Mizuho Custody Newsletter

December 2023 | Japan

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I. Market News

1. It's time for action, ESG!

According to a research by the Global Sustainable Investment Alliance, ESG (Environmental, Social, Governance) related investments in 2022 has declined for the first time since the survey began in 2012. ESG has been positively accepted by the capital market since its inclusion in the United Nations Principles for Responsible Investment (PRI) in 2006. However, some negative news on ESG have been coming up very recently.

Some people say that if Mr. Trump, who is close to the oil industry, would win in the 2024 US presidential election, "ESG" would be a taboo word in the United States. An executive of a US-based investment fund refused to comment on the issue to the press when he came to Japan to research Prime Minister Fumio Kishida's "investment-oriented country," initiative. It appears that the executive was a way too sensitive, however, that also reflects what is going on in the U.S.

The United Nations Framework Convention on Climate Change (COP) had been an event that advocated ESG investments, but COP28 held in UAE turned out to be different from what it used to be. Greenhouse gas emissions have been worsening rather than improving, and perception gaps between the developed countries and emerging/developing countries seem to take time to be resolved. "Many countries may not be able to keep what they had announced in public, and they may start wondering how much more ESG investment they could take." Before joining the COP28, an executive of non-profit organizations (NPOs) expressed such a concern.

"ESG is not just a theme, but a factor in evaluating corporate value. Environmental and social issues have to be seriously considered because they can affect stock prices. The former Secretary-General of the United Nations, Kofi Annan must have so recognized." says Daigo Shimizu, who left Goldman Sachs Securities in this June and published "Changing Capitalism at the Center of Capitalism," commented on the downtrend of ESG. If his view is right, it can be said that ESG is in a normalization process, cutting off inappropriate activities that arose from too much enthusiasm for ESG in the past.

In reality, while weakening popularity of ESG investment trusts funds sold by Japanese securities companies and sluggish discussions at COP28, institutional investors are becoming even more actively advocating ESG.

During the Annual Conference of the Principles for Responsible Investment (PRI) held in Tokyo in October 2023, investors agreed to launch the initiative called "Spring" in which they collaborate to promote the conservation of nature and biodiversity to companies. The initiative aims institutional investors to contribute to the global goal of preventing and reversing biodiversity loss by 2030 and is calling for participation by signatory institutions.

Each asset management company has started making more efforts. A UK based asset management firm, which encourages environmental conservation to its investee companies, has announced to incorporate criteria for companies' efforts for forest conservation in its proxy voting guidelines from 2024.

Here in Japan, a leading asset management company revised its proxy voting guidelines in November, demonstrating its intention to demand to make more efforts on ESG issues to investee companies. The asset manager would expect the constituent companies of the TOPIX 100 (Tokyo Stock Price Index) to serve as role models, and explicitly stated that if their efforts are deemed clearly insufficient from 2024 onwards, it would be reflected in their votes for director appointments. It is anticipated that other asset management companies will also follow suit.

ESG engagement that takes proxy voting into view is one of the highlights at shareholder meetings from next year onward. In the past, shareholder proposals from environmental activist groups demanding companies such as financial institutions to change the articles of incorporation to declare to tackle de-carbonization, have drawn market attention. In the future, it is anticipated that wider range of large corporations would be subject to pressure to tackle ESG issues via proxy voting on selection of their directors.

In addition to Spring, Nature Action 100 (NA100), an initiative launched in December 2022, showed up as another institutional investor initiative that focuses on ESG engagement. NA100 aims to encourage corporate to be more willing to take actions to prevent destruction of nature, by setting up high-level engagement themes and clear expectations. As of the end of November 2023, 200 institutional investors have joined the initiative from various countries, including multiple asset management companies from Japan.

As Spring and NA100 select companies for their engagement efforts on global basis, not so many Japanese companies are directly affected. However, institutional investors with an interest in nature and biodiversity are expected to reference the initiatives of NA100 and Spring in engaging with their investee companies in the future, which may involve more companies indirectly. It would be desirable for companies in the eight business sectors identified by NA100 as having significant dependence on or impact on nature to engage in nature-related assessments and disclosures of information as early as possible.

Compiled from Nikkei Shimbun and Mizuho research.

2. The government to develop a secondary market for unlisted shares

There are approximately 3.68 million companies in Japan, but only about 4,000 of them are listed on the exchanges and traded at a price quoted in the market. In terms of the number, only paltry portion of companies are listed in Japan. In Japan, it is extremely difficult to trade unlisted shares. This is partly because secondary markets for unlisted shares have been pretty underdeveloped.

The Financial Services Agency (FSA) is going to establish a new registration system for operators specialized in broking unlisted shares. FSA also intends to accelerate to create new secondary markets for unlisted shares, by significantly lowering the bar to be applicable for listed stock brokers to handle unlisted shares to enter the new markets where investors can trade unlisted shares as they like. The creation of the new markets would give issuers and investors more options of exit strategy, in addition to Initial Public Offerings (IPOs), which is virtually the sole way out at present. This will provide more financial sources for start-ups and may attract new types of entities providing funds.

FSA aims to submit a bill to amend the Financial Instruments and Exchange Act to the regular Diet session in 2024, following discussions at the Financial Council (an advisory body to the Prime Minister).

In the United States, there is a market where professional investors can trade unlisted shares online, the “Nasdaq Private Market,” established in 2013, whose transaction volume reached USD 45 billion (approx. JPY 6.6 trillion) as of September 2023. “Forge Global”, a U.S. fin-tech company also provide brokerage services of unlisted shares for both individual and institutional investors.

In the United States, the existence of secondary market for unlisted shares gives those shares high liquidity , that enables companies to raise funds in big volume, even they are not listed. Consequently, market capitalization of those companies will also likely be huge when they are actually listed. However, the average market capitalization at the time of IPO on the Tokyo Stock Exchange’s (TSE’s) Growth Market, which is for startups going public, was JPY 10.1 billion (approx. USD 68.8 million) in 2022, which is far smaller than USD 1.92 billion (approx. JPY 281.4 billion), the figure in the U.S. for the same period. Even in 2021, the amount raised in Japan's emerging market per company was at JPY 1.4 billion (approx. USD 9.5 million), much smaller than JPY 45 billion (approx. USD 306.9 million) that in the US. This is also the case for pre-listed "Unicorns" (unlisted companies with a corporate value of over USD 1 billion). According to a survey by a US research firm, there are over 650 Unicorns in the U.S. and just 6 in Japan. China that has 170 unicorns also runs far ahead of Japan.

In Japan, the Japan Securities Dealers Association's has established "Shareholder Community System" for trading unlisted shares. However, in this framework, trading and solicitation are allowed only to those who are closely related to the issuer, such as their shareholders who participated to the community on their own, employees of the issuer, residents of the area where the issuer is located. The total transaction volume on the program has been JPY 6 billion (approx. USD 40.9 million) since its implementation in 2015.

To facilitate trading of unlisted shares more, FSA is working to institute a new framework. To be more specific, it is going to establish a simplified registration system for operators specialized in the brokerage services of unlisted shares, targeting institutional investors and wealthy individuals.

Currently, it is required to have JPY 50 million or more (approx. USD 341 thousand) in capital to be registered as a broker for listed shares. The FSA is considering to lower the capital requirement to "JPY 10 million or more (approx. USD 68 thousand)" and to eliminate regulations regarding capital ratios and side business restrictions if an operator would specialize in brokerage service of unlisted shares.

FSA is also going to review the regulations for "Proprietary Trading Systems (PTS)", developed by private sector that allows for trading shares outside the TSE. It is necessary to obtain a license from FSA to operate a PTS for trading listed shares and to follow strict requirements, such as capital of JPY 300 million (approx. USD 2 million) or more.

FSA will lower of the capital requirement to JPY 10 million (USD 68 thousand) or more, if a PTS would be exclusively for trading unlisted shares. FSA aims to encourage the entry of startups and system development and engineering companies to this business area by the deregulation.

It has been believed that institutional investors had been given very few opportunities to invest in unlisted shares is one of the reasons that transaction volume of many IPOs have been small in Japan. In other words, startups had to go public at a stage where their business size was still small, as institutional investors were not looking at them. "There are few investors for companies in the late stages (stages where startups consider exiting strategies such as IPOs and sale of shares/businesses) in Japan," says the CEO of Japan Exchange (JPX) Group. TSE, which hammered out an idea to lessen listed companies with PBR (Price Book Ratio) less than 1x, is now looking at the emerging market to reform next. The Kishida administration seems to be keen on nurturing startups into Unicorns, but in reality, it is not that easy to make it happen, and many IPOs have ended up in small size. It will be tough for startups to have gone public in a small size IPO to obtain support from institutional investors, due to concern toward limited liquidity of those shares.

It has been fairly common that venture capitals urge their investee companies for IPOs if they could not find buyers of their holdings by the redemption of their funds. If a secondary market for unlisted shares is established, venture capital funds, founders, and other shareholders could sell their holdings into cash, not having to wait for an IPO. This would also make it easier for startups to raise funds for developing their businesses. As for institutional investors, they have been shying away from investing in startups due to liquidity concerns. However, this new framework is anticipated to ease these concerns and give them more opportunities to buy unlisted shares before they go public. Consequently, that would enlarge the transaction volume of IPO helping the issuer more to expand their business after listing. Some analysts say that if the Government Pension Investment Fund (GPIF), which manages nearly JPY 200 trillion (approx. USD 1.36 trillion), were to include Japan's unlisted stocks in its portfolio, that would affect other pension funds, which may eventually make more funds flow into the market supporting companies preparing to go public.

Unfortunately, some domestic entrepreneurs selected the United States as the market for going public, instead of Japan, partly because the market cannot flexibly keep up with their financing needs. It is ironic that while monies have been returning to the Japanese stock market from overseas, some domestic entrepreneurs show the signs of doing IPOs overseas. It is essential for the government to review functionality and convenience of the market for unlisted shares to further support startups, which can be a driving force of development of the domestic economy.

Compiled from Nikkei Shimbun and Mizuho research.

3. TSE requires explanation from parent-subsidiary listed companies

In addition to the enhancement of shareholders' return and unwinding cross-held shares, a noticeable fruit of a company's capital policy reform is the resolution of parent-subsidiary listings which has been attracting market's attention. For listed subsidiaries, parent companies' flexible support for finance and business expansion mean a lot to them, while profits go out of the subsidiary to its parent in this structure, as some market experts point out. A major asset management company comments, "While parent-subsidiary listings may have positive effect, such as strengthening ties within the group, it does not seem desirable that such structure would last long."

The number of shareholder proposals by activists at AGMs in 2023 reached a record high. At an IR meeting held by a leading steel company, which owns more than half of the shares of its listed subsidiary, the company presented to the shareholders to convince that it has been paying sufficient attention to its minority shareholders not to cause conflicts of interest in the existing structure. However, it faced tough questions from vocal oversea shareholders as to whether the subsidiary could really demand profits against the parent company. On another case, delisting of four listed subsidiaries was decided based on a proposal from an activist fund in November.

The Tokyo Stock Exchange (TSE) requires over 1,000 listed companies under parent-subsidiary structure or in equity-method relationships to enhance the level of disclosure regarding corporate governance. Those companies will have to make explanations on the significance of having listed subsidiaries, what they do to ensure independence of their listed subsidiary. TSE would require certain level of accountability for companies with parent-subsidiary listings that could potentially threaten the interests of minority shareholders with a view of improving the overall attractiveness of the market.

TSE requires the enhancement of information disclosure to both sides, the parent companies/major shareholders, and the subsidiaries/affiliated companies. In parent-subsidiary listings structure, it would be extremely difficult for minority shareholders of a listed subsidiary to overturn decisions of the subsidiary, even if the parent company prioritizes interests of the corporate group in ways that could sacrifice those of the subsidiary.

Each listed company will describe its initiatives in the corporate governance reports to be submitted to TSE. It is not mandatory, but TSE states that "the disclosure items are important for investment decisions and this is where the dialogues with investors begin." in their notification to listed companies in order to encourage compliance.

Parent companies and major shareholders are required to explain the background of the establishment of the subsidiaries or affiliated companies, and also rationale of keeping them listed. They are also encouraged to indicate their policies on how they would involve in the nomination process for officers of subsidiaries or affiliated companies, as well as their views on exercising voting rights for appointment and dismissal of executive officers.

Subsidiaries and affiliated companies are requested to explain their thoughts on the group management, on behalf of the parent company and its major shareholders. They would have to present their position within the business portfolio of the group as a whole, and if they are administrating cash position among group companies, they are required to disclose its significance.

For the protection of minority shareholders, they are also required to show whether or not the parent company or major shareholders would be involved in their decision-making process and the details of such involvement, if any. If they have established a special committee supervising actions that appear suspicious of conflicts of interest, such as transactions within the group or the transformation into wholly-owned subsidiaries, disclosure of the composition and actual activities of the committee.

Foreign investors are not only focused on parent-subsidiary listings. A Swiss based investment fund rates the members of the management board and also external directors of listed companies that consist of TOPIX, a major market index. Through that process, the fund digs out some under-valued stocks that the market does not recognize their potential, despite their good governance. As for external directors, the fund assess them with its unique perspectives, such as whether he/she is completely independent of the issuer, not a scholar with little business experience, or not a former bureaucrat.

TSE will issue a notification summarizing roles that independent external directors should play in listed companies that have a parent company or an individual controlling shareholder. The notification will specify that independent external directors are responsible for an important role of protecting the interests of minority shareholders, and their roles at the board of directors, special committees, etc. The companies, including the board of directors, are requested to develop systems so that independent external directors can perform their full potential.

The background of the TSE's demand for more disclosure is the recent increase of listed companies in the equity-methods relation in number, in spite that the number of "parent-subsidiary listings" has been decreasing.

According to the TSE, investors and regulators began to cast a stern eye toward the parent-subsidiary listings, which pushed the number of listed subsidiaries down by 18% during the past four years to 260 companies as of the end of 2022. However, the number of listed companies with a major shareholder (excluding individual shareholders) holding 20% or more but less than 50% of the issued shares went up by 27% to about 960 companies as of the end of 2022. This fact reflects that more and more cases of capital and business alliance have been taking place between listed companies.

In 2019, at the AGM a major e-commerce company, the parent company, which holds more than 40% of its stake, opposed the appointment of the president and independent external directors, and the proposal was voted down. In order to discuss frameworks for protecting minority shareholders in listed companies that have shareholders with substantial control, TSE launched a study group consisting of external experts in January 2020. The study group had been paused when they published an interim report in September 2020, and resumed its discussions in January 2023.

At the study group, a proposal to adopt a method called "Majority of Minority (MOM)" came up in order to enhance the effectiveness of independent external directors. Under the MOM, a proposal needs majority approval from minority shareholders, excluding large shareholders with interest to pass. Since introduction of such rules would require revision of the current listing system, TSE will sort out and summarize the points of discussion and bring them up at the study group.

Being asked "Do you think the governance of Japanese companies has improved?", the previously mentioned, Swiss-based fund manager replied, "At first, I thought most of them would end up just "replacing the wallpapers". However, it appears 20-25% of Japanese companies are actively tackling to improve their governance. 50% of the companies look unwilling and their move looks a bit slow, but they are slowly but surely improving. The remaining 30% did nothing at all. I do not believe these 30% of them could move forward unless their management would remove the nepotism prevailed within. TSE's reforms should keep moving forward, to attract investors from overseas.

Compiled from Nikkei Shimbun, and Mizuho research.

4. Japanese government to issue the world's first transition bond

To tackle climate change as a common challenge for mankind, various measures have been taken worldwide to realize a decarbonized society. In Europe and America, nation-level support for de-carbonization investments is provided, and they are accelerating the implementation of new markets and relevant rules on this subject. It's not too much to say that we are now in an era where success or failure of de-carbonization investments will significantly affect the competitiveness of corporations and nations.

The government of Japan has compiled an outline of its policy on the climate change, viewing the next 10 years. In the outline, the government intends to recognize the efforts to achieve "carbon neutral" by 2050 and "target level of greenhouse gas (GHG) reduction" by FY2030 as opportunities to boost the national economy. The eventual goal is to achieve "Green Transformation" (GX), transformation of the whole social and economic structures and systems, by balancing reduction of GHG and economic growth/enhancement of industrial competitive edge.

To achieve carbon neutrality by 2050 and establishment of a decarbonized society, the government emphasizes the importance of finance for companies working for de-carbonization, such as various energy saving efforts at the offices, switchover of fuel to ones emitting less CO2, mainly in industries that are big emitters of GHG. On the other hand, the government also stressed that no countries, regions, or industries can achieve de-carbonization overnight from both technological and cost perspectives. The government further states the necessity of introduction of technologies that actually work for transition to further reduce emissions at the maximum level. The government recognizes transition finance as a new financial method, aimed at supporting the efforts of companies working for steady GHG reduction, in line with its long-term strategy towards the realization of a "decarbonized society".

The government estimates that over JPY 150 trillion (approx. USD 1 trillion) in investment will be necessary over the next 10 years for GX, for both public and private sectors altogether. The Ministry of Finance (MOF) announced the outline of the initial issuance of GX transition bonds on December 6. MOF is going to issue 10-year bonds and 5-year bonds, in the amount of JPY 800 billion (approx. USD 5.4 billion) for each, totaling JPY 1.6 trillion (approx. USD 10.9 billion), in February 2024. The government plans to launch GX bonds up to about JPY 20 trillion (approx. USD 136.4 billion) over the next 10 years, aiming to attract investment from private sectors, by investing for GX ahead of them via launching GX bonds. Funds raised from GX bonds will be used for limited purposes, such as "to establish mechanisms using renewable energy as the main power source", "active use of nuclear power", and "to promote introduction of hydrogen and ammonia as power sources for machines", which should facilitate attracting investors for clear purposes of use of the funds.

To promote use of hydrogen for power, JPY 3 trillion (approx. USD 20.4 billion) will be invested over the next 15 years to subsidize the difference in prices between hydrogen and the existing fuels such as natural gas. The aim is to promote use of hydrogen for the main power source by keeping its current relatively high cost at reasonable level. Hydrogen is expected to be used not only as a fuel for vehicles and power plants, but also to be useful in manufacturing process in some industries such as steelmaking. Hydrogen, generated by electrolyzing water, can also be produced from renewable energy sources such as solar and wind power. Currently, the supply cost of hydrogen is about ten times higher than that of natural gas, preventing its use from wide-spreading.

In addition to this, another JPY 1.3 trillion (approx. USD 8.8 billion) will be provided over the next decade for de-carbonization of manufacturing industries such as steel and chemicals. This intends to encourage the current manufacturing processes to shift into ones that emit less carbon dioxide (CO2), such as electric furnaces. The government also set aside JPY 1 trillion (approx. USD 6.8 billion) over the next ten years to strengthen the domestic supply chain of renewable energy such as perovskite solar cells that are thin and bendable and wind power generated by offshore floating turbines . It aims to heighten the proportion of renewable energy in the nationwide power generation and foster companies that would be engaged in this industry.

Domestic securities firms are also keen on providing financial supports with companies and advisory services on M&As for de-carbonization. Fundraising deals for de-carbonization investments are currently increasing. According to the Japan Securities Dealers Association, the total amount of domestic SDGs bonds issued from January to September 2023 amounted to JPY 4.9 trillion (approx. USD 33.4 billion), surpassing JPY 4.5 trillion (approx. USD 30.7 billion) in 2022, which was a record high for the full year.

A securities company of a major mega-bank group will recruit more staffs for its 'Sustainability Promotion Department', which handles deals supporting de-carbonization of their clients, to 50 people, 1.5 times more than that at the end of September 2023. They have established a team for M&A and securitization products as well as one covering medium-sized companies and municipalities. They hire new talents from those who were engineers, consultants, or worked at government-related organizations, aiming to make professional proposals to client companies, according to the head of the department.

We wonder how Japan's GX looks to foreign investors. In October, a major American asset management company took the lead, and 20 representatives of institutional investors and asset management companies from all over the globe, including Middle Eastern government funds and Western pensions, gathered at the Prime Minister's Office in Tokyo. Many of them reportedly showed strong interest in Prime Minister's plan, whose AUM in total is estimated to be JPY3,300 trillion (approx.. USD 23.2 trillion).

Japanese companies are also taking actions to attract money from overseas. A leading steel company, which raised approximately JPY 204 billion (approx. USD 1.4 billion) through capital increases in September, gave an online presentation to about 100 investors based in Europe and America how they would accomplish structural reforms and change their mindset to pursue quality rather than quantity". The company will invest the funds obtained through public offerings to projects on high-quality steel plates for electric vehicles, which looks promising, and invest the funds from launch of convertible bonds (CBs) with warrants in medium-to-long term de-carbonization related project. While ceasing domestic blast furnaces to operate, the company plans to invest about 1 trillion yen (approx. USD 6.8 billion) in de-carbonization project by fiscal 2030. The company's foreign shareholders ratio went up to 30% from 24% at the end of March due to the capital increase.

Since the collapse of the economic bubble in 1990s, Japanese companies had prioritized debt repayment, curbing capital investment and Research and Development (R&D). According to the Bank of Japan's statistics, the private sector (excluding finance) had been short of cash since the end of the WWII, but many of them have turned into excess cash holders since around 1998. Now that investors are carefully watching what will happen next in the market, it is about time for Japan to make a giant step forward to demonstrate its good growth potentiality.

Compiled from Nikkei Shimbun, Ministry of Finance (MOF), Ministry of Economy, Trade and Industry (METI) and Mizuho research.

Please visit the following website of MOF for further details regarding the "Japan Climate Transition Bonds"

https://www.mof.go.jp/english/policy/jgbs/topics/JapanClimateTransitionBonds/climate_transition_bond_framework_eng.pdf

II. New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
Jan-11	OneBe, Inc.	JP3994750002	P

**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

Click for up-to-date FOL information:
https://www.jasdec.com/en/description/less/for_pubinfo/for_pubinfo.html

Please visit our Custody homepage on the Web at:

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