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The Strengthening of Foreign Direct Investment Regulations in Order to Secure Stable Supply Chains

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In April of 2023, following the designation in the Economic Security Promotion Act of "Specially Designated Critical Commodities" which require support, and in order to ensure stable supply chains, prevent technology leakage and address military diversion risk, the Core Business Sectors, which were subject to prior notification and review by the Japanese government, were amended to add certain businesses. Hence, companies previously deemed not to be engaged in Core Business Sectors are now classified within that definition and the Foreign Exchange and Foreign Trade Act (the "FEFTA") is more extensively and carefully scrutinized. The following is a brief overview of the Foreign Direct Investment Regulations' past and current amendments.

I. Overview of Foreign Direct Investment Regulations under the Foreign Exchange and Foreign Trade Act

Under the FEFTA, **Foreign Investors** investing in or taking certain acts (**Inward Direct Investments**) with respect to Japanese companies that are engaged in **Designated Business Sectors** (including **Core Business Sectors**) are subject to prior notification and review by the Japanese government.

"**Foreign Investors**", in general, refers to non-resident individuals, corporations and other organizations established under foreign laws and regulations, and companies whose ratio of foreign investment is 50% or more.

"**Inward Direct Investments**" include the following acts (for detail, see Article 26 (2) of the FEFTA.):

- (i) the acquisition of shares or equity in a company;
- (ii) the acquisition of shares of a listed company, etc.;
- (iii) the acquisition of voting rights in a listed company, etc.; or
- (iv) consent given with regard to a substantial change of the business purpose of a company or any other

matters specified by Cabinet Order as those having a material influence on the management of a company.

“Designated Business Sectors” include business sectors which are material from a security perspective. **“Core Business Sectors”** are business sectors with a potentially significant risk of compromising national security. Clearance must be obtained before Inward Direct Investments may be implemented with respect to a Japanese company engaged in such businesses.

II. Past Amendments regarding “Designated Business Sectors”

Since safeguarding such resources is important with respect to economic security, and in order to appropriately maintain and secure exploration capabilities of critical mineral resources, such as rare earths, on October 5, 2021, the following business sectors pertaining to 34 critical minerals, including rare earths, were added to the Core Business Sectors:

- Metal mining (including the operation of mineral exploration vessels or land/underwater surveys for mining)
- Manufacturing, repair/maintenance or software for devices or products used for metal mining (including mineral exploration vessels, marine equipment, excavators and drilling machines)
- Component analysis services of minerals

On June 15, 2020, in light of the Covid-19 infection outbreak, and in order to maintain the domestic manufacturing base of the medical industry, which is crucial for human lives and health, as well as to prevent a situation whereby there may be a serious impact on domestic security, life and health, the following industries were added to the list of Core Business Sectors:

- Manufacturing of certain pharmaceutical products
- Manufacturing of certain medical devices

On May 8, 2019, in order to regulate investments that may undermine national safety and prevent the outflow of safety-related technology, resulting in the loss of business activity, the following industries were added to the Designated Business Sectors:

- Manufacturing of information processing equipment and its components.
- Manufacturing of information processing related software
- Industries related to information processing services

III. 2023 Amendments: Addition of Core Business Sectors

(1) Background

Following the designation of “Specially Designated Critical Commodities”, targeted to support the provisions under the Economic Security Promotion Act, and in order to ensure stable supply chains, Public Notices under the FEFTA were amended for the integrity of supply chains and management of leakage

risk in connection with technology and diversion to military use.

(2) Addition of Core Business Sectors

On April 24, 2023, the following business sectors were added to the Core Business Sectors:

Business Sectors
1 Fertilizers (importing business) *Limited to imports of potassium chloride and ammonium dihydrogen phosphate.
2 Permanent magnets (manufacturing and raw material manufacturing businesses)
3 Machine tools and industrial robots (manufacturing business, etc.)
4 Semiconductors (manufacturing equipment business, etc.)
5 Storage batteries (manufacturing and raw material manufacturing businesses)
6 Natural gas (wholesale business)
7 Metals and mineral products (refining business)
8 Marine Equipment (business of manufacturing engines, etc.) *Limited to diesel engines and navigation tools used to ensure the safety of navigation and propellers.
9 Metal 3D printers (manufacturing and manufacturing metal powder businesses)

In addition, the amendment clarifies that drones are included in the business of manufacturing aircrafts, which is a Core Business Sector. Manufacturing antibacterial products and the petroleum refining businesses were also added to the Core Business Sectors.

(3) Key Points

The new regulations came into effect as of May 24, 2023. Inward Direct Investments on or after such date will be subject to the new regulations. Even if prior notification had been filed and clearance obtained prior to May 24, 2023, if the target company is engaged in a newly added Core Business Sector, it must re-file the notification and obtain a new clearance. Therefore, if a foreign investor plans to conduct a stock acquisition, merger, consent to a proposal for the election of directors at a general shareholders' meeting or take other action defined as Inward Direct Investments in relation to a target company on or after May 24, 2023, it should verify whether the target company is engaged in a newly added Core Business Sector. If so, it must file a prior notification and obtain clearance for the acts it contemplates undertaking.

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