

Mizuho Custody Newsletter

July 2023 | Japan

Contents:

I. Market News

1. Election of directors at the AGMs held in June 2023
2. Shareholder proposals at the AGMs held in June 2023
3. The reviewing process for the quarterly disclosures
4. FSA starts discussions to review the TOB and large shareholding reporting system

II. New Equities Listing Approvals

III. Foreign Ownership Limit Ratio

I. Market News

1. Election of directors at the AGMs held in June 2023

Shareholders scrutinized proposals of the election of directors with extra care than before at many Annual General Meetings (AGM). At the AGMs in June held by companies with fiscal year ending March 31, approval rates of proposals for elections of directors turned out as low as 60 to 70% at more AGMs than ever. This is because more and more institutional investors started voting against companies with low capital efficiency and/or with delays in hiring women in their board members. These issues have been growing importance for electing top executives, and debates between companies and investors toward AGMs in 2024 are likely to be more heated up.

Companies with large number of cross-shareholding transactions have received many opposition votes on their top executive election. There has long been a criticism that cross-shareholding would lead to a deterioration in capital efficiency, and institutional investors have set voting standards such as "if cross-shareholding shares of a company account for 20% or

more of its net assets, vote against the election of the top executive."

The approval rate for the president of a leading construction company fell by about 20 percentage points to 65.96% from the previous year. At the end of March, 2023, the company's cross-held share amounts (including subsidiaries) turned out to be more than 40% of its net assets. Although it unwound the transaction volume by 17 issues from the previous quarter, but it is still a long way to go.

The low return on equity (ROE) was also a negative factor for shareholders. An electronic machinery company, which has posted a final loss for four consecutive quarters since the fiscal year ended March 2020, saw its president's approval rate to drop about 5 points to 71.45%.

Shareholders are more stringent on "corporate governance" than other issues. In particular, many institutional investors have tightened their voting standards in terms of diversity of the board of directors. At some companies, their CEOs lost the approval rate by around 20 points in comparison with the last year. On the other hand, a president of a leading chemical company, who hired a female director for the first time in its history, increased his approval rating about 16 points from the previous year to 93.74%.

External directors were reviewed in term of their independence and appropriateness of their tenure period. An external director of a construction machinery company, who also acts as a president of a private equity investment firm lost his support by 7 percentage points to 70.2%. This may be due to the fact that this machinery company's largest shareholder is the special purpose company in which the private investment firm has a 50% stake.

On the other hand, investors highly appreciated companies that have increased their corporate value, by improving management efficiency and/or enhancement of the governance. Among the TOPIX 100 (TSE Stock Price Index) constituents, 89.8% of the those whose fiscal year ended in March had approval

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ratings of 90% or higher for their proposal of election of directors, up more than 1 percentage point from the previous year. Both domestic and foreign investors are becoming more conscious of capital efficiency, corporate governance and shareholder returns than ever before, partly because of the Tokyo Stock Exchange's call for improvements in listed companies with low PBR (price-to-book value-ratios) at the end of March. In addition, if those companies could demonstrate measures to improve corporate value and convince the shareholders of their strategies, it could give them opportunities to attract investments on a long-term perspective.

Compiled from Nikkei Shimbun and Mizuho research.

2. Shareholder proposals at the AGMs held in June 2023

At the Annual General Meeting (AGM) held in June 2023, seven proposals from shareholders were approved at four companies. The total number of proposals submitted this time reached 344 which is the record high at 90 companies. Proposals related to governance, which increased in number this year, received considerable support from other shareholders. On the other hand, many shareholders viewed proposals on anti-takeover measures matters of less importance as it does not contribute to improve corporate value.

According to a research by a leading trust bank acting as shareholders registrar, the number of companies that received shareholder proposals at the June AGM exceeded 77 of the previous year, and the total number of proposals submitted also increased by 52, both are higher than the figures of last year. By type of shareholder proposals, 30 were related to appointment and dismissal of directors. Governance proposals came close to the main concerns of shareholders, as well as proposals seeking shareholder returns such as dividends and other surplus (33 proposals) and acquisition or cancellation of treasury stock (26 proposals).

Among the above of proposals approved, four of them led to the election and dismissal of directors at the three companies. At a leading company of marine civil engineering, seven out of nine candidates proposed by a shareholder who was an asset manager were selected. At a conveyor manufacturing

company, 3 of 8 proposals proposed by a Non-Japanese fund, including increase of a dividend rate for the fiscal year ending March 2023, were approved.

Some rejected proposals also received considerable support from other shareholders. Among the proposals related to governance, at a leading paper manufacturing company, proposals to change the articles of incorporation to make more than half of board members to be outside directors and to introduce a share-based compensation system collected 36% of supporting votes.

On the other hand, anti-takeover measures proposed by companies have been getting more difficult to obtain shareholders' support. An energy company adopted a "majority of minorities" (MOM) method to resolve its anti-takeover measure by excluding a large shareholder investment company. Although the measure was approved by 59.54% of voters, it would have been rejected if the excluded investment company had opposed. This might cause further friction in future.

Other anti-takeover measures proposals were also approved by a close margin. One of the leading stainless steel company's proposal was approved with less than 60% support. A leading air energy business company's approval rate, which was 68.67% in year 2021, continued to fall every year to 62.69% in 2022 and 57.24% this year (2023).

"Engagement between company and shareholders may escalate. Small- and mid-cap companies are more susceptible to radical proposals that involve transfer of control, such as appointment or dismissal of directors or spin-offs." said a researcher of an investment company. More than 70% of the companies that received proposals from institutional investors have PBR (Price-to-Book Value-Ratio) lower than 1.0. Companies that have been unable to present measures to improve their corporate value are likely to face more severe criticism.

Compiled from Nikkei Shimbun and Mizuho research.

3. The reviewing process for the quarterly disclosures

There are currently two types of quarterly disclosure requirements for listed companies in Japan. One is

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the quarterly securities reports required by the Financial Instruments and Exchange Act (“Shihanki-Houkokusho”), and the other is the quarterly earnings reports required by the Tokyo Stock Exchange rules (“Kessan-Tanshin”). With regard to these two disclosures, it has been pointed out heavy workload and inefficiency imposed on companies, due to overlapping of items to be disclosed and the disclosure timing being very close, but with some differences in the type and depth of information needed to be disclosed.

The Financial System Council’s Working Group on Corporate Disclosure (“DWG”), established by the Financial Services Agency, publicized its plan in June 2022 to integrate the quarterly securities report into the quarterly earnings report, “Kessan-Tanshin”. In December 2022, the DWG presented how it would realign each issue to make sure what shape the new disclosure report should take.

Reasons the DWG aims to integrate the two quarterly disclosure reports into “the quarterly earnings report” (Kessan-Tanshin) are, i) to maintain the timeliness of disclosure at earlier level, carried out under Kessan-Tanshin, and, ii) more investors have been looking at quarterly earnings reports (Kessan-Tanshin). It is understood that, the DWG plans to add items requested by investors such as segment information and cash flow information, which are not included in the quarterly earnings report but included in the quarterly securities report, to maintain the current level of timely disclosure of information.

Considering the current situation on disclosure by Japanese companies, the DWG proposed to make issuance of the quarterly earnings report mandatory for the time being, in order to avoid the market would take less frequency of the disclosure report as a sign of deterioration of company information disclosure practice in Japan market as a whole. Making quarterly earnings report voluntary, which has already in place in UK and France, will have to be studied from a broad perspective on an ongoing basis by further exploring how the market could develop opportunities or environments where they could provide useful information to investors, in addition to the reports.

A bill to partially amend the Financial Instruments and Exchange Act, etc. was submitted to the Diet on March 14, 2023 and approved by the House of

Representatives on June 8. The bill is still examined by the House of Councilors. The bill is supposed to be executed for the abolition of the quarterly securities report on April 1, 2024. Therefore, if this bill was enacted, issuers would have to establish practical operation procedures before the execution date. The DWG will further discuss on this subject, getting investors, listed companies, academic experts and market participants involved. The first meeting of the committee was held on June 29, and the policy on the practical operation is expected to be finalized this fall.

For details of the current situation of the reviewing process for the quarterly disclosures, please refer to the website of the Tokyo Stock Exchange from the following URL:

<https://www.jpx.co.jp/english/equities/improvements/quarterly-disclosure/index.html>

Compiled from Tokyo Stock Exchange, Nikkei Shimbun and Mizuho research.

4. FSA starts discussions to review the TOB and large shareholding reporting system

On June 5th 2023, the Financial Services Agency (“FSA”) held the first meeting of a working group (“Financial System Council”, the prime minister’s advisory body) to review the takeover bid (“TOB”) system and structure, which obligates investors to conduct transactions that would affect the targeted company’s control in the form of TOB. The working group also discusses about a review of the “large shareholding reporting system,” which require shareholders holding on or above a certain ratio of shares defined in the rule to disclose detailed status of their holdings. Implementation of a system to identify “substantial (beneficial) shareholders” who do not appear in the shareholder registry but being in a position to make decisions on voting is also now under consideration. The working group plans to take a year or so on this subject, taking revision of the Financial Instruments and Exchange Act into view.

To be in line with changing market environments, the government started on working to overhaul the system for the first time in 17 years and adopt a fair system that emphasizes transparency and effectiveness. At the meeting, the working group discussed matters to

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be prioritized.

Regarding the current TOB system, the government studies to make it mandatory to do any transactions that acquire more than 1/3 of voting rights even trades made at the exchange as TOB. There were cases in the past that a company's control had been transferred to a specific entity without disclosing the information that were considered to affect investment decisions of ordinary shareholders, which caused serious concern in terms of fairness for all shareholders. A member of the working group said, "From the viewpoint of the background of TOB system and to ensure investors to make rational investment decisions, we should seriously consider to apply this rule for transactions made at the exchange."

The working group will also discuss whether to radically change the "Japanese-style" regulations that impose TOBs on stock purchases that aim to acquire control of the company to the "European-style" regulations that require TOBs on the shares left over after the completion of the deal.

Some market participants pointed out that the large shareholdings reporting system has had issues in its effectiveness. "We need to think about a system that can spot malicious or problematic cases," said one member of the working group referring to the fact that around 1500 reports have been submitted after the deadline during a year on average. The report must be submitted to the Prime Minister within 5 business days from the occurrence of the share transaction, and copies of the report needs to be sent to the stock exchange and the issuing company.

In the cases of an institutional investor, etc., if its holding ratio of share certificates does not exceed 10% of the total number of issued shares, the report may be submitted within 5 business days from the record date on which the obligation arises (the "Special reporting system"). The Special reporting system is also in the scope of review. (※).

On the issue of substantial (beneficial) shareholders, a working group member stressed, "In Japan, unlike other countries, we need more and more resources than they do in other countries to identify substantial shareholders, due to the current complexity of the relevant rules. If this process would become clearer and more simplified, companies would be able to focus

more on dialogue with investors, which would improve quality of that dialogue as well."

(※) Please note that Mizuho Bank, Settlement and Clearing Services Department does not provide any specific supports on this Large shareholding reporting requirement, since it is up to investors to complete and submit the report. The details to be reported should be based on trade basis, which is out of the scope for custodian banks. Please contact your brokers or accounting firms in relation to this requirements.

For details of the current situation of the reviewing process of the TOB and large shareholding reporting system, please refer to the website of the Financial Services Agency from the following URL (in Japanese only):

https://www.fsa.go.jp/singi/singi_kinyu/tob_wg/shiryou/20230605.html

Compiled from Financial Services Agency, Nikkei Shimbun and Mizuho research.

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II. New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
Jul-12	Strawberry jams Co., Ltd.	JP3399810005	P
Jul-14	Kokyo, Inc.	JP3286360007	P
Aug-4	Nippon Souken Co., Ltd.	JP3726300001	P
Aug-9	JRC Co., Ltd.	JP3386910008	G
Aug-10	Futonmaki Jiro, Inc.	JP3825100005	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

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