the recent enactment of the above, which makes restrictive provisions in relation to foreign investment in Japanese companies which are deemed to be of strategic importance. The apparent potential for the definition of "strategic" to be all-encompassing (the FT cites, for example, the inclusion of leather goods in the definition) has rung alarm bells among foreign investors who see this as a rolling back of some of the progress in corporate governance made under Abenomics, becoming, in effect, a one-size-fits-all poison pill.

Although the government's handling of this matter from an investor relations standpoint has been somewhat inept, some clarification of the intent was offered by Yoshiki Takeuchi, Vice-Minister of Finance for International Affairs, in a riposte to the earlier FT piece in that journal on November 11th, in which he says:

“ We remain firmly committed to welcoming foreign direct investment and making the best of corporate governance to urge companies to be more efficiently managed. Activists are welcome to engage with Japanese companies to increase corporate value. Yes, to align with international trends in reviewing rules on foreign investors, the bill does review the current pre-screening system. But this is strictly from the perspective of national security, intending to prevent leakage of information relating to critical technologies and the disposition of important business activities. The Bill calls on only two specific actions relating to shareholders' rights for pre-screening. These actions are: 1) Foreign investors or closely related persons will become board members of the invested company; and 2) Foreign investors will propose and vote for

the transfer or disposition of important business activities of the invested company at shareholders' meetings. Shareholders are free to exercise any other rights or engagement. In addition, investors can take actions in 1) and 2) after pre-screening. This process is not lengthy or prohibitive and will be completed within five days if there are no national security concerns. Over the last 20 years, Japanese authorities received about 7,500 prior notifications. Your editorial kindly referred to the one and only instance in which we ordered investment to be suspended. To conclude, improving corporate governance remains our top priority. We have no intention at all to obstruct FDI; rather, we welcome it. So, please continue to buy Abenomics! ”

The government also points out that the United States harbours similar concerns regarding acquisition of strategic assets and technologies by potential geopolitical rivals, most specifically China, and has enacted similar legislation. Simply stated, the message is that this is all about China and foreign investors/activists in general have nothing to fear. The question for investors is "Do we believe this?"

For our part, we are inclined to, for the following reasons:

- 1) Any Japanese government would be negligent if it did not respond to potential or actual encroachments on the nation's strategic integrity from powerful and/or unpredictable near neighbours – be they testing ballistic missiles over Japanese airspace, building naval bases on disputed islands nearby or potentially purchasing controlling stakes in Japanese companies with important technologies.
- 2) The reassurances offered above are sufficiently specific that it would be difficult for the government to justify the blocking of an investment which did not give rise to this kind of strategic concern, simply because it had been lobbied by a company whose management was running scared.

YOSHIKI TAKEUCHI  
VICE-MINISTER FOR FINANCE FOR INTERNATIONAL AFFAIRS

3) The power and influence of Keidanren (Japan Business Federation) within the LDP and the government is now much reduced and, given the extent of the commitment to reform made explicit in the Stewardship and Corporate Governance Codes, there is little likelihood that the government could be summoned as a white knight to defend a Japanese company from legitimate foreign influence.

At a more parochial level, we do not expect this to influence the way in which we manage our Japan Stewardship strategy mandates. Unlike some other activist or engagement managers, we typically do not take large stakes in companies in which we invest because we do not need to. Our relationship with Nissay Asset Management, the investment arm of Japan's largest insurance company, means that we can engage and influence corporate managers from a position of mutual respect without forcing discussions through ownership. This in turn is what allows us to remain liquid enough to have a UCITS construct.

Whilst we have, from time to time, taken stakes in smaller companies which have exceeded the new 1% threshold<sup>1</sup>, our style has never been confrontational and we have never sought to appoint directors to boards or to move resolutions at company meetings, favouring, as our clients will be aware, a softer, diplomatic approach which we have always found to be more effective. It is possible, of course, that our approach might change over time but even in the hypothetical case that we were to take a more aggressive line with any of our current smaller invested companies, it is hard to believe that the Japanese authorities would consider any of them (think retailers, hair-care product or biscuit manufacturers etc.) to be of strategic significance to the defence of Japan.

As such, while we are aware that constant vigilance is the price of liberty, we believe that this legislation is all about geopolitical concerns surrounding China and our answer to the opening question is: "No; we should not be too worried".

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1. The bill passed by Japan's parliament on Friday 22nd November 2019 to amend the existing Foreign Exchange and Foreign Trade Act (FEFTA) has reduced the ownership threshold at which foreign investors have to notify regulators from 10% to 1% of a "potentially sensitive" company's shares.

**CONTACT US**

Please contact us if you have any questions or would like to discuss any of our strategies.

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