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Research Division, International Bureau
Ministry of Finance
3-1-1 Kasumigaseki, Chiyoda-ku, Tokyo
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9th April 2020

Re: Public consultation on the draft rules and regulations of the Foreign Exchange and Foreign Trade Act

Dear sirs or madams,

We welcome the opportunity to provide our comments on the draft rules and regulations for the implementation of the amended Foreign Exchange and Foreign Trade Act ("FEFTA" hereafter).

EOS at Federated Hermes is a leading stewardship provider advising on $877bn/JPY96tn assets (as of 31 December 2019) on behalf of global institutional investors. Federated Hermes is a global leader in active, responsible investing with US$576bn/JPY63tn (as of 31 December 2019) in assets under management. Our goals are to help people retire and invest better, to help clients achieve better risk-adjusted returns, and to contribute to positive outcomes that benefit the wider world. The views expressed in this communication are those of EOS and do not necessarily represent the views of all clients.

In our earlier letter dated 6th November 2019, we expressed concerns about the potential negative impact of the amendments which would require foreign investors acquiring as little as 1% stake in a Japanese company to file a prior notification. We strongly welcome the additional information that the Ministry of Finance (MoF) has since provided to clarify details of the requirements and conditions. We are grateful for the helpful visual material the MoF has published both in English and Japanese, to decode the highly complex and technical legal changes.

However, we continue to have concerns about the amended Act and implementation rules which we detail below, and ask that either the exemption conditions or the designated sectors be reviewed. While the consultation paper asks for comments on specific legal documents, these are highly technical and only available in Japanese, so we will not reference them directly in our response below. We will instead provide our comments on specific points in the explanatory material ("Kanren Shiryo").

1. Exemption conditions

We understand that foreign financial institutions, including asset managers, are exempt from the requirement for prior notification for stock purchases (PN-SP) as long as they comply with the exemption conditions. However we believe that these conditions that investors do not nominate themselves or closely-related persons as board members (condition (a) on page 4) or propose at the general shareholders' meeting the transfer or disposal of the investee company's business activities in the designated business areas (condition (b)), appear inconsistent with the promotion of

stewardship and good corporate governance in which the Japanese government has put a lot of effort into in the last few years.

We are also concerned about the additional conditions for some other investors, including sovereign wealth funds and public pension funds, with regard to their investments in companies in the 'core sectors', which appear to have been added recently. They will now have to file PN-SP if they are to make proposals, in a written form, to the executive board of the investee companies or board members requiring their responses and/or actions by certain deadlines (condition (e)). We believe this puts a significant burden to these shareholders and can be an obstacle to exercising shareholder rights. Letter writing to boards or management is a common practice in investor engagement with companies and the attempt to make the process more difficult is questionable. It should be noted that investor letters can be about a wide range of topics, including environmental, social and governance issues. We are not convinced that it is necessary to regulate such activities particularly if they relate to issues which could no way infringe national security, even at a company operating in a 'core' business sector.

2. Sovereign wealth funds and public pension funds

For sovereign wealth funds and public pension funds to be considered to pose no risk to national security and exempted from the prior notification requirement, they need to sign a memorandum of understanding (MoU) with the MoF, who will grant the accreditation (page 5). It is not clear what needs to be done for these funds to sign the MoU and we ask that the MoF provides further clarity on the qualifying conditions for the MoU.

In addition, we question the requirement for these investors to file a post-investment report when the total shareholding reaches 1% and again when it reaches 3% for the first time (the additional reporting requirement at 3% appears to have been added recently in the updated document, page 12). This applies to all designated sectors, including those outside the 'core' sectors. In particular, we are concerned that this could create a further administrative burden on sovereign wealth funds and public pension funds, potentially deterring foreign investments in Japan.

3. Screening process

We understand that, following the submission of PN-SP, the authorities are expected to notify investors of clearance of screening within five business days, if the notification is not of concern from national security perspectives. The same applies to filing of prior notification for certain actions (PN-CA) which is required for foreign investors who intend to vote at the shareholder meeting for: a) nomination of the investor itself or its closely related person as a board member of the investee company; or b) a proposal, filed by the investors themselves, to transfer or dispose the investee company's business activities in the designated business sectors (page 14).

However, it is possible that the clearance process takes much longer than five days, or indeed that the authorities decide not to clear the notification, should the notification be deemed to be of concern by the authorities. We note that the MoF announced this week an additional consultation on the factors to be considered in the screening process. We welcome the efforts to enhance transparency around the screening process, however, we believe the consultation is only available in

Japanese and we strongly ask that it is made available in English. It is particularly important as the Act affects foreign investors, many of them do not understand Japanese.

4. Business sectors

There are 155 designated business sectors under the FEFTA. We welcome the new breakdown of these sectors into 'core' designated sectors and 'non-core' designated sectors (page 9). We however continue to have concerns about the large number of business sectors where the FEFTA is applicable. For example, we struggle to understand why leather manufacturers are among the designated business sectors. Although it is not classified as a 'core' business sector, investors will still be required to file a prior notification if they wish to nominate themselves or closely related persons to the board or propose at the AGM the transfer or disposal of business activities.

Similarly, while we understand that agriculture, forestry and fisheries could be linked to national food security and resource sufficiency, we believe that only companies which are categorised as systematically important should be included in the list.

In addition, many companies operate multiple businesses, falling into different sectors. There is a chance that a company's classification changes from 'non-core' to 'core', or from not 'designated' to 'designated' over time, due to changes to their business models or revenue streams. This leaves great uncertainties for investors. We would seek further clarification on how companies are classified and how often the list of companies to which the new FEFTA rules are applicable is reviewed.

Thank you for considering our comments. In addition to these points, we also support the letter from the Asian Corporate Governance Association (ACGA), of which we are a long-standing member. Please do not hesitate to contact us should you have any questions.

Yours sincerely,

Sachi Suzuki
Associate Director – Engagement
EOS at Federated Hermes