

Overview of Revision Proposals for the Financial Instruments and Exchange Act and Act on Investment Trusts and Investment Corporations

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金融庁

Financial Services Agency, the Japanese Government

Overview of Revision Proposals for the Financial Instruments and Exchange Act and Act on Investment Trusts and Investment Corporations

Develop a new system for asset management (AM) business, large shareholding reports and tender offers to revitalize the Japanese capital market by enhancing the capability and diversification of AM business and promoting dialogue between investors and companies and ensuring transparency and fairness in the market

Enhance the capability and diversification of AM business

Implement the following measures to improve corporate value and returns to investors, including households, and revitalize startups by enhancing the capability and diversification of asset management by assisting new entrants.

Promoting new entrants

- Introduce a voluntary registration system for middle and back-office operations, and deregulate the requirement on the personnel structure of an AM company if entrusting the business to a registered entity.
- As in Europe and the US, where the division of AM businesses is advancing, AM companies will specialize in fund management functions (planning) and will be able to fully entrust their asset management (investment instruction/execution) authority to various AM companies.

Vitalizing Circulation of Unlisted Securities

- Take the following measures in order to promote new entrants into the brokerage business of unlisted securities issued by startups and vitalize the circulation.
 - Deregulate the requirements for Type I Financial Instruments Business only dealing with unlisted securities for professional investors basically without receiving deposits.
 - Allow registered Type I Financial Instruments Business Operators to operate a PTS* for unlisted securities without authorization if the transaction volume is limited.

* PTS (Proprietary Trading System) is a trading system that uses electronic technology to provide transaction intermediation services.

Promote constructive dialogue between investors and companies

To promote constructive dialogue from a mid- to long-term perspective, the following policies are to be implemented

Clarifying the Large Shareholding Reporting Rule

Large Shareholding Reporting Rule: Ex post facto disclosure of shareholdings when the shareholder holds more than 5% of shares

- **Clarify the scope of “joint holders”** subject to aggregation of the ownership ratio (in cases of acts of proposal not directly related to corporate control without a continuous agreement, the application is to be excluded)

Ensure transparency and fairness in the capital market

To ensure transparency and fairness in the capital market, the following policies are to be implemented

Enlarging the scope of the tender offer rule

Tender Offer Rule: To require disclosure of the purpose and terms of purchase in advance and give all shareholders an equal opportunity to sell their shares regarding a purchase of listed shares exceeding a certain ratio

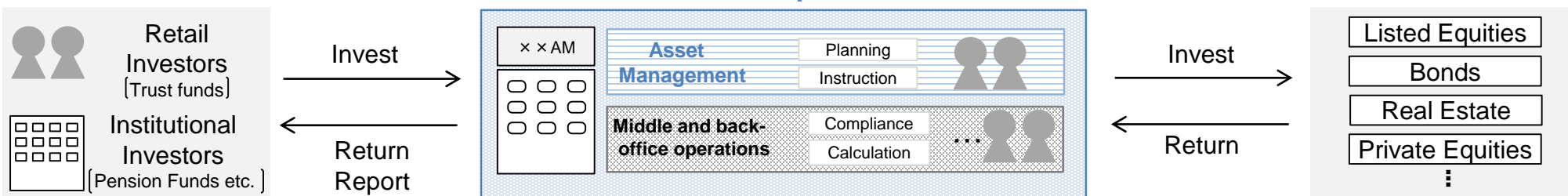
- Make transactions through **a market trade (on-floor transaction) subject to the application of the tender offer rule**
- **Lower the threshold for a tender offer to be implemented from “1/3” to “30%” of the voting rights**

Current Situation of and Issues Involved in Asset Management (AM) Businesses

- AM companies manage clients' funds by investing equities and bonds. They manage trust funds or funds from pension funds through discretionary contracts.
- Japanese AM business, there are fewer new entrants with various ideas, and AUM per GDP, and the number of companies are less compared to other countries.

⇒ The government should promote improvement of the capability of AM companies by enhancing the human resources and competition of those companies to achieve economic growth and increase the national income from assets.

Overview of AM business



AUM and the number of AM companies by country/region [end of 2021]

	Japan 🇯🇵	US 🇺🇸	UK 🇬🇧	France 🇫🇷	Singapore 🇸🇬	Hong Kong 🇭🇰
AUM ^(*1) (trillion dollars)	7.2	50.0	13.5	5.7	4.0	4.6
(per GDP)	(1.4x)	(2.1x)	(4.3x)	(1.9x)	(9.4x)	(12.5x)
The number of AM companies ^(*2)	405	14,806	1,100	708	1,108	1,979

(Ref) JFSA, SFC of Hong Kong, MAS, IAA, EFAMA, IMF

(*1) Total of trust funds and discretionary investment contracts with the FX rate at the end of 2021

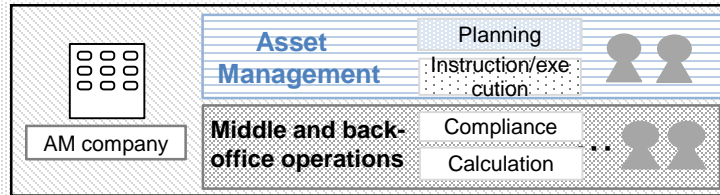
(*2) For Japan, except investment management business for qualified investors, specially-permitted business for qualified institutional investors and specially permitted services for foreign investors. For Hong Kong, Type 9 Asset Management Business. For Singapore, registered/licensed fund managers. For France, registered entities. For UK, it's estimation by EFAMA

Promoting New Entries of AM Companies

Issues and policy measures

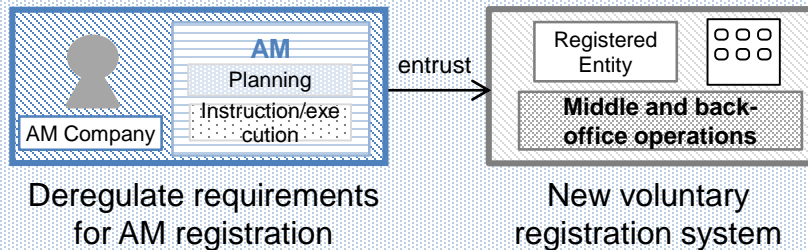
- For AM registration, it is hard for new entrants to hire a professional in the middle and back-office in addition to a fund manager.

Issues



Develop the system for entrusting the middle and back-office

Policy



Deregulate the requirements for AM registration by introducing a registration system for the middle and back-office operations

- Introduce a voluntary registration system for middle and back-office operations, such as compliance and calculation entrusted from AM companies. A registered entity has to follow conduct control and the FSA monitors registered entities.
- For an AM company that entrusts those operations to a registered entity, requirements on personnel structure will be deregulated.
- Requirements on capital will be mitigated when an AM company does not take deposits (e.g., from 50 million yen to 10 million yen as stipulated in a Cabinet Order) Also, the application form will be changed on this matter.

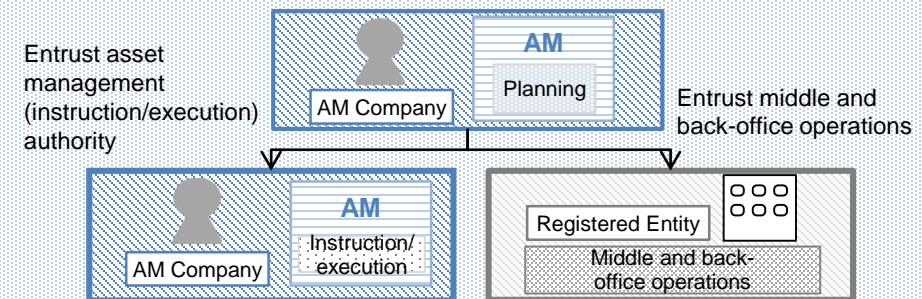
Law revision

- In Europe and the US, where the division of AM business is advancing, it is common to specialize in the fund management function and fully entrust the asset management (investment instruction/execution) authority to another licensed company

Current regulation

Prohibiting AM business from fully entrusting the asset management (instruction/execution) authority to another AM company

Allowing the AM companies to specialize in the fund management function



Allow to fully entrust the asset management (instruction/execution) authority to another AM company

- Abolish the regulation prohibiting an AM business from fully entrusting the asset management (instruction/execution) authority to another AM company, allowing the entrustor to specialize in the fund management function.
- When the asset management (instruction/execution) authority is entrusted, the entrustor (specializing in fund management function) is required to decide on the object and policy of investment and monitor the entrusted party.

Current Status and Issues Related to Unlisted Stocks

- ❑ Since there is no trading venue for unlisted stocks, the liquidity needs of holders and the investment needs of investors cannot be met.

Note: There are trading platforms for unlisted stocks in the U.S. Vitalizing transactions on such platforms will contribute to facilitating financing for startups.

- ❑ Japanese startups are often listed with small market caps (small-lot listing). These startups are not invested in or subject to stewardship activities by institutional investors, which can be one of the reasons for sluggish growth after listing.

Circulation of Unlisted Stocks

Market Cap at IPO in 2022***

Japan

As below, though the holdings of unlisted stocks are increasing, as there is no matching venue between holders and investors like a trading platform, it is difficult for holders to cash unlisted stocks and to provide investors with investment opportunities without IPOs.

- Use of unlisted shares, including stock options, to provide incentives to executives and employees of startups.
- Expansion of Venture Capital (VC) investment in startups.*

Year 2013 53.4 ▶ 2018 181.9 ▶ 2023 303.9

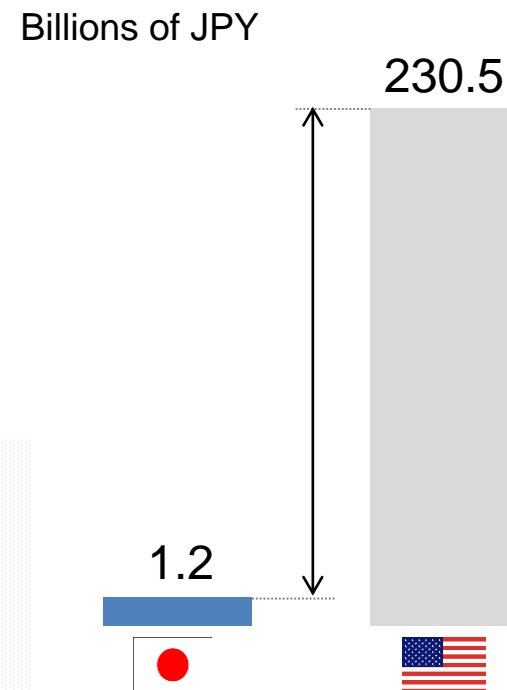
Billions of JPY

U.S.

There are trading platforms for professional investors to trade unlisted stocks on the Internet.

Examples of a trading platform for unlisted stocks**

- Forge Global (Established in 2014) Cumulative trading size: \$12 billion
- NASDAQ Private Market (established in 2013): Cumulative trading size: \$45 billion



* Values for each year are for those observed up to the time of tabulation; investment figures include estimates.

** Trading size represents that as of March 2022 for Forge Global and as of September 2023 for NASDAQ Private Market.

*** Represents an average calculated on a public offering price basis. For Japan, the data is based on IPOs on the Prime, Standard, and Growth markets of Tokyo Stock Exchange, and for the US, the data is based on IPOs on the NASDAQ and NYSE. Converted at 120 yen to the dollar based on the exchange rate at the time.

Source:

VC investment in startups: INITIAL; Examples of trading platform for unlisted stocks in the US: information published by each company; Market Cap at IPO: Tokyo Stock Exchange for Japan; Jay R. Ritter "Initial Public Offerings: Underpricing" for the US

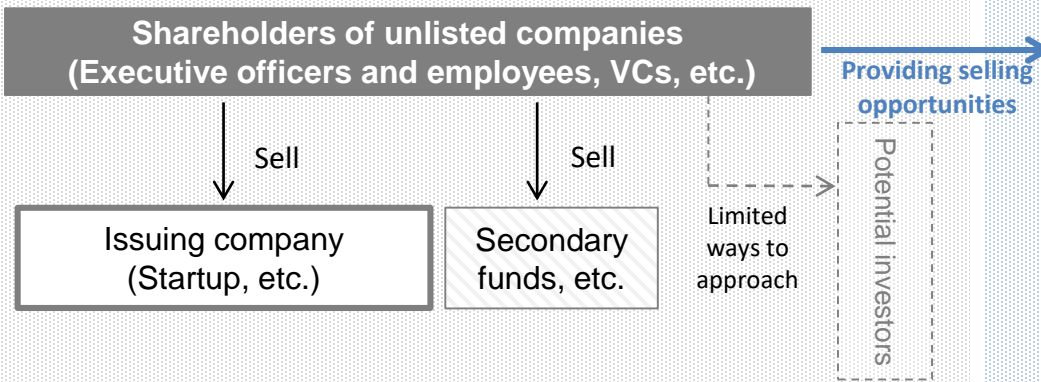
Vitalizing Circulation of Unlisted Securities

- ❑ Deregulate requirements for entry into the unlisted securities brokerage business and vitalize their circulation.

Issues and policy measures

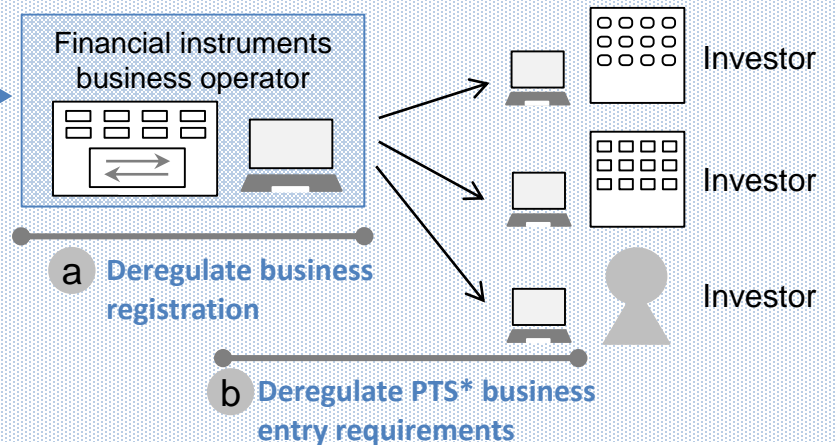
Issue

- Trading opportunities of unlisted stocks are limited (difficult to approach potential investors and to cash unlisted stocks).
⇒ Pointed out that small-lot listings for cashing them are responsible for the subsequent sluggish growth after listing.



Policy

- Promoting the entry of entities engaging in the brokerage business of unlisted stocks and providing shareholders with selling/cashing opportunities for unlisted stocks.



Law revision

- a Deregulate business registration for entities engaging in the intermediary business of unlisted stocks.

- Deregulate the requirements for Type I Financial Instruments Business only dealing with unlisted securities for professional investors basically without receiving deposits. (Reduction of capital requirements (from 50 million yen to 10 million yen for example) and exemption from capital adequacy ratio, etc.)***

** Allow non-professional investors to “sell” to meet cashing needs.

*** Intermediation of foreign securities (e.g. foreign investment trusts) to Japanese professional investors is also available.

- b Deregulate business entry requirements for PTS dealing with only unlisted stocks.

- Allow registered Type I Financial Instruments Business Operators to operate a PTS* for unlisted securities without authorization if the transaction volume is limited.
- Not require the additional capital (currently 300 million yen) and deregulate the system requirements (duplication of systems).****

**** Necessary regulations on transaction management are applied.

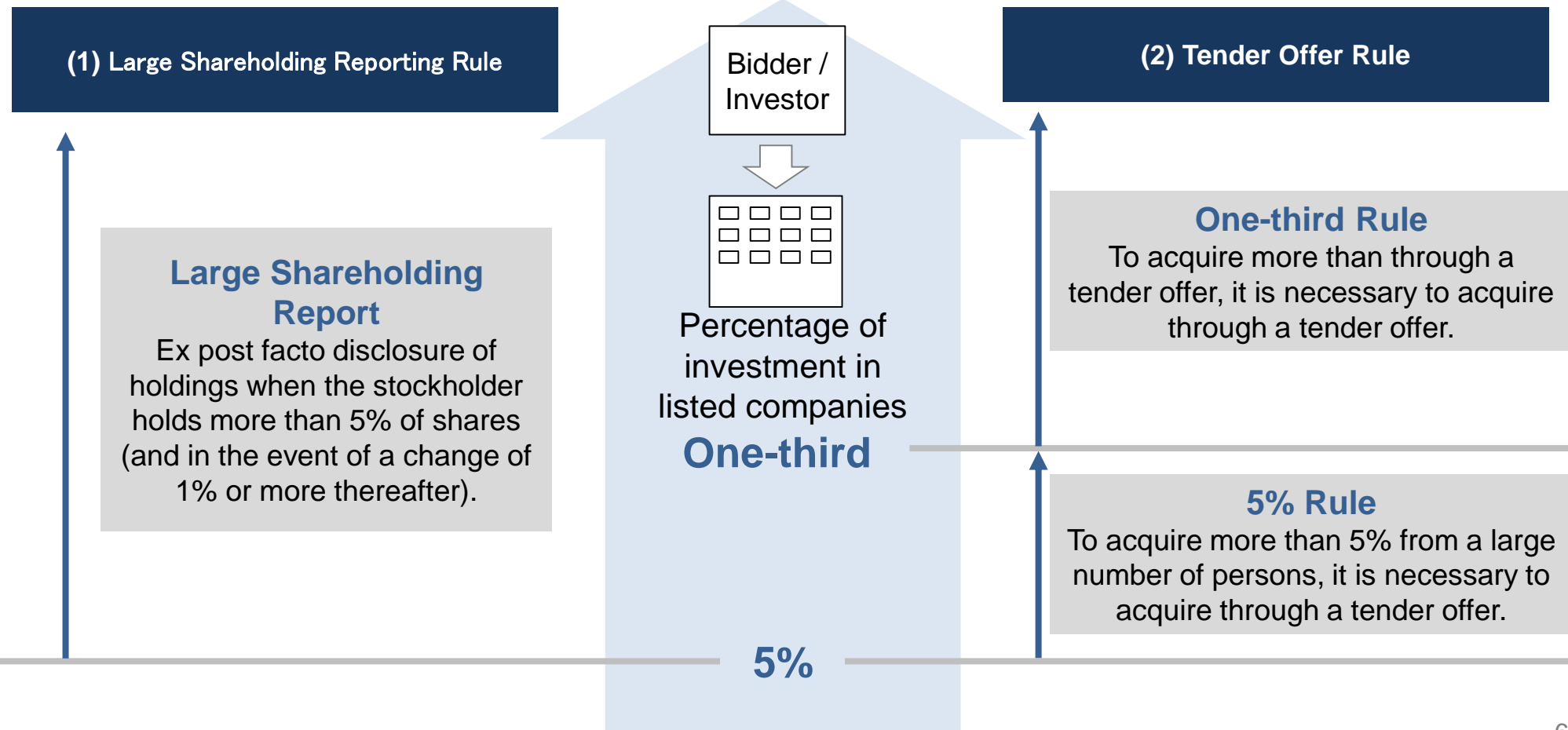
* PTS (Proprietary Trading System) is a trading system that uses electronic technology to provide transaction intermediation services.

Outline of the Tender Offer Rule and the Large Shareholding Reporting Rule

What are the Tender Offer Rule and the Large Shareholding Reporting Rule?

In order to ensure transparency and fairness in the capital market, stock trading and holdings that affect the control right to a company are required.

- (1) Ex post facto disclosure of holdings through a large shareholding report.
- (2) Trading through tender offers (= (i) the purpose and terms of the purchase are disclosed in advance, and (ii) all shareholders are given an equal opportunity to sell)



Clarifying “Joint Holders” in relation to the Large Shareholding Reporting Rule

- To promote constructive dialogue from a mid- to long-term perspective, the scope of “joint holders” is to be clarified

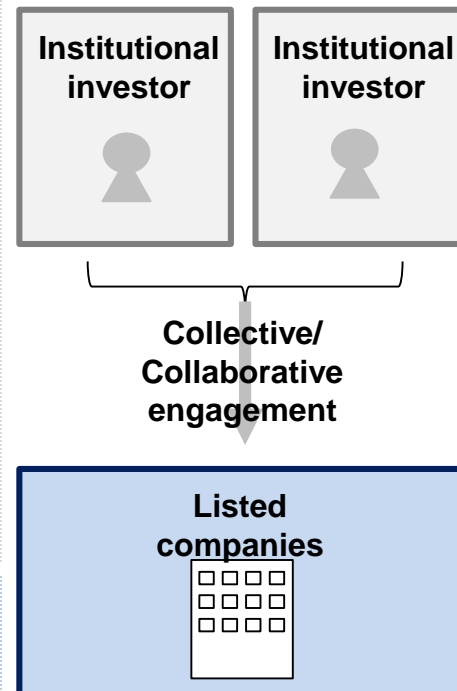
Issues and policy measures

Issues

- As investors are expected to engage in dialogue with companies based on their in-depth understanding of individual companies, it is important to compensate for the lack of investors’ qualitative and quantitative resources and increase the effectiveness of dialogue by means of collective or collaborative engagement.*
 - * Refers to the effort to engage in dialogue with individual companies in collaboration with other institutional investors about specific topics
- However, it is pointed out that joint holders as defined under the large shareholding reporting rule may have room for legal ambiguity and hinder collective or collaborative engagement.
 - ※ If two or more investors (Investor A ■%, Investor B □%) fall under the category of "joint holders" (i.e. persons who have agreed to jointly exercise voting rights and other rights as shareholders) and the combined ownership ratio (■%+□%) exceeds 5%, they will be required to submit a large shareholding report.

Policies

- In light of promoting constructive dialogue from a mid- to long-term perspective, the scope of “joint holders” is to be clarified at the level of acts.



Law revision

Clarifying “joint holders” in relation to the Large Shareholding Reporting Rule

- **Unless two or more investors reach an agreement which would have a material impact on a company’s management,* they should not be required to aggregate their ownership ratio as “joint holders”**

* Assuming a case where two or more investors jointly make a proposal that is not directly related to corporate control, such as a change in dividend policies or capital policies

(Ref.) On the other hand, in order to appropriately respond to cases that may threaten the fairness of the capital market, such as cases in which two or more investors stealthily failed to submit reports, a cabinet order is to be revised to deem a joint holder when there are certain external facts, such as an officer concurrent position relationship and a funding relationship.

Enlarging the Scope of the Tender Offer Rule

- ❑ To ensure transparency and fairness in the capital market, market trade (on-floor transaction) is to be subject to the tender offer rule.

Issues

- As environmental changes have emerged in the market, including an increase in cases of hostile acquisitions through market trade (on-floor transaction) and diversification of M&A, transparency and fairness of securities transactions should be attained
- ※ Tokyo Kikai Seisakusho Case (the Nov. 9, 2021 Tokyo High Court Ruling): Concerning a transaction that acquired more than one-third of voting rights through market trades (on-floor transactions) by Asia Development Capital, it was pointed out that such purchase did not provide general shareholders with sufficient information or time necessary for investment decisions.

Policies

- To ensure transparency and fairness of securities transactions, the scope of the tender offer rule is to be enlarged

	Over 5%	b Over 1/3	Majority	2/3 or more
Off-market trades		The 5% rule	The 1/3 rule (A tender offer is required.)	The 2/3 rule (Partial tender offer is not allowed.)
Market trade (off-floor transaction)			Partial tender offer is allowed.)	
Market trade (on-floor transaction)		a	In principle, not subject to rules	

Enlarging the scope of the tender offer rule

- a** To ensure transparency and fairness of securities transactions, transactions through **market trade (on-floor transaction) should be made subject to the application of the one-third rule**
- b** The threshold to determine whether the transactions have a material impact on corporate control should be lowered from “1/3” to “**30% of the voting rights**” in light of the actual ratios of voting rights exercised and the levels in foreign countries

Issues and policy measures

Law revision