Mizuho Custody Newsletter

October 2021 | Japan

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I. Market News

1. Customary review may urge institutional investors to vote more electronically

Digitalization of shareholder meetings has been progressing rapidly. Existing practices of the industries will be reviewed from October, making it easier for institutional investors such as asset managers to exercise their voting rights via internet, reports Nikkei Shimbun, Japan's leading financial daily. The digitalization is expected to improve efficiency in counting votes if many institutional investors begin to use electronic voting. The number of online shareholders meetings without actual venue is expected to rise, and digitalization, which lags behind other countries, will gain momentum.

There are two ways for shareholders to exercise their voting rights at a shareholders meeting; (1) by attending the meeting to exercise their votes at the venue, or (2) by mail or via internet in advance. The revision of the Commercial Code (the current Companies Act) in 2002 has allowed shareholders to exercise voting rights online in advance, but the online voting has not been a "common practice" yet even after about 20 years from the implementation. According to the Ministry of Economy, Trade and Industry, the ratio of electronic voting of asset management companies in the U.S. and Europe is 70-90%, but in Japan, it stood at around 17% in 2017.

One of the reasons for the slow progress of electronic voting is the requirement of "individual consent" from asset owners ("AOs"), which is imposed on institutional investors.

In many cases, AOs, such as pension funds, have contracts with institutional investors, such as asset management companies, to which AOs entrust investment. These contracts usually delegate the institutional investors to make decisions on proxy voting.

On the other hand, AOs entrust the custody of their equity assets to trust banks appointed as a trustee. The trust banks actually exercise the voting rights. Under the existing framework, the asset managers instruct the trust bank on whether to vote for or against the proposals, and the trust banks exercise the voting rights at the shareholders meetings on behalf of AOs.

In electronic voting, institutional investors can exercise their voting rights directly through the internet, without through the trust banks. In the past, the Trust Companies Association in Japan ("TCA") formed by the trust banks, called on institutional investors to obtain individual consent from all AOs if the asset managers vote via electronic voting platforms. This is because direct voting via electronic platform has not been defined in the conventional procedures. In addition to that, keeping a strict watch on asset management and that some AOs may not want to use electronic voting are the reasons.

But there are dozens to hundreds of AOs from which asset managers are entrusted with assets. Obtaining individual consent from all the AOs are cumbersome, and consequently, only a few asset management companies have actually introduced electronic voting.

The Corporate Governance Code ("Code") introduced in 2014, called for taking steps to organize rules and infrastructures for electronic voting, and the new Code revised in this June specified that companies to be listed on the Prime market, which will be the most prestigious market in the new market segment to be implemented in April 2022, should make the electronic voting platform available, at least to institutional investors.

Amid growing momentum for the digitalization of shareholders meetings, which are lagging behind those in other countries, TCA decided not to ask for individual consent from AOs any longer from October this year. Asset managers will be able to vote electronically without obtaining individual consent from AOs, if companies holding the shareholders meetings use the system provided by ICJ, Inc. ("ICJ"), which TSE has its stake.

According to TSE, 60.3% of the companies listed in the 1st Section used the ICJ system for the AGMs held in June this year, and over 80% of the companies with market capitalization of JPY 100 billion or more use the system. As companies are getting prepared for the electronic voting framework, the use of electronic voting platform may spread rapidly by abolishing the requirement on "individual consent".

Electronic voting will help making shareholders meeting process more efficient, such as by reducing the time required to count votes and preventing counting errors.

It is also expected to give more time to investors to review the meeting agendas. Convocation notices containing shareholders meeting proposals and business reports are currently sent out no later than 2 weeks before the shareholders meeting, but given the time to instruct the trust bank and mail the paper ballots, investors may have only 3-4 business days to review the proposals.

Major asset managers need to review and analyze proposals of more than 1,000 companies in June, the peak season for AGMs. If they can vote electronically, they can have about 10 days for consideration. Having enough time for analyzing the agenda and for making voting decision would help forging a relationship in which they can communicate with the companies in candid manner on shareholders meetings.

However, asset managers who are investing in index funds point out that more companies to join the ICJ system, the electronic voting platform in Japan. The coexistence of two forms of voting methods, paper and electronic, could cause some mistakes. In case of TOPIX, some market participants say that unless all the companies listed on the TSE 1st Section participate in the electronic voting platform, it would be difficult to move to the electronic voting framework.

The revised Act on Strengthening Industrial Competitiveness, which took effect in this June, allows shareholders to hold meetings online without a physical venue. Some companies changed their articles of incorporation at their AGM in June so that they can go online from next time. In August, the country's first full-online shareholders meeting took place. The digitalization of pre-voting, which accounts for the majority of the voting rights exercised, is essential to make most of online meetings, and this review of industry practice is expected to encourage the digitalization of shareholders meetings as a whole.

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

2. G7 establishes Public Policy Principles for Retail CBDCs, and BOJ progresses experiment

The Group of Seven ("G7"), including Japan, U.S. and the European nations, held "Finance Ministers and Central Bank Governors' Meeting" ("Meeting") on 13th of October and established the "Public Policy Principles for Retail Central Bank Digital Currencies ("CBDCs")" ("Principles"). It has comprehensively sorted out 13 topics, including the impact to financial system and measures against money laundering. It has stressed the importance of accountability and transparency by the digital currency issuing central bank in protecting users in order to stabilize the international monetary order, reports Nikkei Shimbun, Japan's leading financial daily.

In addition to basic issues such as ensuring the stability of financial system and complying with the rule of law, the Principles also include opportunities CBDCs could bring, such as promoting financial inclusion and digitalization. The Principles are positioned as the

guidelines for considering and developing CBDCs inside and outside of G7.

The “Statement on CBDCs and Digital Payments” specified that CBDCs must operate in a transparent and competitive environment. It includes strict privacy standards and importance of accountability to gain trust from the users. It also pointed out that any CBDCs must support the central banks’ ability to meet the mandate for monetary and financial stability.

At a press conference after the Meeting, Haruhiko Kuroda, the Governor of Bank of Japan (“BOJ”), mentioned about the significance of the Principles that it would contribute to the stability of the financial system and the efficiency of settlement and remittances. BOJ has no specific plan to issue CBDCs at the moment, but has started experiments from this spring. They are examining technical issues if CBDCs are to be issued.

At the end of September, seven major central banks, including BOJ, along with Bank for International Settlements (BIS), released a series of reports that summarize the issues and topics regarding the issuance of CBDCs. They mention that CBDCs should be carefully designed and implemented. In the future, cooperation and collaboration with other countries, including emerging countries that are progressing research on CBDCs, will also be an issue.

The G7 evaluate that the CBDCs can complement cash and function as settlement system. A number of emerging countries are issuing CBDCs, and digital settlement systems such as DeFi (decentralized finance) are now being developed rapidly in private sectors. Although there are still many issues to be addressed, such as how to ensure stability of the financial system, there have been demands from public for improved convenience of settlement, and discussions are underway for the issuance in each country.

No country in the G7 has decided to issue CBDCs, and there is a difference in the level of development. While BOJ is accelerating its experiment, Haruhiko Kuroda, the Governor of BOJ, said it would be up to the public whether to issue CBDCs. Some members of the U.S. Federal Reserve Board (FRB) have been cautious and releasing the report on CBDCs has been delayed, which was originally scheduled for September.

BOJ assumes to conduct a three-phase experiment. In the first phase, in which the proof of concept (“PoC”) began this spring, they created an experimental environment on a computer system and examined whether basic settlement functions work properly, such as the remittance and distribution of money in electronic form. BOJ is also examining the processing capability of settlement, and according to BOJ, the task is progressing as planned.

BOJ plans to move the PoC of the digital currency to the second phase in April next year. Based on the result of the first phase, they will mainly examine how the digital currency and cash can be exchanged to each other and how governments’ system can be linked to settlement systems in private sector. Closely watching the movements of the central banks in the Western countries and China that are accelerating the introduction of the digital Renminbi, BOJ will be sorting out the technical issues and topics in issuing CBDCs.

In the second phase, BOJ plans to conduct practical checking of setting limits on the amount CBDC per holder and calculating and paying interests, and also plans to study further to enhance convenience such as opening multiple accounts for one entity and doing settlements offline. It would also take into consideration connection to an experimental wallet app to test technical issues. It is not certain at this point how long it would take to complete the second phase.

In the third phase, following the PoC conducted in the second phase, BOJ will consider conducting a pilot-scale testing where companies in the private sector and consumers participate if necessary.

Shinichi Uchida, the Executive Director of BOJ, made an opening remarks at the “Second Meeting of the Liaison and Coordination Committee on CBDCs” held on 15th of October consisting of the members from the government and the private sector, and pointed out that CBDC was becoming one realistic option in many jurisdictions. BOJ has no specific plan to issue CBDCs at the moment, but he mentioned “Not issuing CBDC is also a big decision” and appealed the necessity to consider establishing a settlement system suitable for a digitalized society.

Information compiled from Bank of Japan, Nikkei Shimbun & Mizuho

research

3. TCFD recommends disclosure on companies' plans to transition to a net zero economy

A framework to call for disclosure of concrete steps to reduce greenhouse gases will begin shortly. On 14 October, Task Force on Climate Related Financial Disclosures ("TCFD") announced a new recommendation to call for disclosure on companies' plans to transition to a net zero economy. In addition to the call for disclosure on targeted reduction level and financial risks from the past, it suggests to present companies' specific measures to realize such as technological development. If validity of the plans would be properly evaluated, this framework would be a new standard for investors to select companies as their investment objects, reports Nikkei Shimbun, Japan's leading financial daily.

For example, companies are suggested to present their concrete plans for research and development of technologies and reinforcement of personnel that will lead to reduction in emissions, and withdrawal from or reduction of businesses with high emissions. Examples for automobile manufacturers would be to "increase the shares of producing electric vehicles (EVs) by 40 percent by 2030," or "switch all the power to be used at a company to renewable energy in 10 years from now."

The international community is discussing to institute common rules based on the TCFD concept, and Japanese companies will also be strictly checked by investors for their measures against global warming.

TCFD was established in 2015 by the Financial Stability Board (FSB), which consists of financial regulatory authorities of major countries. In 2017, they made a recommendation calling for companies to adopt disclosure for climate change risk, and as of September this year, 504 companies and organizations in Japan supported the recommendation, which is the largest number in the world.

The Corporate Governance Code revised in this June stipulates that companies listed on the Prime market under the new market segment to be launched in April 2022 should "enhance the quality and quantity of disclosure based on the TCFD recommendations, which are an internationally well-established disclosure framework, or an equivalent framework."

Following the restructuring of the market by Tokyo Stock Exchange (TSE) in April 2022, listed companies in the Prime market, the most prestigious market at TSE, will be required to follow the disclosure recommendations of the TCFD. For example, companies with their fiscal year end in March need to disclose in their corporate governance report that will be submitted after their AGM in June 2022. The Financial Services Agency of Japan began to discuss internally whether to expand the scope of the TCFD recommendations from 2023 or after to all companies that issue securities report.

TCFD recommends four topics as items for disclosure: (i) governance, (ii) strategy, (iii) risk management, and (iv) indicators and goals. More specifically, it includes the structure of the board to deal with climate changes and financial impacts of rising temperatures and tighter regulations. A plan to reduce greenhouse gas emissions is added to the new recommendation this time.

However, TCFD did not provide any templates on how the impacts on corporate finances should be presented. The recommendation does not have any compelling power, and it is up to the companies what they would disclose and how.

The institution of universal rules on disclosures will also begin shortly. The IFRS Foundation, which develops international accounting standards, plans to compile a draft of disclosure standards on climate changes by June 2022.

The recommendation will be analyzed and discussed at a council to be newly established at the end of October, which will likely end up with being in line with the TCFD recommendations. Depending on specific disclosure items, such as numerical indicators, there may be a major impact on corporate activities.

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

4. TSE discusses to extend stocks' trading hours for 30 minutes

Tokyo Stock Exchange ("TSE") has made a report

about the extension of trading hours for actual stocks by 30 minutes to 3:30 pm, reports Nikkei Shimbun, Japan's leading financial daily. TSE plans to extend the trading hours in autumn 2024 at the earliest, after discussion with the Financial Services Agency of Japan ("FSA") and the industry groups on some practical issues. If the trading hours are extended, it will be the first time in 70 years.

On 15 October, TSE held a "Working Group for Strengthening the Functions of the Cash Equity Market" ("Working Group") with securities firms and institutional investors and shared the report there. There were no objections for the extension of the trading hours by 30 minutes. Currently, trading hours are 5 hours from 9 am to 3 pm (lunch break from 11:30 am to 0:30 pm), but if extended, it will end at 3:30 pm. TSE intends to release the report at the end of October.

It will be the first time in 70 years since trading hours were extended in 1954, when the closing time was extended from 2 pm to 3 pm. This time, the plan is to extend the closing time by 30 minutes from 3 pm to 3:30 pm.

TSE intends to extend the trading hours along with the renewal of TSE's trading system, the Arrowhead, scheduled in autumn 2024 or after. TSE will make a final decision at the end of October, after discussion in the TSE's market management committee, an advisory body to the board of directors, based on the report prepared by the Working Group on 15 October.

The extension will require an amendment to the regulation and an authorization from the FSA. In addition to providing explanations to market participants, they will coordinate the practical aspects with relevant industries and the FSA.

The longer the trading hours, the more trading opportunities for investors on the TSE. It makes easier for investors to reflect events taking place in the Asian markets, and to help keep those trades in TSE, which currently flow out to overseas markets or to proprietary trading system (PTS) which has long trading hours.

The TSE's large-scale computer system failure in October 2020 triggered the debate on the extension. Having scrutinized the cause of all stock transactions suspended throughout the day, TSE has been trying to secure as much trading hours as possible. Under the current TSE's system, it takes about three hours for it to resume, even if a malfunction is fixed. Considering the need to receive orders in advance, it is impossible to resume trading on the same day unless the system is restored in the morning.

FSA executive said, "Extending by 30 minutes is meaningful" in securing time for restoration in the event of system malfunction. TSE attempted to extend trading hours 3 times, in 2000, in 2010 and in 2014, but failed to do so due to opposition from major securities firms concerned about increase in their workload.

Financial product dealers and securities firms will bear a burden in their operations. For example, net asset value of an investment trust fund is calculated after closing price of all issues held by the fund are fixed.

TSE has made every effort for the extension of trading hours to be accepted, for example by excluding options that securities firms are particularly reluctant to cope with, such as introduction of night time trading and the abolition of lunch breaks.

Even if the trading hours are extended by 30 minutes, Japan still lags behind major exchanges in other countries. New York, Singapore, and London each have six and a half hours, seven hours and eight and a half hours, respectively.

In order to enhance the attractiveness of the market towards a global financial city, which attract human resources and investments from overseas, it is necessary not only to extend trading hours but also to take measures in various aspects. A person in charge at a domestic asset management company said, "Revitalization of a financial market depends on whether there are strong investment destinations in the market."

According to the "International Financial Center Index" released by a British research firm in this March, Japan fell three places to seventh place from its previous ranking six months ago.

In 2020, about 160 foreign banks are licensed to do banking business in Hong Kong and about 140 in Singapore, while only about 60 in Tokyo. There are many challenges in attracting talent and investors from overseas, such as shortage of English-speaking staffs

in the financial industry, relatively high corporate tax rate, etc.

The response time of trade orders is also one of the mid- and long-term issues to be considered. Although TSE updated the Arrowhead in 2019 and shortened the order response time to 0.2 milliseconds, it still takes longer than other exchanges such as the New York Stock Exchange (NYSE), which had the fastest time of 0.03 milliseconds in 2019. It will be important to discuss to what extent the high-frequency traders (HFT) should be taken in, that account for many of trades in the market.

It is also halfway to raise corporate value by nurturing startups that could be potential investment targets. It has been pointed out that the number of unicorns, which are unlisted companies having corporate value of USD 1 billion or more, is small in Japan.

According to an international accounting firm, investment in startups from April to June this year was USD 157.1 billion globally, up 2.2 times on a year-over-year basis. In Japan, investment was USD 800 million, about 1% of that in the U.S.

Hong Kong has proposed lifting the ban on special purpose acquisition company (SPAC) and is trying to win over unlisted leading companies. There are concerns from an investor protection perspective about listing companies like "empty boxes", which do not conduct substantial business. In Japan, discussions have just begun.

TSE will restructure the markets in April 2022 and will impose higher requirements. For example, companies that are listed on the most prestigious Prime market will have to enhance quality of information disclosure on their ESG (environmental, social and corporate governance). Market reform will become effective when the two sides of the playing field, namely the rules of the exchange as a hardware and the companies to be invested in as a software, work properly.

Information compiled from Nikkei Shimbun & Mizuho research

5. JPY LIBOR to be switched to an alternative indicator by the end of this year

It is now less than three months to the publication of JPY LIBOR will be ceased. Financial institutions are moving quickly to switch to an alternative base rate, but about 30% of transactions still remain being JPY LIBOR based, according to Nikkei Shimbun, Japan's leading financial daily.

LIBOR has been used worldwide as the base rate to set interests on corporate loans and bonds. It has been decided to cease the publication of JPY LIBOR at the end of December 2021, following the revelation of intentional manipulation of LIBOR by one of the major foreign financial institutions in 2012.

As a result, financial transactions (including derivatives) worth of about JPY 2,600 trillion (as of the end of 2020) based on JPY LIBOR needs to be switched to an alternative base rate. The alternative would be: (1) the Tokyo Interbank Offered Rate (TIBOR), which is determined on suggested rates by the major banks in Japan; (2) the compound rate of Tokyo OverNight Average rate ("TONA"); and (3) the Tokyo Term Risk Free Rate ("TORF"), which is calculated on the market transactions based on TONA.

According to a survey conducted by the "Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks" which the Bank of Japan ("BOJ") acts as the administrative office, the TORF, which the rate is determined in advance as in the way as the JPY LIBOR, was the most popular option. It began to be published from this April, and Quick Benchmarks Inc. that publishes TORF obtained approval from the Prime Minister in this October on the operational rules, code of conduct, etc., based on Financial Instruments and Exchange Act, for the purpose of ensuring transparency in calculating the indicator. TONA, the rate based on overnight uncollateralized call rate, has been assessed as being "less convenient than other indicators", due to the fact that the rate is determined just before the payment date (deferred rate setting), in spite of its high reliability.

For interest rate swaps, which are used to hedge risks of interest rate fluctuations and has the largest amount of transactions based on JPY LIBOR, the amount of transactions using TONA surpassed the amount of transactions using JPY LIBOR in this August. In September, TONA based transactions amounted to JPY 44 trillion, which was more than 5 times the amount in June, and double the amount compared to JPY LIBOR. However, JPY LIBOR based

transactions still remain a little less than 30% of the total.

According to the International Swap Derivatives Association (ISDA), the use of TONA accounted for 54% of JPY transactions as of September. Although it is less than 65% marked for sterling pound (STG), it exceeds the shares of the Swiss Franc (CHF) which was higher in this spring. Considering that Japan's share was 7% as of June, the transition seems to have been progressing rapidly.

BOJ stopped accepting JPY LIBOR based transactions as a collateral for supplying funds to financial institutions in late September. Together with the Financial Services Agency, BOJ had asked to cease new JPY LIBOR based interest rate swaps transactions that mature after the end of 2021 by the end of September. Loans and bond issues, which have been asked to cease new transactions based on JPY LIBOR by June end, are now actively using the alternative base rate.

Some leading local banks have been dealing with the issue by forming a special task force since discussions on ceasing the publication of JPY LIBOR started, and they view that around 90% of the loan agreement has been amended or will be amended very soon.

For the transactions with corporations, detailed explanations are required from the viewpoint of user protection, and the banks will have to continue the communication until the last minute.

Person in charge of financing at a trading company that uses TONA as an alternative for JPY LIBOR said, "Although TORF is more convenient than TONA, TORF based transactions are still less liquid than those of TONA. I hope the use of TORF would expand in the interbank market." Many companies now use TONA as a temporary measure, but some may switch to TORF if its usage would expand.

Information compiled from Nikkei Shimbun, Quick Benchmarks, Reuters & Mizuho research

II. New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
Nov-05	Photosynth	JP3803090004	M
Nov-09	NITCHO	JP3729300008	T
Nov-18	GRCS	JP3386790004	M
Nov-19	AB&Company	JP3160630004	M
Nov-24	Last One Mile	JP3967550009	M
Nov-24	Science Arts	JP3310370006	M
Nov-25	Slogan	JP3411600004	M
Nov-30	baudroie	JP3855450007	M

**Information compiled based on postings from the TSE (T), Mothers (M), NSE (N)、FSE (F), SSE (S) & JASDAQ (J), Tokyo Pro Market (P)*

***Board lot size is unified to 100*

III. Foreign Ownership Limit Ratio

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