

ACGA Open Letter: Japan Foreign Exchange and Foreign Trade Act (FEFTA)

December 2021

The Foreign Exchange and Foreign Trade Act (FEFTA) was revised in November 2019 to promote economic growth while providing sufficient oversight of foreign direct investment (FDI) to ensure that investments in Japanese companies by non-Japanese investors would not pose a risk to Japan's national security.

While the Asian Corporate Governance Association (ACGA) understands the rationale driving the revised law, we have raised various concerns regarding the lack of clarity surrounding FEFTA's implementation. Our concerns included the scope of companies' restricted industry classifications, the administrative actions required on the part of foreign investors, and the conditions for investors' blanket exemptions for prior-notification requirements. We were pleased that the Ministry of Finance (MOF) subsequently took several measures to improve transparency of the Act, key issues surrounding the industry classifications and exemption conditions remain unclear and no further revisions were made to FEFTA when it became effective in May 2020. We invite anyone interested to read our prior Open Letters that are available on our website.

- [Letter 1](#) – 24 October 2019
- [Letter 2](#) – 6 November 2019
- [Letter 3](#) – 9 April 2020

In the past several months, we have witnessed various players within Japan's investment chain (companies, regulators, and shareholders) take various and often contradictory interpretations of FEFTA. In March 2021, e-commerce operator Rakuten announced a capital alliance with Chinese IT conglomerate group, Tencent, that was reportedly met with questions from regulators as to whether Tencent's US\$600m investment into Rakuten should be subject to a required pre-screening.¹ In the third-party commissioned Toshiba Investigation Report of June 2021, questions were raised as to whether it was within the purview of FEFTA for the company and regulator to pursue actions that involved the obstruction of shareholders' fundamental rights, including putting forth proposals at shareholder meetings.² Toshiba's own subsequent Investigation Report released in November 2021 concluded that the way its former executives colluded with regulators to approach shareholders were not in violation of the law, but were in breach of the company's own ethical standards, highlighting the precarious situation companies face when complying with FEFTA while trying to uphold the interests of shareholders.³

What is evident from both the Rakuten and Toshiba cases is that market participants have diverging interpretations of FEFTA. Given the important role that FEFTA plays in regulating foreign investment, we believe the lack of a more uniform understanding of the Act could become an even greater concern over time.

Furthermore, in June 2021, the *Yomiuri Shimbun* newspaper reported that the Japanese government is considering amending FEFTA further in various areas, including enforcement. The *Yomiuri* report

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

² Investigators of Toshiba Corporation, "Investigation Report" (June 10, 2021)

³ Toshiba Corporation, "Investigation Report of Governance Enhancement Committee" (November 12, 2021)

suggests that the changes may allow the Japanese government to push shareholders to divest stakes in companies within restricted industry sectors even after an exemption has been granted if it were to conclude that shareholder demands could lower the company's competitiveness or heighten the risks of a leak of information sensitive to national security.⁴ Although we recognise that the *Yomiuri* report lacks specifics and is not based on any official announcement, we believe that if such measures were to become a reality, they would likely be seen by many foreign investors as a direct challenge to upholding the fundamental rights of shareholders in Japan. Should our concerns be true, ACGA believes that some foreign investors would perceive the risks and uncertainties to outweigh the benefits of investing in the Japanese equities market, leading to a reduction of investments and ultimately constructive engagement with companies on financially material issues. Such an outcome would undermine the long-term sustainable growth of the very companies the Japanese government wishes to protect for national security reasons.

ACGA recognises that there is a difficult balancing act between protecting national security and not impeding the free flow of international capital. To minimise unintended consequences, we believe that open and transparent discussion on the issues raised in this letter among relevant players in Japan's investment chain is a critical part of the solution. Therefore, we would like to suggest that the Japanese government consider holding open discussions between regulators, companies and shareholders to clarify any misconceptions of FEFTA and to promote the continuation of long-term investing in Japanese companies that would ultimately support their sustainable growth and that of the greater Japanese economy. ACGA would, of course, welcome any opportunity to participate in a constructive dialogue.

Yours truly,

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⁴ The Yomiuri Shimbun, "Japan to consider tighter rules on foreign investment (translated title)" (June 23, 2021)