

Mizuho Custody Newsletter

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Contents:

I. Market News

1. Investors are getting increasingly interested in “investing in people”
2. METI compiled a draft guideline for the companies to prevent human rights abuses
3. Proof of Concept of CBDC by BOJ progresses
4. Exercising shareholders meetings’ online voting exceeds that in paper form

II. New Equities Listing Approvals

III. Foreign Ownership Limit Ratio

I. Market News

1. Investors are getting increasingly interested in “investing in people”

Investors are getting increasingly interested in “investment in human capital”, including human resources development, reports Nikkei Shimbun, Japan’s leading financial daily. This is because more and more people are coming to believe that they could not tell how good a company is until they have appreciated its employees’ abilities and personnel strategies. Financial statements describe very little about human capital. Analysis using alternative data show that companies that emphasize skill development of young employees tend to record high share prices and/or good business performance.

A major asset management firm in Japan have been managing a fund since January 2021 that focus on investing in companies that maintain excellent investment policy in human capital.

It calculates the efficiency of the companies’ investment in human capital, based on information such as changes in the number of employees and labor costs, and it will invest in companies that are high on the list. From the historical data since 1998, companies who are top 20% scorers recorded

cumulative investment return of 28%, in comparison with negative return of 25% for the lowest scorers.

The current analysis focus on financial information, but more information is supposed to be given for investment decision. The person responsible for development of information analysis for the fund said, “We’d like to incorporate data such as training expenses if such information becomes available.” Prime Minister Fumio Kishida administration’s “new capitalism” will call for disclosure on the items such as training time, costs, and employee diversity in the near future.

The question is, “Is it a fact that companies, which develop employees’ business skills and abilities and makes them find their jobs challenging but rewarding, have high corporate value in general?”

With the support of a company which collects and analyzes employees’ reviews, Nikkei Shimbun analyzed correlation between companies’ business performance / stock prices and company’s score, which is given by employees and former employees on a five-point scale. Evaluation items are “Compensation level”, “Employees’ morale”, “Openness”, “Mutual respect for employees”, “Working environment for employees in their 20s”, “Long-term human resources development program”, “Awareness of legal compliance”, and “Fair personnel evaluation”, as well as the “Overall scores”. The top 20 and the bottom 20 companies as of 2021 in the survey were analyzed.

Firstly, analysis of “Overall score” revealed that a stock prices of the top 20 companies as of 19 July 2021 were up 72% from the end of 2016, well above 18% up for the 20 companies at the bottom. Sales of the top 20 companies in 5 years from FY2016 to FY2021 also rose by over 40%, while the 20 companies at the bottom recorded just over 10% increase.

Secondly, the researcher examined correlations between the eight items and various financial indicators to see which items of the eight contributed to companies’ better performance. As a result, growth in

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revenue per capita and the "Working environment for employees in their 20s" showed strong correlation. It turned out that a major company that obtained the highest score on this item, had an expert committee where managers review training policies for each employee. Stock prices were mostly affected by "Fair personnel evaluation".

A machine manufacturer in Japan achieved to improve its corporate value through promoting internal transformation. In 2017, the company instituted more employee training programs than before, and a new compensation structure which is based on each employee's role and actual performance. These new arrangements have been introduced to 50% of its offices outside Japan. Under the slogan of "promoting performance of human resources", foreign nationals have accounted for approximately 15% of the company's employment of new graduates by 2020. Its sales are on the rise and final profit for the fiscal year ending December 2022 is expected to be the record high for 2 consecutive years. General Manager of the human resources department said, "We have reformed our management culture into what emphasizes on "people", which, I believe, led to improved job satisfaction for employees and development of excellent human resources."

Some companies have put a lot of thoughts into their disclosure to investors. An electronic company links its "employee engagement index", which indicates the level of employees' confidence for the company and their willingness to contribute, with management's compensation and disclose it in its integrated report. The score in FY2020 was the record high. An IT company disclose training hours and overtime hours per person and employee turnover.

A person in charge at a leading asset management firm says, "Enhancement of human capital has significant impact on corporate value among Japanese companies that put emphasis on bottom-up approach." However, according to The Life Insurance Association of Japan, companies that selected "human resource investment" as an important item of medium- to long-term investment account for only 31% of the respondents. Companies' future prospects rest on how they could refine their growth strategies and how well such strategies could attract money.

Information compiled from Nikkei Shimbun & Mizuho research

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2. METI compiled a draft guideline for the companies to prevent human rights abuses

The Ministry of Economy, Trade and Industry ("METI") drew up a draft guideline for companies to prevent human rights abuses, reports Nikkei Shimbun, Japan's leading financial daily. Regarding "human rights due diligence ("DD")", which aims to identify and prevent risks in supply chain, the guideline indicates that it would be desirable to disclose implementation status at the companies at least once a year.

At a press conference, Koichi Hagiuda, the Minister of Economy, Trade and Industry said, "We will work to strengthen our international competitiveness by reducing risks and improving corporate value through the use of the guideline." It is the first time for the Japanese government to draw up a guideline on this subject. It will be finalized following a public consultation.

The draft guideline calls companies to explain how they have managed to mitigate the impact to their business activities and their people when they have identified risks of human rights abuses. Examples of disclosure methods include its own website, integrated reports and human rights reports.

To prevent companies from abusing human rights in their business activities, the government set out a guideline on the matters to comply with. Companies, including their business partners, are required to identify cases of discrimination, child labor, etc., if any, and are encouraged to disclose their efforts for prevention and resolution, and background. Japan has been lagging behind Western countries in its efforts, and the companies could be removed from the suppliers list of the global companies, if they fail to act properly on this subject. Based on the guideline, the government will hasten to adopt international standards.

Companies engage not only with their own employees, but also with those working at the suppliers of raw materials and places where they buy them. Human rights DD is efforts to redress corporate human rights violations if such indications are discovered.

The guideline states that "all companies operating in Japan" should make every effort possible to implement

human rights DD. It calls companies to tackle this issue throughout the procurement and sales networks.

There are a wide range of human rights to protect. Discrimination based on race, disability, religion or gender, as well as forced or child labor, will never be condoned. The guideline recognizes foreigners, women, children, the disabled, indigenous peoples, and ethnic, religious, and linguistic minorities also tend to be treated unfairly.

It will require companies to disclose their policies to eliminate human rights abuses, and then encourage to take a four-step approach. Firstly, it requires to identify such abuses and assess the severity of them. Secondly, companies have to take prevention and mitigation measures and thirdly, assess effectiveness. Fourthly, they disclose results.

If companies fail to prevent or mitigate human rights abuses, the guideline require companies to provide remedies. The remedies include apologies, monetary and non-monetary compensation, and representation of measures to prevent recurrence.

The guideline also urges companies to take actions, when they find human rights violations cases at their suppliers of raw materials or at the shops, and to suspend transactions, if such cases would not appear to be solved by any means. It also says "suspension of transactions also needs to be considered" even if human rights violations may be occurring "under the involvement of a sovereign such as a nation".

Companies in Western countries have been making progresses. In June 2022, the United States enforced "The Uyghur Forced Labor Prevention Act", which prevents companies from importing goods unless they can prove they are not related to forced labor. In February, the European Union published a draft directive obligating human rights DD.

The guideline requires companies to "consider taking appropriate measures based on their own circumstances". It is difficult to identify some human right abuse cases such as discrimination. Although the guideline is not legally binding, companies may be in difficult situations in dealing with these issues.

Companies can lower their risks if they follow the legal system of each country based on the guideline. On the other hand, Germany has provisions such as fines

and a ban on participating bids for public procurement. The Japanese government is also eyeing for future legislation.

Information compiled from Nikkei Shimbun & Mizuho research

3. Proof of concept of CBDC by BOJ progresses

Shopkeepers would be able to collect money immediately, which used to take up to a month for them to collect payments by credit card. In a world where central bank digital currency ("CBDC") is used, shopkeepers could receive payments like cash in normal shopping. CBDC would make payment flow more efficient and make shopkeepers' cash management much easier as CBDC would bring them higher liquidity. Shoppers would also benefit from CBDC as it could reduce various costs such as remittance charges, reports Nikkei Shimbun, Japan's leading financial daily.

Not only developing countries, but also Western countries have been prompted to the introduction of CBDCs. The Bank of Japan ("BOJ") is also currently conducting proof of concept. The first phase examined the basic functions such as issuance and distribution. In the second phase, which began in April, BOJ examines whether services such as automatic remittance reservation would work. It will enter the third and final phase as early as the next fiscal year, getting private companies and consumers involved.

For CBDCs, BOJ assumes a "two-tier structure" between the central bank and the private sector, rather than BOJ provides all the functions. BOJ will replace physical delivery of cash with digital money and develop infrastructure for digital payments. On the other hand, the private sector is expected to take the lead in the management of deposit accounts and settlement, which is not much different from the current situation where people make purchases via credit card or e-money.

One of the advantages of CBDCs is that it would make settlement process more efficient. Each central bank aims to do the same thing digitally as they currently do with notes and coins, by creating a system that allows all the payments booked to shops exactly at the time of shopping. If payments would be recorded

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immediately, there will be no account receivables for shops, which would make shops richer in cash at hand. Besides improving payment efficiency, it would be possible to make payments on biometric authentication in future, if innovation would go further under the initiative of private sectors.

"Programmable" settlement functions that incorporate specific programs could also be developed. It is also envisioned that payments would be completed automatically once goods are delivered, or electric vehicles could be charged.

However, whether to adopt CBDCs is still up in the air. That is what an executive director of BOJ stressed at the beginning of the public-private council on CBDCs in this April.

In 2021, Japan's cashless ratio was 30%, which lags behind other countries with 50% or higher cashless ratio. The elderly still prefer strongly physical notes and coins to digital money. CBDCs can be used by anyone of any age, nationality or gender, but giving them too much anonymity could result in inciting money laundering, tax evasion, etc.

With such concern in mind, countries around the world are stepping up their pace to adopt CBDCs. If China's digital yuan and crypto assets would become common, that might make Japanese yen far less influential to the global society. The special advisor to the prime minister who chaired the Liberal Democratic Party's Digital Money Promotion Project Team points out, "Introduction of CBDCs has an aim of maintaining monetary sovereignty and maintaining a monetary system that is desirable for Japan."

He also said, "The Japanese version of the CBDCs will take shape at the end of Phase 2, which is around the end of 2022." The biggest challenge is to obtain national consensus. Even if the government officially decided to introduce the system right now, a BOJ official seems to believe it would take at least several years to ensure the CBDC actually work, as it would take time to revise the laws and to establish a system.

From shell and stone to metal and paper, currency has changed its appearance with the times. It is an inevitability of history that currencies are shifting to digital as advances of technology. The era of CBDCs is slowly but surely approaching.

Information compiled from Bank of Japan, Nikkei Shimbun & Mizuho research

4. Exercising shareholders meetings' online voting exceeds that in paper form

Digitalization of shareholders meetings has been accelerating. At the shareholders meetings held in June for which a trust bank acted as the operator, more than half of the voting rights (based on the number of shareholders) were exercised via internet before the meetings, which exceeded those exercised in paper form for the first time, according to Nikkei Shimbun, Japan's leading financial daily. Companies that held AGMs online in June increased by 30% compared to the previous year. Convocation notices are planned to be digitalized from 2023, which is believed to make AGMs' practices more efficient.

The trust bank has tallied data of 857 companies on how institutional and individual investors exercised voting rights on their agendas. 41% of the shareholders voted in advance, 52% of which were via online. Online voting accounted for 18% in June 2020 and 46% in June 2021, respectively, which shows how it has become common practice in the past 2 years.

Many issuers' introduction of electronic voting systems for individual investors in the wake of the global pandemic explains the recent rapid spread of online voting. Among the trust bank's clients, 76% adopted electronic voting system for individual investors, which is by 22% up from FY2020. Because individual shareholders are much greater in number than institutional investors, the fact that shareholders that voted online outnumbered those that voted in paper form means that more and more individual investors selected online voting.

When institutional investors vote electronically, they do so through the electronic voting platform provided by Investor Communications Japan ("ICJ"), which is owned by Tokyo Stock Exchange ("TSE") and Broadridge. As of June end, 1,738 companies, or 46% of the listed companies in TSE, use the ICJ platform. 499 issuing companies newly joined the platform in a year, after the revision of the Corporate Governance Code in 2021 urging companies to advocate electronic voting.

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More companies started holding their AGMs online. Among all AGMs held in June 2022, 402 of them were held online, which is 97 companies up from the previous year, according to the trust bank. Out of the 402 companies, 377 held "observation-type" AGM, which only broadcast shareholders meetings live online, 17 held as "attendance-type", which allow attendees to ask questions and exercise voting rights online, and 8 held as "full online type", which had no physical venues.

Traditional interpretation of the Companies Act had not allowed issuing companies to hold full online type AGMs, but the amendment to the Act on Strengthening Industrial Competitiveness in June 2021 changed the landscape. After the two-year special period, companies may hold full online-type AGMs if certain requirements are met, such as amending the articles of incorporation or taking measures to mitigate problems in their communication facilities. At AGMs in June 2022, 150 companies brought up a proposal to change the articles of incorporation to allow "full online type".

Convocation notices, which have been required to be mailed no later than two weeks before the AGM, will also be digitalized. Under the amended Companies Act, which will be enforced in September 2022, all listed companies that hold shareholders meetings after March 2023 will be required to do so. It gives investors more time to analyze the proposals, and it helps issuing companies reduce printing and shipping costs.

The president of ICJ said, "It takes a lot of manpower and costs for companies to hold shareholders meetings from advance preparations for it. Digitalization of AGMs may not only make those work more efficient, but also enable the use of data, etc."

Information compiled from Nikkei Shimbun & Mizuho research

New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
Sep-01	PICKLES HOLDINGS	JP3801810007	PR
Sep-12	Pear Capital	JP3836120000	P
Sep-13	Japaniace	JP3389420005	G
Sep-16	eWeLL	JP3130160009	G
Sep-22	FP Partner	JP3167010002	G
Sep-28	GLAD CUBE	JP3273840003	G
Sep-28	Fines	JP3802410005	G
Sep-28	Kitalive	JP3240730006	S
Sep-29	PROGRIT	JP3833860004	G
Sep-29	PORTERS	JP3855840009	G
Sep-30	GUPPY's	JP3273740005	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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