6 November 2019

Mr. Kenji Okamura
Director-General, International Bureau
Ministry of Finance
3-1-1 Kasumigaseki, Chiyoda-ku
Tokyo 100-8940, Japan

By post and email c/-: yukihiro.takahashi@mof.go.jp

cc: Mr. Kenichi Habu, head, Legal Office, MOF
cc: Ministry of Economy Trade and Industry; Financial Services Agency, Japan Exchange

Re: MOF Q&A on FEFTA Bill

Dear Sir,

Following our letter of 24 October 2019, we would like to write again to the Ministry of Finance (MOF) regarding the four-page Q&A released on 25 October that sought to clarify the amendments. We note also the English version released on 31 October.

We would, firstly, like to express our appreciation for the following clarifications:

1. MOF will publish the names of listed companies to be included in each of the three categories for reporting and exemption purposes.
2. Sovereign wealth and pension funds that pose no risk to national security, or which invest indirectly in listed companies (ie, through other financial institutions) and are not on the shareholder register, will be exempt from pre-notification.
3. The prohibition on influencing management through proposing the sale or divestment of assets relates only to making a shareholder proposal in a general meeting. It does not include having a dialogue with companies on such matters.
4. Foreign investors who do not intend to seek board seats or propose shareholder resolutions on sales and divestments are not required to make prior notification to MOF of a 1% stake. They only need to make a post-investment report.
5. Foreign investors who do intend to seek board seats or propose shareholder resolutions on the sale or divestment of assets can exercise such actions, but they must submit a prior notification to MOF.

We very much look forward to understanding the detailed provisions for the implementation of each of these measures.

ASIAN CORPORATE GOVERNANCE ASSOCIATION
Room 1801, 18th Floor, Wilson House, 19-27 Wyndham Street, Central, Hong Kong Tel 852 2160 1788 Fax 852 2147 3818

Continuing concerns and questions

While the Q&A has been helpful in shining light on certain aspects of the proposed amendments, the fundamental concerns expressed in our letter of 24 October 2019—namely, that the FEFTA amendment bill will dampen foreign investor enthusiasm for investing in Japan and engaging with companies—remain unchanged. Key ongoing issues and questions include the following:

1. The 1% threshold is very low and will likely capture thousands of funds in either pre- or post-investment reporting. Goldman Sachs Japan, in a recent paper (16 October), calculated that 2,529 foreign mutual funds hold 1% or more of companies in just the TOPIX1000. Compliance and administrative costs will therefore rise for foreign asset managers even if they are deemed no threat to national security. The potential for negative unintended consequences is considerable. (It also seems reasonable to conclude that the additional administrative burden on the MOF and other government agencies will be significant.)
2. The objective of the bill is "to prevent, for national security reasons, leakage of information on critical technologies as well as disposition of business activities". It remains unclear how a foreign asset manager holding just 1% of a listed company would be able to facilitate such outcomes. Even those with a 5% or higher stake may have little influence over management in most cases and are not necessarily privy to corporate secrets.
3. It is not clear why a foreign investor who holds just 1% should have to seek pre-clearance to pursue board representation or make a shareholder proposal, which are common shareholder rights in most developed markets. While we understand the MOF's concern here as regards firms in highly sensitive sectors, we strongly encourage the list of restricted sectors to be made as narrow as possible so as to limit the negative impact on shareholder rights and corporate governance.
4. As the Q&A document is brief, it remains unclear what process the MOF will follow in responding to foreign investors who must pre-notify. While the authorities will "conduct screening in a way that is in full respect of corporate governance", the factors to be taken into account will only be published later. Meanwhile, the MOF promises to notify investors within five (5) business days if they are not deemed a national security threat; however there is no indication of how long notification will take if an investor is deemed a threat.

Confusion also remains over the status of foreign asset owners. What criteria will be used to determine whether or not they pose a threat to national security? Moreover, if a foreign asset owner allocates funds to a domestic asset manager to invest and some of the stakes are 1% or higher, will these be classified as foreign or locally owned?

Although the clear preference of ACGA investor members is for the FEFTA review threshold to remain at 10%, we urge the Japanese Government to set it at no less than 5% for the reasons outlined above. This would not only be a fairer and more acceptable level than 1%,

ASIAN CORPORATE GOVERNANCE ASSOCIATION
Room 1801, 18th Floor, Wilson House, 19-27 Wyndham Street, Central, Hong Kong Tel 852 2160 1788 Fax 852 2147 3818

but it aligns with existing reporting requirements in Japan and will be much more efficient to administer for both government and investors. A 5% threshold would allow the government to target its resources more effectively at the few foreign investors who genuinely pose a national security threat. The overwhelming majority of investors do not welcome restrictions on their legitimate exercise of shareholder rights, but instead wish to support the growth of the Japanese capital market and ongoing improvements in corporate governance.

Thank you once again for your attention.

Yours truly,

Jamie Allen
Secretary General

ASIAN CORPORATE GOVERNANCE ASSOCIATION
Room 1801, 18th Floor, Wilson House, 19-27 Wyndham Street, Central, Hong Kong Tel 852 2160 1788 Fax 852 2147 3818