Mizuho Custody Newsletter

April 2023 | Japan

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I. Market News

1. AGM of the companies whose fiscal year end in December peaked on 30 March

Shareholders' meetings of the companies whose fiscal year end in December peaked on 30 March, reports Nikkei Shimbun, Japan's leading financial daily. Even in an unfavorable business environment, many companies rose profit and institutional investors are calling for the companies to return more to them. The number of shareholder proposals calling for share buybacks and paying more dividends rose to 8 from 5 in 2022, backed by the TSE's market restructuring that aims to drive companies improve capital efficiency. More companies paid more dividends than in the past, but domestic and foreign investors moving in line with global standards need more from companies.

In March, about 530 companies held shareholder' meetings, and 30%, or about 150 companies, held them on 30 March. It was the lowest concentration ratio in the past 15 years, which allows investors to participate more AGMs than in the past, when the concentration ration was over 40%.

Shareholder proposals has still been attracting market's attention every year. According to a trust bank acting as a registrar, 17 proposals were submitted by institutional investors, requiring companies to proceed management reforms at AGMs in this March, which turned out to be the same level as in 2022. Proposals related to financial matters, including requests for share buybacks and dividend increases, rose from 2 to 5 between 2019 and 2022 and it rose to 8 this year.

On the other hand, companies' awareness on corporate governance is improving. According to a tally of the convocation notices for AGMs by a trust bank, 23% of the companies listed on the Prime market with fiscal year ending in December, had independent outside directors in majority, up from 16% a year earlier. The move reflects companies' efforts to comply with the revision of the Corporate Governance Code and the TSE's market reorganization, which have an aim of expanding outside directors.

However, some people are doubtful if outside directors actually have been playing roles as originally anticipated. There are many outside directors who hold appointment in multiple companies as it seems difficult for companies to find appropriate person for the position. It is one thing that the number and the ratio of outside directors look sufficient, but another that those directors are doing to make companies better.

Investors need more companies to disclose securities reports (financial statements) before the shareholders' meeting. A securities report with sufficient disclosure would be an important source of information for judging the pros and cons of shareholders' meeting proposals. A food manufacturer has been disclosing its securities report before the shareholders' meeting for more than 10 years, saying that "it is desirable for shareholders to exercise their voting rights after being fully informed," but less than 1% of listed companies are doing the same as the above food manufacturer. In U.K, U.S., and Germany, companies are required to file their securities report within 2 to 4 months after the end of the fiscal year.

The shareholders' meetings in March were also notable because it predicts the shareholders' meetings held in June, when about 70% of the listed companies are concentrated to hold. "There are some proposals from investors that haven't submitted proposals before, and they are likely to increase," said a consultant at a trust bank.

To retrieve the details of the Corporate Governance Code (provisional translation), please refer to the following URL:
https://www.jpx.co.jp/english/news/1020/b5b4pj0000046kxj-att/b5b4pj0000046l07.pdf

Information compiled from Nikkei Shimbun, Tokyo Stock Exchange & Mizuho research

2. TSE calls to disclose and implement specific measures to the companies with PBR below 1x

On 31 March, Tokyo Stock Exchange ("TSE") urged listed companies with price-to-book ratio ("PBR") below 1x to disclose and implement specific measures to raise their stock prices. Such a request is an unusual one for an exchange, TSE is aimed at boosting languishing Japanese stocks, reports Nikkei Shimbun, Japan's leading financial daily.

TSE has issued notices to about 3,300 companies listed on the two markets, Prime and Standard, requesting them to take steps to manage their companies with being more conscious of cost of capital and share price. TSE recognizes PBR falling below 1x as "a yardstick that suggests growth potential is not fully appreciated by investors (shareholders)".

The companies with PBR of less than 1x in the 2 markets accounted for about 1,800 companies, or slightly more than 50% of the total, based on the latest closing price at the exchanges.

TSE acknowledges that this effort is "very unique in the world". The management of Japanese companies still believe that share prices are determined by supply and demand in the market. TSE took this unusual step as an exchange to stimulate their mindset. At the panel of experts, many of them pointed out that companies look only at sales and profits, and are less conscious of balance sheet and capital efficiency. PBR tends to decline when capital inflates.

The Japanese market are said to be less attractive than the rest of the world in capital efficiency of the companies listed. In Japan, just limiting to large-cap stocks, companies with PBR of less than 1x account for 40%. In Europe, they account for about 20% and in the United States, they account for less than 10%.

The Corporate Governance Code, which came into effect in 2015, calls for capital efficiency improvements, but PBR has been slow to improve. Feeling increasingly alarmed, TSE has taken new measures.

TSE estimates that if stocks of companies listed on the Prime market, that are currently below 1x, were corrected to 1x, market capitalization would increase to about JPY 850 trillion from current JPY 700 trillion. The CEO of Japan Exchange Group, Inc. said, at a press conference on 30 March, "We want management of all the companies to do more to improve their corporate value."

From now on, the market will look more at what efforts companies will do and how. TSE will require initial disclosures to be made "as soon as possible" and after that, the disclosures should be renewed at least once a year. Specifically, TSE will establish further details about how the exchange would check and assess companies' disclosures and implementation status.

Companies have already started taking actions, and share buybacks are on the rise.

Some companies have declared to lead their market capitalization to a certain level as their target.

TSE expects companies to aim for sustainable growth while being conscious of capital costs and return on capital. In a notice to companies on 31 March, TSE reminded that they did not expect a one-off response such as only a stock buyback or dividend increase.

For details of the notice by the TSE, please refer to the following announcement made by TSE:
https://www.jpx.co.jp/english/news/1020/e20230414-01.html

Information compiled from Nikkei Shimbun, Tokyo Stock Exchange & Mizuho research

3. MOF sets up a new panel of experts to discuss digital yen

Ministry of Finance ("MOF") set up a new panel of experts in April to discuss the feasibility of issuance of a digital yen, which the Bank of Japan (“BOJ”) is conducting demonstration experiments. The panel will discuss the current status of other countries and the impact of the issuance, according to Nikkei Shimbun, Japan’s leading financial daily. In April, the BOJ began the final phase of the demonstration experiment involving companies from private sector. The government has no plan to issue at the moment, however, it will also begin to prepare the environment in earnest.

The digital yen is recognized as one of the forms of "central bank digital currency (CBDC)" that can be used in the same way as ordinary coins and notes. First, the panel will sort out how the digital currency should work in the society and analyze how other countries are dealing with it. They are going to discuss the current amount of currency actually issued and circulated, as well as potential impact to the market and the society if CBDC was actually launched.

The BOJ had been conducting a "proof of concept" program since 2021 to explore the technical feasibility of a digital yen. In addition to basic issues such as issuance and circulation of a digital currency, they have checked availability of peripheral functions such as pre-registered remittance, whether to institute a limitation on the amount of digital currency to be held by each entity.

In April, they began the final phase of the demonstration experiment, getting entities from the private sector involved. The BOJ establishes the “Central Bank Digital Currency Forum” to solicit ideas about technologies, features and functionalities that should be equipped with the digital yen from companies from the private sector. In the final phase, the system will be connected to the banks' core banking accounting systems on a trial basis to make sure regular transactions such as deposits/withdrawals, money transfers and payments could be duly processed.

While the BOJ explores possibility of issuing digital yen from technical standpoints, MOF begins to enhance its preparation for the issuance as the governmental ministry. MOF would not touch upon any technical issues, but will explore the possibility of the issuance from practical point of view.

At the MOF, the section in charge of preparing and reviewing the legislative aspects of the CBDC is the "Digital Currency Section" of the Treasury Division of the Financial Bureau. In summer of 2022, the ministry has increased the number of personnel assigned to the section from 2 to 7 to be better prepared.

The introduction of a digital yen could cause revision of wide range of laws related to banking, including currency and settlement and other commercial activities involving electronic payment. Some other important issues, such as personal information protection, Anti-Money Laundering measures, etc. should also be addressed, and it may have to hold a referendum to implement CBDC. The issues that are not directly related to financial transactions may have to be addressed in future.

Other countries are prioritizing introduction of CBDC. In the United States, President Biden made R&D of the digital currency as a top priority of the administration in 2022. The European Central Bank (ECB) is also expected to decide in 2023 whether to develop “digital euro”. In 2022, China conducted a demonstration experiment using a "digital yuan" at a venue of the Beijing Olympics.

Some market experts say that China aims to accelerate the internationalization of the yuan by getting ahead in the introduction of the digital yuan. Who would take the supremacy in digital currency directly affect Japan's economic power, such as trade and financial transactions. The current developmental status of CBDC in each country may be showing how yen’s future would be.

For details to set up a new panel of experts, please refer to the following announcement made by MOF in Japanese:
https://www.mof.go.jp/about_mof/councils/meeting_of_cbdc/20230414.html

The materials used in the 1st meeting of the panel of experts are available in Japanese only from the following URL:
https://www.mof.go.jp/about_mof/councils/meeting_of_cbdc/cbdchaihu.html

Information compiled from Ministry of Finance, Nikkei Shimbun & Mizuho research

4. Foreign investors who short sell 10 year JGBs are disappearing from the market

Foreign investors who short sell 10 year Japanese government bonds ("JGBs"), mostly held by the Bank of Japan ("BOJ"), are disappearing from the domestic bond market, reports Nikkei Shimbun, Japan's leading financial daily. This was because the BOJ has limited the lending of JGBs needed for short selling. Investors who had sold short suffered losses, making it difficult to sell further.

The BOJ has capped long-term interest rates at 0.5% under its yield curve control ("YCC") policy. To keep to this limit, the BOJ conducts a "fixed-rate bond-buying operation", in which the BOJ buys 10 year JGBs at a specified yield without limitation. It has curbed interest rates by buying several 10 year JGBs issued very recently by the Ministry of Finance ("MOF").

Foreign hedge funds have continued their short selling, assuming that BOJ would not be able to continue intentional interest rate controls. The BOJ absorbed the massive sell-off by foreign investors through its fixed-rate bond-buying operations, and the BOJ holds more than 100% for some JGB issues. Still, some funds keep short selling by securing bonds. Here's the trick.

The BOJ has a scheme of lending JGBs to ensure a minimum level of liquidity in the market. Some funds borrowed JGBs from brokerage firms that had borrowed the position from the BOJ. If the BOJ modifies the YCC and the interest rates rise, that would push JGB prices down. The funds can make profit if they buy back JGBs when they are cheap. In this scheme, 10 year bonds, which could expect high returns attracted those "short sellers"

Things began to change in late February to early March. Many brokers began to find it difficult to borrow current issues. "The game of musical chairs has begun." Securities firms having relied on borrowing JGBs from the BOJ were shaken up. This is because the BOJ has gradually squeezed the amount of JGBs it lends.

Brokers submit bids to the BOJ to borrow bonds, the one submitted the best price can borrow the position. If the broker fails to roll over the borrowing, the broker would be virtually forced to buy the position from the BOJ. That would expose them to price fluctuation risks of the JGBs. As many brokers rushed to borrow the JGBs, the BOJ's annual lending rate of JGBs jumped up to over 4%, which is more than 10 times compared to the normal levels.

Brokers' lending fee of JGBs to funds also soared. "Some securities firms seem to lend JGBs at an annual rate of about 10%," said a strategist at a major securities firm. Rising lending rates is extremely damaging for the funds. This is because even if interest rates of 10 year JGBs rose, they would not be able to earn profit if they have to pay more to borrow bonds.

"Is the BOJ serious for limiting bond lending?" Several securities firms received such questions from investors one after another. As the market began to recognize the BOJ's intention, funds moved to buy back JGBs in an effort to cut losses. Although there has been a rush for JGBs in circulation, the BOJ holds almost all of them, so the amount in circulation is limited. In fact, there was one more place to buy back, which was the BOJ.

Investors can buy JGBs the BOJ lent to the market through brokerage firms. This is called a "reduction measures", in Japanese "gengakusochi". Through the recent upheaval, the word "gengakusochi" rapidly spread to foreign investors. According to some market participants, this gengakusochi drove many investors to buy back the bonds unwillingly but inevitably, even if that would cause losses.

The sharp buybacks can be found also in the MOF data. By early March 2023, foreign investors had sold about JPY 5 trillion worth of mid- to long-term bonds on net basis. After just a month and a half, the net sales plummeted to the level below JPY 0.4 trillion. "There are no reckless funds left trying to challenge the BOJ with huge sales of 10 year JGBs," says a source at a foreign securities firm.

The BOJ's moving to limit short selling is under the intention to quell confusion caused by pulling up the upper limit on long-term interest rates in last December. Raising the ceiling from 0.25% to 0.5% caused a spike in selling. With long-term interest rates stayed at the upper limit level, the BOJ has significantly increased its purchases. That pushed the yield on the 10 year bond down, creating distortions in yield curve. The distortions led to speculation of policy revisions, which created a vicious cycle in which long-term interest rates stay at the ceiling.

This is, in short, the BOJ calmed down short selling, which the BOJ could not achieve by intensive buying, by limiting JGB lending. Distortions in the yield curve of the JGBs have almost disappeared. Even if the cap on long-term interest rates was raised, the chances of sticking to a new cap were reduced.

The MOF announce the amount of investment in securities by non-residents every month. To retrieve the details of the announcement, please visit the MOF's website from the following link:
https://www.mof.go.jp/english/policy/international_policy/reference/itn_transactions_in_securities/index.htm

Information compiled from Ministry of Finance, Nikkei Shimbun & Mizuho research

New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
	(None)		

**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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http://www.mizuhobank.com/service/custody/actions.html

Please visit our Custody homepage on the Web at:
http://www.mizuhobank.com/service/custody/index.html