

Mizuho Custody Newsletter

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Contents:

I. Market News

1. Financial System Council will study large shareholding reporting system and TOB system
2. Japanese companies obtaining SBT certification is growing
3. FSA will introduce new standards for its internal control report system
4. FSA decide to regulate all digital securities backed by real estate as financial instruments under the FIEA

II. New Equities Listing Approvals

III. Foreign Ownership Limit Ratio

I. Market News

1. Financial System Council will study large shareholding reporting system and TOB system

Financial Services Agency (“FSA”) reviews the large shareholding reporting requirements, which obligate disclosure to ordinary investors, reports Nikkei Shimbun, Japan’s leading financial daily. Exceptional measures for institutional investors will be revised to facilitate their dialogue with companies on issues such as climate change. FSA also seeks to confine “stealth acquisitions”, which use on-exchange trading to acquire large amounts of shares without intent of the buyer being known to public. FSA will revise the takeover bid (“TOB”) system to thoroughly protect investors.

The Financial System Council, an advisory body to the prime minister, held its general meeting on 2 March. The Minister of State for Financial Services, Shunichi Suzuki, presented the Financial System Council to study and review the large shareholding reporting system and the TOB system. The Council will also

consider revision of the Financial Instruments and Exchange Act (“FIEA”), which will be the first revision in 17 years since 2006.

The large shareholding reporting system requires shareholders holding more than 5% of the outstanding shares of a listed company to disclose information to ordinary investors. Among them, exceptional measures for institutional investors will be revised. Currently, there is a special provision that ease the frequency of submission of reports, on the condition that the institutional investor would make no important proposals, such as appointment or dismissal of directors.

In some cases, institutional investors shied away from making proposals to companies, for fear of such proposals as climate change measures to be recognized as important proposals, which would need them to take extra steps for disclosure. The review would clarify what constitutes an important proposal, with a view to encourage investors to have more dialogues with issuers.

The review would also clarify the scope of “joint holders”. If an institutional investor have a certain relationship with other investors, the shares held by them should also be aggregated at the time of filing their reports. In recent years, more and more institutional investors have been talking to companies about specific topics, such as decarbonization efforts. Some institutional investors are not willing to join the dialogue with issuers as they are concerned that it would violate the joint ownership rules.

They will also discuss measures to enhance the transparency of beneficial owners who make decisions on investment and voting. If an investor holds less than 5% of the shares, below the threshold of the submission of a large shareholding report, it would make difficult for issuers to identify its actual shareholders and to engage in dialogue with them.

In the U.S., there are rules that institutional investors disclose their substantial shareholders on a quarterly basis. In the UK, there are rules that institutional

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investors need to reply to companies if inquired about beneficial ownership. In Japan, there are no such rules.

TOB system, which requires buyers to disclose information in M&As will also be subject to the review. The FSA will consider expanding the scope of the rule requiring TOBs in cases where shareholding ratio would exceed 1/3 of the total amount issued, from the current "off-exchange trading only" to include "on-exchange trading". Under the FIEA, if a company intends to hold more than 1/3 of the shares after the acquisition via an off-exchange transaction, it must declare a tender offer, and it must disclose information about the purpose of the purchase.

Under on-exchange transactions that are not covered by the existing rules, hostile takeovers take place. A "stealth acquisition" in which a company is acquired without knowing the purpose of the purchase could also cause investors to miss right times to sell their holdings. A number of the Financial System Council members agreed with the review, mentioning that the protection of existing shareholders became an issue in the case of an acquisition of a certain amount of control by buying up shares under on-exchange transactions.

They will also address the issue of parent/subsidiary listings in pairs, which is unique in Japan, where both parent companies and subsidiaries are listed. This listings practice exists around 300 cases, in which the subsidiary tends to favor actions that prioritize interests of the parent company as the majority stakeholder. In the UK, an entity owning more than 30% of a company would be required to buy all the rest of the shares, which virtually rules out parent/subsidiary listings in pairs. In Japan, if an entity turned out to hold more than 2/3 of the outstanding shares of a company as the result of a TOB, the entity would have to launch a TOB for all types of shares of the company and purchase all the shares applied to the offer. The regulator will study mechanisms for investor protection, taking into account of the systems overseas.

FSA publishes materials that are used at the Financial System Council held on 2 March. To retrieve the details of this discussion material in Japanese, please visit the following URL:

https://www.fsa.go.jp/singi/singi_kinyu/soukai/siryou/20230302/1.pdf

Information compiled from Financial Services Agency, Nikkei Shimbun & Mizuho research

2. Japanese companies obtaining SBT certification is growing

A growing number of companies are obtaining certification from major international organizations for their target to reduce greenhouse gas emission. About 360 Japanese companies were certified in FY2022 (as of 1 February), which is 2.2 times of the number as of the end of FY2021, reports Nikkei Shimbun, Japan's leading financial daily. Companies are aiming at obtaining higher reputation from investors and business partners, backed by endorsement of international certification in the midst of decarbonization targets with various qualities being established. In overseas markets, some stock exchanges are launching investment indices made up of certified companies. Certification on decarbonization may help attract investors' money.

The certification comes from the Science Based Targets ("SBT") initiative, which was established in 2015 by the United Nations organizations. It verifies and certifies that a company's goals are based on scientific evidence in line with the Paris Agreement, an international framework for climate change. In addition to seeking consistency with a scenario that would limit global temperature rise up to 1.5 degrees celsius above pre-industrial levels, the initiative requires measures for "scope 3" emissions, including post-product distribution and business partners, and target calculations using state-of-the-art methods. It is considered as the mainstream in the certification of CO₂ reduction targets.

More and more Japanese companies have been applying for SBT certification in recent years. According to data provided by the Ministry of the Environment ("MOE"), 358 companies in total obtained certification in FY2022 (as of 1 February), 2.2 times the number as of FY2021 and 5.8 times the number as of FY2019, increasing by 50-70% from FY2019 to FY2021. By industry, electronics sector and construction sector are the main certification holders. Globally, more than 2,200 companies obtained certification most recently, up by 80% from the end of FY2021. UK tops the list with 360 companies, while Japan comes the second, followed by the United

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States (294) and Germany (129). "In addition to a strong emphasis on reputation, the encouragement of the MOE prompted many SMEs in Japan to acquire certification," said a senior ESG strategist at a major securities firm.

Companies obtain SBT certification to enhance their reputation among the stakeholders, including investors and business partners. A vice president at MSCI, an ESG rating agency, said, "We have seen a proliferation of 'arbitrary net-zero targets' with disparate standards and assumptions." Reliability and transparency of each company's standard are the issues to be looked at further.

Certification may actually lead to attract investors' money. CDP, an environmental NGO in the UK, has a section on SBT certification in evaluation questionnaire for companies, which is used by ESG rating agencies and institutional investors. Euronext, the largest European stock exchange, announced in January the launch of an investment index made up of companies certified by SBT to be aligned with the 1.5 degree target.

As markets put more emphasis on decarbonizing the entire supply chain, an appeal to its business partners is an important factor. More than a few companies have incorporated needs to encourage a part of their suppliers to set SBT-level targets into their target. More and more SMEs dealing with large companies have been applying to certification, and 216 SMEs obtained the certification which is on less stringent standard, accounting to 60% of the certified companies in Japan. However, SBT certification is still limited for listed companies. According to MSCI, about 50% of companies that constitute the main Japanese stock index, which are around 1,000, have greenhouse gas reduction targets, and only 10% of them are SBT-certified.

The vice president at MSCI said, "Pressure from investors to achieve targets will strengthen from now on. Companies with SBT certification will be recognized as more reliable in meeting their goals, as they disclose more about climate change than others do." The senior ESG strategist at a major securities firm said, "A phase where progress against reduction targets will be looked at more is coming soon." The issue is whether Japanese companies as a whole can improve the quality of their decarbonization goals and

the ability to take actions toward the goals.

MOE publishes various materials in Japanese in relation to SBT and make them available on their website. To retrieve the details, please visit the MOE website from the following URL:

https://www.env.go.jp/earth/ondanka/supply_chain/gvc/itr_trends.html.

Information compiled from Ministry of the Environment, Nikkei Shimbun & Mizuho research

3. FSA will introduce new standards for its internal control report system

From FY2024, the Financial Services Agency ("FSA") is going to introduce new standards for its "internal control report system", which requires listed companies to submit reports on its internal control, reports Nikkei Shimbun, Japan's leading financial daily. In addition to encouraging companies to include the businesses of their overseas subsidiaries, companies will also be required to include details of the circumstances and reasons when they are making corrections in the reports. The FSA intends to review and refine the reporting system, which has been becoming a mere shell during the past 15 years since its introduction.

The internal control report system was introduced in 2008 in the wake of window-dressing and misrepresentation of some listed companies. About 4,000 listed companies are required to file internal control reports. The Financial Instruments and Exchange Act requires them the evaluation and audit of internal control over financial reporting, and submission of internal control reports to the government annually.

The FSA will release a revised version of the internal control practice guidelines as early as this spring. Cabinet Office Ordinances relevant to this subject are also subject to the revision. The new standards will become effective from the fiscal year beginning from 1 April 2024, and companies will be required to file reports under the new standards as early as June 2025.

The new standards would urge company managements to properly pick out high-risk areas that might cause window dressing and misrepresentation, and to check overseas subsidiaries that have not been subject to the checking process for a long time.

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Problems found in an overseas subsidiary that has not been checked for more than 10 years as it has been exemplified for reporting due to its small sales amount, actually account for 20 to 30 percent of significant issues that should have been disclosed. There was a suspected case of fictitious trading in processed products at an overseas subsidiary of a seasoning manufacturer. The lack of organizational management structure of its subsidiaries was believed to have caused the problem.

In Europe, regulations have been tightened following accounting fraud cases at major companies. In the wake of the accounting scandal at a construction giant, the UK demanded board of directors of companies to report on effectiveness of internal controls and evidences of their investigation in May 2022. In Germany, listed companies have been required to establish internal control system in accordance with their risk status since July 2021, following accounting irregularities at an online payment company.

The FSA decided to review the existing internal control system in line with other countries, because internal control reports submitted from companies had lost substance during the past 15 years and many of the reports now appear to be just for the sake of formality. The internal control framework of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in the U.S., which Japan used as a model for its system, was revised to incorporate risk management into corporate governance due to advances in information technology (IT), but this was not reflected onto the Japanese standards.

The review will also require more accountability for companies that had problems with internal controls. Companies that had reported once that their internal controls worked properly and corrected them afterwards will be required to describe the circumstances and reasons for the correction as to why defects were not discovered in the first place in their correction reports, aiming to present specific details that led to the correction to investors. This also aims to cope with criticism that many companies are taking actions only for formalities sake.

If a company had reported internal control problems that might have a significant impact on its operations in the past, the company must state how these have been corrected in the report. It has not been required to

disclose such issues, despite it may influence investors' decision-making.

The FSA recently published the "Revised Standards for the Evaluation and Audit of Internal Control over Financial Reporting and Standards of Practice for the Evaluation and Audit of Internal Control over Financial Reporting (exposure draft)", which was subject to public consultation. To retrieve the details of this exposure draft, please visit the following URL: <https://www.fsa.go.jp/news/r4/sonota/20221215/1.pdf>

Information compiled from Financial Services Agency, Nikkei Shimbun & Mizuho research

4. FSA decide to regulate all digital securities backed by real estate as financial instruments under the FIEA

Financial Services Agency ("FSA") has decided to regulate all digital securities backed by real estate as financial instruments under the Financial Instruments and Exchange Act ("FIEA"), just like stocks, bonds and investment trusts, reports Nikkei Shimbun, Japan's leading financial daily. The FSA and the Ministry of Land, Infrastructure, Transport and Tourism ("MLIT") were both in charge, and there were some ambiguities about the rules for selling these instruments to investors. They will introduce regulations to sell or solicit investors and allow to take administrative actions to dealers if they violate the regulations.

Digital securities, also known as security tokens, are issued electronically using technologies such as blockchain. The aggregated value of digital securities issued worldwide is USD16.2 billion, according to Security Token Market in the U.S.

Digital securities will allow its issuers to raise small amounts quickly, and allow investors to invest in smaller amounts. The underlying assets are not limited to real estate, but in Japan, where the market for digital securities has just been launched, those backed by real estate have been issued one after another, whose cash flows are more visible than other instruments, and the amount issued in public offerings exceeded JPY 20 billion.

Digital securities backed by real estate are regulated by two laws. In Japan, the revised FIEA, which came into effect in April 2020 and the Act on Specified Joint

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Real Estate Ventures (“AREV”), govern issuance of digital securities independently to each other. The FIEA is under the control of the FSA, whereas the AREV is under the control of the MLIT.

In the past, a leading company providing real estate information online, has test-issued digital securities in accordance with the AREV. Some experts in the financial industry had pointed out that AREV’s requirements for the system review and the internal control system of the dealers are less strict than those under the FIEA.

The FSA will amend the FIEA to allow solicitation rules for digital securities issued under the "Specified Joint Real Estate Venture Contract" that distributes profits to equity investors in the sales and lease of real estates. Specifically, the FSA will require dealers to register as financial instruments service provider to sell products according to their customers' knowledge and experience. Improper solicitation by registered provider could be penalized by business improvement or business suspension order.

The FSA and the MLIT, which has jurisdiction over AREV, have been in talks since 2021 and are ready to revise the FIEA. After the FIEA is revised, it will be used in conjunction with the existing regulation of AREV. This will soon be approved at the cabinet.

Digital securities make differences from exchange-traded REIT in that investors can buy individual properties and continue to hold them. Digital securities have been attracting investors’ attention because they can be invested as if they are investing in real estates, and because some products offer yields of over 3%. A real estate service provider which focuses on issuing real estate-backed digital securities expects the market to grow to JPY 2.5 trillion by 2030.

Some parties have already started to develop a secondary market for digital securities. Osaka Digital Exchange (“ODX”), an operator of a private trading system, is aiming to start handling digital securities by November 2023. ODX aims to become an operator of the nation's first security token exchange market. The details of the company information of ODX is available at the following URL:
<https://www.odx.co.jp/en/company/about/>.

Please note that discussions on the execution in the

secondary market are based on the current legal framework in Japan, which may need further preparation and analysis on issues, such as compatibility with the Act on Book-Entry Transfer of Corporate Bonds and Shares.

Information compiled from Nikkei Shimbun, Osaka Digital Exchange & Mizuho research

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New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
Mar-28	Axis Consulting	JP3108230008	G
Mar-28	Monstarlab Holdings	JP3928200009	G
Mar-28	Arent	JP3126570005	G
Mar-29	SBI Sumishin Net Bank	JP3400650002	ST
Mar-29	AnyMind Group	JP3164770004	G
Mar-30	Bizmates	JP3800440004	G
Mar-30	NOVA SYSTEM	JP3762020000	ST
Mar-31	Cocorport	JP3297310009	G
Mar-31	Fusic	JP3826050001	G / F
Mar-31	Sun Feste	JP3336870005	P
Mar-31	Ecology and Combustion	JP3161340009	N
Apr-3	NIPPON KANZAI Holdings	JP3695010003	PR
Apr-3	BBD Initiative	JP3799820000	G
Apr-4	Transaction Media Networks	JP3635690005	G
Apr-12	ispace	JP3102360009	G
Apr-12	Trial Holdings	JP3635490000	G
Apr-14	JAPAN SYSTEMBANK	JP3712750003	N
Apr-18	JENOBA	JP3386860005	G
Apr-19	Excite Holdings	JP3161350008	ST
Apr-20	NANKAI CHEMICAL	JP3652150008	ST
Apr-21	Rakuten Bank	JP3967220009	PR
Apr-25	RHEOS CAPITAL WORKS	JP3979330002	G
Apr-26	STADIUM	JP3399360001	G
Apr-26	Ridge-i	JP3974490009	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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