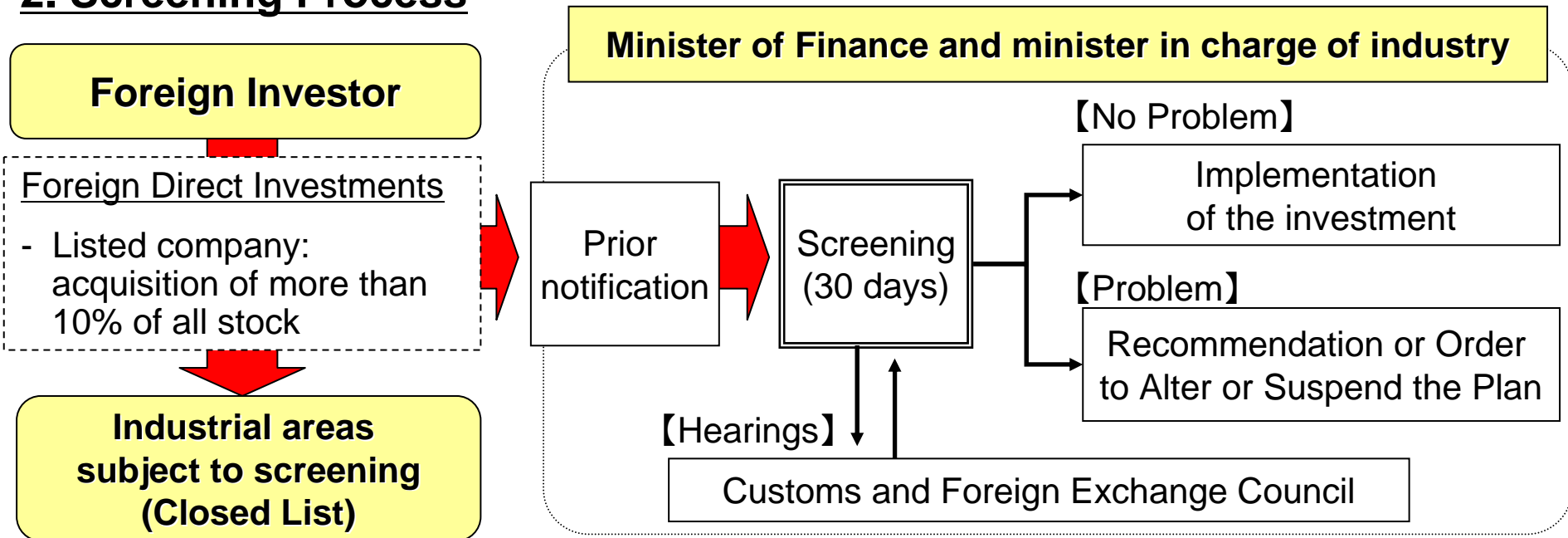


OUTLINE OF THE SCREENING SYSTEM

1. National Legislation

- Foreign Exchange and Foreign Trade Act (Articles 26 & 27)

2. Screening Process



1. National security: Aircraft, weapons, nuclear industry, spacecraft, gunpowder

2. Public utilities: Electricity, gas, heat supply, communications, broadcasting, water, railroads, passenger transport

3. Public safety: Biological chemicals, guard services

4. Special industries: Primary industry, oil, leather, air/maritime transport*

*These areas are reserved under Article 2 of the OECD Code due to particular Japanese circumstances.

The Need for Regulatory Revision

- **As a system foundation that supports a free and open international investment environment, the regulation of inward investment needs to be modernized with a view toward security in light of the recent intensification of international investment activity and changes in the security environment.**

Environmental change surrounding inward investment regulation

- The environment surrounding the regulation of inward investment has changed drastically since the amendment of the Foreign Exchange Act in 1991.
- Advanced nations have revised their regulations one after the other in recent years in light of the intensification of investment activity and changes in the security environment.

Intensification of international investment activity

- In recent years, cross-border M&As have expanded significantly worldwide. New investment actors, such as the state-run companies of newly industrializing countries and funds, have emerged.
- Japan is aggressively promoting inward direct investment, aiming to double inward direct investment on a GDP basis by 2010.

Changes in the security environment

- In addition to military conflicts between nations, new threats to the security, including the proliferation of weapons of mass destruction and international terrorist organizations, have increased.
- The progress of private sector technology is surpassing that of military technology, especially IT-related technology, resulting in a marked increase in conversion of private sector technology to military uses.

Foreign regulatory trends

- One after the other, major countries have revised their inward investment regulations, making them stronger, in recent years (UK in 2002, Germany in 2004, France in 2005, and China in 2006).
- The purchases by state-run Chinese companies (CNOOC's attempted purchase of Unocal Corporation) has led the US to consider regulatory strengthening.

Need to revise regulations on inward investment

- Japan's inward investment regulations for ensuring national security is an important system foundation for supporting a free and open international investment environment, and a highly effective regulatory framework needs to be developed to encourage inward direct investment.
- In light of recent environmental changes, it is especially important to respond adequately to the risk of Japan's security being severely impacted by sensitive and important technology with a high probability of conversion to military use flowing out of the country unlawfully when Japanese companies are purchased by foreign investors connected to certain countries of concern and international terrorist organizations.

Basic principles for regulatory revision

- When revising the regulations, a highly transparent regulatory framework should be developed rapidly based on three basic principles: (1) Consistency with international investment rules, (2) Consistency with regulatory trends in developed nations, and (3) Consistency with measures that encourage inward direct investment.

Three basic principles for regulatory revision

1. Consistency with international investment rules

- Revise regulations with a view toward security, based on international investment rules (OECD Code of Liberalisation of Capital Movements).
- Ensure consistency with principles widely agreed to by OECD member nations, including (1) Ensure transparency and predictability of regulations, and (2) Maintain a proportionate relationship between regulation aims and methods.

2. Consistency with regulatory trends in advanced nations

- When revising the regulations, be sure to make them appropriate in comparison with regulatory standards in advanced nations.

3. Consistency with measures that encourage foreign direct investment

- Considering the fact that the balance of direct investments in Japan is currently insufficient compared to other advanced nations—only about 2% in terms GDP—regulations should not be a disincentive to the encouragement of investment and should not cause misunderstandings about Japan's basic policy, which is to encourage investment from abroad.
- To that end, at the least, it would be reasonable to revise the scope of regulations at the present time while maintaining the existing system of advance notification (list method) and ensuing predictability and legal stability for foreign investors.

Direction of revisions: I. Revision of items subject to notification

- **Dual use items with a high probability of being converted to military uses need to be added to regulation** in order to respond appropriately to the risk of technology important to security unlawfully flowing out of the country when certain foreign investors purchase Japanese companies.
- Specifically, it would be reasonable to **enumerate the individual products subject to regulation**, using as a reference export control regulations based on international agreements concerning the scope of general purpose items with a high probability of being converted to military uses (international export control regime).

Items subject to conventional regulations

Direction of revisions

Regulatory objective philosophy

- Regulate defense-related industries with a view to maintaining Japan's defense production infrastructure.
- Regulate the nuclear power industry with a view to nuclear nonproliferation.



- Regulate dual use items with a high probability of being converted to use in weapons of mass destruction in order to prevent technology important to security from unlawfully flowing out of the country.
- Continue to regulate items that are critical to maintaining Japan's defense production infrastructure.

Enumeration method of items subject to regulation

- Enumerate the subject industry sectors according to the Standard Industrial Classification for Japan (standards for preparing economic statistics).



- Enumerate subject products, using the items regulated under the export control regulations (Appendix 1 of the Export Trade Control Order) as a reference.
- For products other than those that are subject to export control regulations, enumerate items with a clear basis for regulation in terms of maintaining the defense production infrastructure.

Specific scope of regulations

1. Manufacture of weapons, etc.
2. Electronic machinery and equipment exclusively for weapons, information and communications machinery and equipment, electronic parts, etc.



1. Weapons (including materials and parts critical to their manufacture).
2. Dual use items related to weapons of mass destruction (nuclear power, biochemical weapons, missiles)
3. Some dual use items related to conventional weapons (advanced materials, material processing, electronic equipment, communications, sensors, etc.)

Direction of revisions: II. Revision of subject transactions

- In light of recent investment situations, consideration should be given to making investment in parent companies and coalition investment by multiple investors subject to regulation, and to exclude some listed companies with high percentages of foreign investment from regulation.

1. Transaction that should be made subject to regulation

Transaction type	Current regulations
Inward direct investment in parent companies that control subsidiaries and sub-subsidiaries engaged in businesses subject to regulation.	Regulations apply only when a company the receives inward direct investment is engaged directly in a regulated business.
Inward direct investment in which multiple foreign investors agree to exercise their voting rights collectively.	Only when there are capital ties between multiple foreign investors is the shareholding ratio calculated for the combined voting rights held by these investors.
Acts by foreign investors to obtain shares of Japanese companies on foreign markets.	Acts for foreign investors to obtain share on foreign markets is excluded from regulation.

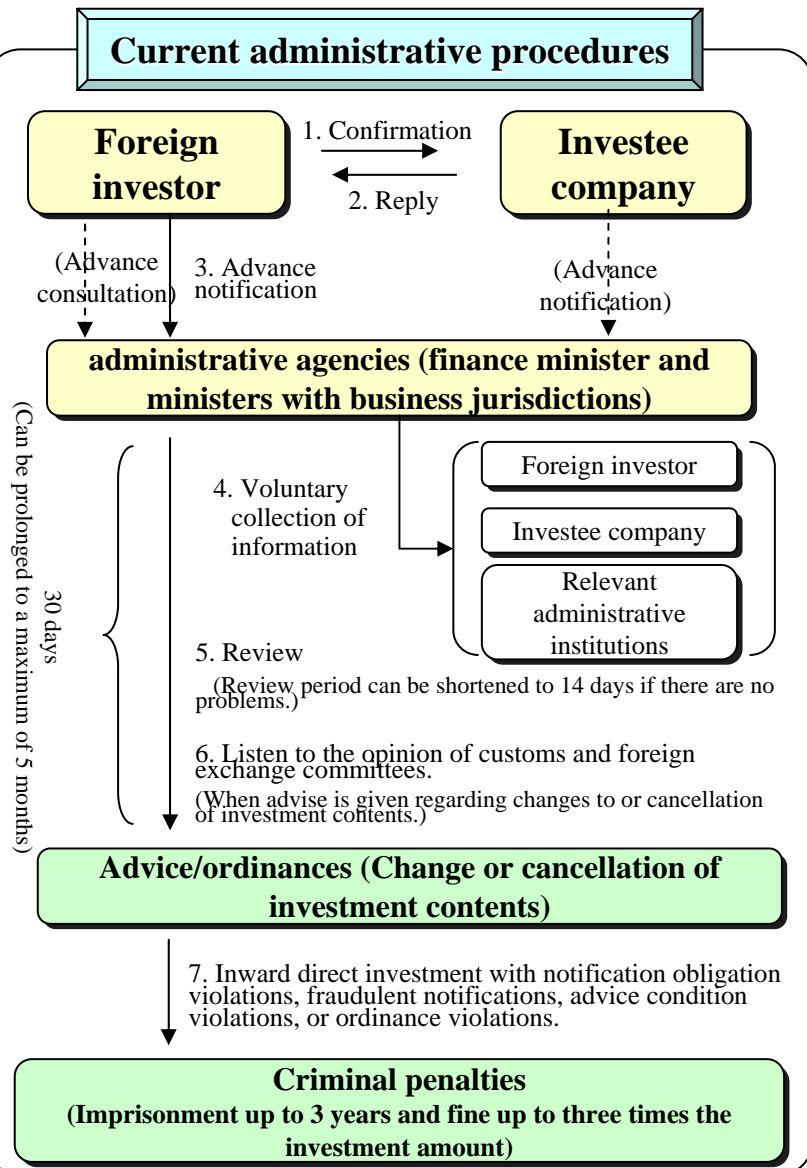
Note: In addition, the handling of fund investment and the acquisition of shares of multiple voting stock needs to continue to be considered in reference to other laws and ordinances.

2. Transactions that should be excluded from regulation

Transaction type	Current regulations
Inward direct investment by Japanese companies at which the ratio of voting rights held by foreigners exceeds 50%.	Japanese companies at which the ratio of voting rights held by foreigners exceeds 50% are subject to regulation as foreign investors.
Long-term loans to and acquisition of private offering bonds from Japanese companies.	Long-terms loans and private offering bonds by foreign corporations other than financial institutions are subject to regulation.

Direction of revisions: III. Revision of administrative procedures

- Revision of the administrative procedures for inward direct investment needs to be considered with a view to ensuring predictability for foreign investors and ensuring the effective enforcement of regulations.



1. Ensure predictability for foreign investors

- As a general rule, foreign investors and investee companies need to gather necessary information on their own and judge whether they are subject to notification submission. However, when there is doubt as to the interpretation of laws and ordinances, it is reasonable for administrative agencies to work to furnish a prompt reply if the party concerned gathers the necessary information about the products manufactured by the investee company and requests the administrative agencies to confirm an interpretation of laws and ordinances.
- Consideration should be given to promoting voluntary disclosure of information by individual companies, such as their confirmation of the necessity of advance notification requirements and disclosure in negotiable securities reports and on homepages, with a view to protecting investors.

2. Development of procedures for administrative agencies to request reports

- Currently, when sufficient information cannot be obtained from notifications submitted by foreign investors, the information needed for review is collected by obtaining the voluntary cooperation of the foreign investors and investee companies.
- In order to develop a means for administrative agencies to collect information, consideration should be given to a system for administrative agencies to request reports from the persons concerned while ensuring that the operation of such a system does not place an unreasonable burden on the persons concerned.

3. Development of means of effective enforcement

- Consideration should continue to be given to the development of notification items for imposing criminal penalties when foreign investors have agreed to comply with certain investment conditions when submitting notifications and then violated those conditions after the event.
- In addition to criminal penalties, consideration should continue to be given to the advisability of introducing enforcement measures such as ordinances to reinstate original conditions, liability to pay administrative fines, and nullification of voting rights with a view to obtaining an overall balance to the regulations.