

# Mizuho Custody Newsletter

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## I. Market News

### 1. Update on information disclosure system in Japan

A new section describing on corporate sustainability, such as human capital, which measures the value of human resources, and climate change risks, is to be added to “Annual Securities Reports”, wrote Nikkei Shimbun, Japan’s leading financial daily. At a Working Group of the Financial System Council held by the Financial Services Agency (“FSA”) on 24 March, members of the council agreed on obliging issuers to make such disclosure. The requirement of disclosure on supervision by the board and risk management structure in the Annual Securities Reports could come into effect as early as in FY2023.

Around 4,000 companies, including listed companies and some unlisted companies, are legally required to submit Annual Securities Reports. The IFRS Foundation, which is responsible for formulation of the international accounting standards, has started to draw up international standards for information disclosure on

sustainability.

International Sustainability Standards Board (ISSB) will soon release an exposure draft on climate change risks. The members of the council requested that contents to be included in the Annual Securities Reports should be in line with the new standards.

The new ISSB standards are to require description of four items on climate risks and human capitals: (1) governance; (2) strategy; (3) risk management; and (4) indicator and goal. As for issuers’ governance that represents their structure of supervision and how they conduct risk assessment and management, the council members agreed to require all companies submitting the reports making the disclosure on these items.

The Council also shared the view that it was necessary to enhance disclosures on human capital and diversity, such as companies’ human resources development policies and ratio of female managers at work places. At the meeting, some participants said, “Disclosure system on human capital in Japan may be lagging behind the Western countries,” and “Disclosure should be done on a consolidated basis as disclosure on non-consolidated basis could not provide the reality in detail.” Further discussions will be held on these subjects, including institutional measures.

Further, FSA held a Working Group of the Financial System Council on 18 April, and approved the consolidation of the two financial statements that listed companies are required to compile at present. FSA plans to abolish the Quarterly Report (Shihanki-Houkokusho) that listed companies are required to compile under the Financial Instruments and Exchange Act (“FIEA”), and instead focus on the Summary of Financial Result (Kessan-Tanshin) based on stock exchange rules by enriching its content.

The review on quarterly disclosures was proposed by Prime Minister Fumio Kishida as one of the featured policy at the time of his inauguration. The government had been reviewing the quarterly disclosure rule with an aim of raising a question about the market focusing too much on short-term results.

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However, the global trend is supportive to maintain quarterly disclosures. In the U.S., former President Donald Trump requested the Securities and Exchange Commission (SEC) to review the requirement in 2018, but it went up in smoke. Germany removed the legal requirement in 2015 but maintained it under the exchange rules. The U.K. and France abolished their legal obligations in 2014 and 2015 respectively, but most companies continue the quarterly disclosure.

Abolishment of quarterly disclosure could give an inadequate impression to investors that disclosure level is retreating in Japan market, which led to a conclusion to consolidate the report to the Summary of Financial Result. Chief Cabinet Secretary Hirokazu Matsuno explained at a press conference that the move was a part of efforts to pave the way for companies to operate on a long-term perspective.

On the other hand, these two documents have many overlapping items with each other, and therefore, the consolidation aims at reducing issuers' burden of compiling two similar reports. FSA will compile a draft report of discussions at the Financial System Council as early as in May. Details on the content to be included in the Summary of Financial Result will be further discussed by the end of this year, and the government aims to revise the law during the ordinary diet session in 2023. The Quarterly Report is expected to be consolidated into the Summary of Financial Result reportedly from FY 2024.

Quarterly Reports complied on the FIEA are subject to criminal penalties if there were false statements, which is not the case for the Summary of Financial Results. At the Working Group, FSA proposed that issuers make disclosure as an extraordinary report containing the same information as the company's Summary of Financial Result so that false statements could be penalized.

*Information compiled from Nikkei Shimbun & Mizuho research*

## **2. LDP puts together recommendations to support startups**

The Liberal Democratic Party ("LDP"), a party in the ruling coalition, will put together recommendations that include measures to support startups, reports Nikkei Shimbun, Japan's leading financial daily. It will be

submitted to the Prime Minister Fumio Kishida as early as in April. They plan to pave the way for startups to improve corporate value by creating a secondary market where unlisted companies' stocks are actively traded. They aim to reflect it to the government plan which is to be formulated around June.

The prime minister has designated 2022 as the "first year for the creation of startups" and will draw up a five-year plan to realize "new capitalism."

Citing "a culture that want risk free", certain regulations and tax systems as issues to tackle, the LDP warns that leading to an outflow of human resources to overseas may become a great concern to the country. The recommendation advocates a drastic strengthening of the ecosystem, which makes it easier to raise funds and conduct business.

The recommendation proposes to establish a secondary market to trade shares of unlisted companies. They will also seek tax incentives having capital gain tax in mind. It assumes to apply to cases where an entrepreneur sells his or her own shares for cash while they are unlisted, so that he/she could invest in new businesses.

*Information compiled from Nikkei Shimbun & Mizuho research*

## **3. TSE restructured and started the three new market segments, the Prime, the Standard and the Growth**

Tokyo Stock Exchange ("TSE") started operating under the restructured three new market segments on 4 April 2022. The markets are divided by stricter listing standards, and a total of 1,839 companies have been listed on the Prime market, which is virtually the most prestigious market. Less companies are listed on the Prime market than the 1<sup>st</sup> Section of the TSE, which increases the average market capitalization per company by 17% to JPY 384.3 billion, reports Nikkei Shimbun, Japan's leading financial daily.

The four TSE's markets, the 1<sup>st</sup> Section, the 2<sup>nd</sup> Section, the JASDAQ and the Mothers market were reorganized into three new markets, the Prime, the Standard and the Growth. This is the first reorganization of the TSE's core markets in about 60 years since the establishment of the 2<sup>nd</sup> Section in 1961.

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The Prime market is designed to attract companies of the size and quality of management that would be suitable for investment by global institutional investors. A total of 1,839 companies, or more than 80% of the companies listed on the 1<sup>st</sup> Section of the TSE, including foreign companies, moved to the Prime market with the listing maintenance standards which are stricter than those of TSE 1<sup>st</sup> Section, including a total market capitalization of tradable shares at JPY 10 billion or more.

Under the Corporate Governance Code, companies listed on the Prime market are required to have at least one third of their directors as independent outside directors. The ratio of companies that meet this standard is 81%, which is higher than 77% for domestic companies listed in the 1<sup>st</sup> Section of the TSE. With regard to the Task Force on Climate-related Financial Disclosures ("TCFD") which calls for disclosure of financial impact from climate change, 57% of the companies listed on the Prime market touch upon this issue in their disclosure reports, whereas it was only 49% for the companies listed on the 1<sup>st</sup> Section of the TSE.

On the other hand, companies are struggling to improve their profitability. The net profit margin of the companies listed on the Prime market is 6%, which is almost the same as that of the companies listed on the TSE 1<sup>st</sup> Section. Not few companies are having difficulties to have high expectations for growth from investors, and the average total market capitalization per company is only JPY 384.3 billion, which is about JPY 56 billion higher than that of the companies listed on the TSE 1<sup>st</sup> Section.

This time, some experts criticize that the screening process of companies to be listed on the Prime market has been watered down. TSE has established a transitional measure that allows a company that fails to meet the listing standard of the Prime market to be listed on the market, if it submits a plan document describing how it would meet the listing standard in the future. Slightly less than 20% of the companies listed on the Prime market, or 295 companies, have applied for the transitional measure, lowering the overall level. Market capitalization per company was JPY 447.7 billion for the companies meeting the standards, but it was JPY 52.7 billion for those subject to transitional measures. TSE has not yet publicized how long the transitional measures would last. There were also

209 companies listed on the Standard market that have applied for the transitional measures. Market participants will keep watching whether and how such companies would enhance their corporate value by strengthening profitability and/or boosting investor relations to meet the listing maintenance standard in the end.

It has been pointed out for long that Tokyo market has been getting less vigorous for the past decades. The Nikkei Stock Average (Nikkei 225) is still 30% below its high in 1989. In the meanwhile, the Dow Jones Industrial Average (Dow 30) grew 13 times. It is the main challenge for the market how companies could achieve sustainable growth through management innovation, together with TSE's continuous review and reform of the market structure and rules.

At a ceremony held before the start of trading on 4 April, the CEO of Japan Exchange Group, Inc. said, "It is JPX's aim to ensure sustainable growth of listed companies and to make markets more attractive. We look forward to the new initiatives of 3,771 companies listed on the TSE to improve corporate value over the medium to long term."

One of the key elements of the reform is the introduction of the listing standard to apply also as the listing maintenance standard which are stricter than those under the old market segment. For example, the standard to maintain listing on the Prime market is the total market capitalization of tradable shares at JPY 10 billion or more. The standard is stricter than that set by the 1<sup>st</sup> Section of the TSE, which was at least JPY 1 billion, and it will fall below the standard if stock price continues to fall.

A chief investment strategist at a major brokerage firm said, "It is commendable that the market structure now emphasizes corporate governance. In the future, I hope that stricter formal standards will be introduced primarily for the Prime market to make it as a market of excellent companies."

*Information compiled from Nikkei Shimbun & Mizuho research*

#### **4. The number of issuers participating the electronic voting platform increases**

A growing number of issuers are allowing institutional investors to exercise voting rights at shareholders

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meetings via internet, reports Nikkei Shimbun, Japan's leading financial daily. As of 31 March, 1,641 companies are participating to the common electronic voting platform, which is 40% up from a year ago. The restructuring of the market segment at the Tokyo Stock Exchange ("TSE") calls companies listed at the most prestigious Prime market for participation to the electronic voting platform. This trend may accelerate the digitization of shareholders meetings in Japan, which now lags behind that in overseas markets.

Shareholders have two options for how to exercise their voting rights at a shareholders meeting: (i) to attend physically at the meeting and vote; or (ii) to send their votes by snail mail or via internet in advance. ICJ, Inc. (Investor Communications Japan), in which TSE has an interest, provides the electronic voting platform. Institutional investors can vote electronically through the ICJ platform if an issuer joins the platform by paying charges to ICJ.

According to ICJ, 457 companies newly joined the platform in FY2021, which is more than 3 times of the number in FY2020. Most of the major companies had already participated by the previous fiscal year end, and in FY2021, many medium-sized companies followed suit.

The biggest reason for the rapid increase of ICJ participants is that the Corporate Governance Code, revised in last June, encouraged companies to do so.

The code has stipulated that the companies listed on the TSE's "Prime market" should participate in the electronic voting platform for the benefit of shareholders. 90% of the companies that participated the platform in FY2021 went to the Prime market.

According to the Ministry of Economy, Trade and Industry, about 14% of institutional investors voted via electronic platform in 2017, which was lower in comparison with 70-90% usage in the Western countries. If electronic voting becomes common, companies can run shareholders meetings more efficiently, such as taking less time for vote counting and preventing errors due to less manual processing.

Electronic voting could give institutional investors more time to analyze proposals and make decisions. Although notices of AGM are sent out at least 2 weeks before the meeting date, voting by paper gives only 3-4

business days for institutional investors to analyze the proposals since delivery and receipt of proxy materials and voting cards by snail mail takes certain length of time. Electronic voting may give them about 10 days.

Especially in Japan, 70% of the AGMs of the listed companies tend to concentrate in June, which forces investors to do everything in relation to proxy voting in extremely tight timeframe.

Next, investors may look at how the companies listed on the Standard and the Growth market deal with this issue. As of 31 March, the companies listed on these two markets account for less than 10% of the ICJ platform participants.

In addition to electronic voting, shareholders meetings themselves are being digitalized. In 2021, legislative changes allowed issuers to hold a "full online shareholders meeting" without a physical venue.

At the AGMs held in March this year by the companies with the fiscal year end on 31 December 2021, about 5 companies held the AGMs fully online. If advance voting, which is the mainstream of the current proxy voting methods, would be carried out electronically, that could further spur digitalization of shareholders meetings which might make the entire process more efficient.

*Information compiled from Nikkei Shimbun & Mizuho research*

## **5. TSE starts developing to upgrade its core trading system, the Arrowhead, in FY2024**

Tokyo Stock Exchange ("TSE") is entering into the final stage of system upgrading after the large-scale system failure in October 2020. TSE decided to contract with its incumbent system vendor to upgrade its core trading system in the second half of FY2024 and started the development, reports Nikkei Shimbun, Japan's leading financial daily. Around JPY 25-30 billion will be invested for this development. The upgraded system will have a function for users to grasp potential impact of the failure, and it will take only an hour and a half to reboot the new system from current "three hours".

TSE launched its core system, the Arrowhead, to trade cash equities in 2010. To cope with the growing

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number of high-frequency traders (HFT), TSE has significantly enhanced order processing speed and increased the number of orders it can process per day. TSE launched the system as one of the world's best performing systems, but in October 2020, a large-scale system failure forced TSE to halt trading all day. The main reason was that switching function to the backup system did not work properly when the malfunction occurred.

In order to secure trading hours, it is important to shorten the time to recovery. Under the current specifications, even if the failure was fixed in the morning, TSE would be unable to allow participants to trade on that day, as it would take three hours to reboot. The system upgrade halves the restart time to an hour and a half, and TSE would also extend the cut-off time by 30 minutes to 3:30pm.

The system upgrade will also facilitate users to obtain whole image of the failure. At present, when a failure is detected, it is notified by sentences containing technical terms, which required a person in charge to assess level of the impact on his/her own. After the update, contents of the service to be affected by the failure will be automatically listed up, so that people involved could sense the point of failure by looking at a whole configuration diagram visually showing where the problems are.

TSE will finalize details of its orders with its incumbent system vendor by this summer. TSE said, "Considering the shortest path to strengthening system resilience, it is the best choice for TSE to retain the incumbent provider."

TSE plans to close Arrowhead's backup data center in the Kanto region (Eastern Japan) in the second half of FY2024, and to set up a new hub in the Kansai region (Western Japan). With its main hub in the Tokyo metropolitan area, it will form a dual-hub structure. In the event of a major disaster hitting the Tokyo metropolitan area, the structure mitigates risks of both the primary and the secondary data centers to become unavailable by lack of power and personnel supply.

*Information compiled from Nikkei Shimbun & Mizuho research*

## New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
May-31	TRIPLEIZE	JP3637050000	G

*\*Information compiled based on postings from the Prime (PR), Standard (ST), Growth (G), Tokyo Pro Market (P), NSE (N), FSE (F) & SSE (S).*

*\*\*Board lot size is unified to 100*

## III. Foreign Ownership Limit Ratio

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