Provisional Translation

The Financial System Council

The Working Group on Tender Offer Rule and Large Shareholding Reporting Rule

Report

December 25, 2023

List of Members of the Working Group on Tender Offer Rule and Large Shareholding Reporting Rule

As of December 25, 2023

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	Kansai Economic Federation	Japan Investment Advisers Association
	Japan Securities Dealers Association	International Bankers Association of Japan
	Ministry of Justice	Ministry of Economy, Trade and Industry

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Introduction

At the general meeting of the Financial System Council on March 2, 2023, the Minister of State for Financial Services consulted that a review be conducted of the tender offer rule and the large shareholding reporting rule, from the viewpoint of ensuring market transparency and fairness and promoting constructive dialogue between companies and investors, taking into consideration the recent environmental changes in the capital market. In response to the consultation, the Working Group on Tender Offer Rule and Large Shareholding Reporting Rule was set up under the Financial System Council.

Japan's tender offer rule and large shareholding reporting rule were introduced respectively in 1971 and 1990 and have since been amended in response to such factors as environmental changes in the market. However, no significant amendment has been introduced to either since 2006. In the meantime, diverse issues have been pointed out about the tender offer rule and the large shareholding reporting rule as the market environment has changed recently. Issues have been raised also about the transparency of beneficial shareholders.

To address these issues, this working group has deliberated the tender offer rule, the large shareholding reporting rule and the transparency of beneficial shareholders in six meetings since June 2023. This report outlines the deliberations.

I. The tender offer rule

The tender offer rule, modelled after U.S. regulations, was introduced in 1971. It has since incorporated additional disciplines modeled after European regulations in 1990 and 2006 in response to subsequent environmental changes in the market and other factors. As a result, the current tender offer rule requires tender offers to be made mainly in cases in which:

- the voting rights ratio exceeds 5% after purchase from many people (more than 10 people over 60 days) through off-market trades (known as the “5% rule”), or
- the voting rights ratio exceeds one-third after purchase through off-market trades or market trades (off-floor transaction) (known as the “one-third rule”)

The purposes of the tender offer rule have been currently considered as requiring equal treatment of shareholders and sufficient information disclosure regarding securities transactions that may have an impact on corporate control from the perspective of ensuring transparency and fairness of these securities transactions.

Wide-ranging issues have been pointed out about the tender offer rule in recent times as environmental changes have emerged in the market, including an increase in cases of hostile acquisitions through market trades (on-floor transaction) and diversification of M&A. Based on these issues, we considered the necessity and content of the review for the tender offer rule from a broad range of views, including the purposes of the tender offer rule, as follows.

1. European-style rules

In European countries, tender offer rules are considered to ensure opportunities for minority shareholders to sell their shares at fair prices at the time of transfer of control, and thus, the following are adopted:

- rules that require tender offers to be made in principle after the event when a specified threshold for beneficial ownership ratio is exceeded regardless of the type of transactions;
- ban on partial tender offers, in principle; and
- minimum price rules.

This working group considered whether Japan’s tender offer rule should shift to a European-style rule.

Many opinions that regard such a European-style rule as desirable as a way of the tender offer rule, have been expressed. For example, such a rule has clear regulatory purposes and discipline that is fully consistent with the purposes, provides especially ample protection for general shareholders, and can have the effect of curbing structural conflict of interest between controlling shareholders and minority shareholders from occurring. On the other hand, there were opinions that the shift to the European-style rule would need a

structure that flexibly allows exceptions to avoid undermining sound M&A deals (an organization that has expertise and flexibility). There were also opinions that we should reach a conclusion after considering a broad range of options for the protection of minority shareholders, including related rules (e.g. fiduciary duties of controlling shareholders, sellout right of minority shareholders, duties of neutrality of directors).[1]

Based on the above, this working group did not reach the conclusion that a shift to a European-style rule should be carried out immediately, but decided to individually consider the issues explained later in this document, including the applicable scope of the tender offer rule and whether partial tender offers should be allowed or not, keeping in mind a possible shift to a European-style rule in the future.

In addition, the possible shift to a European-style rule should remain to be discussed, taking into consideration the progress in the Financial Services Agency to develop a structure to take on the substantial judgment function (see “6. Making tender offer rule more flexible; its operational structure” below).

2. Market trades

(1) Market trades under the one-third rule

Under the current tender offer rule, market trades (on-floor transactions) are in principle not subject to application of the 5% rule or the one-third rule based on the view that they ensure a degree of transparency and fairness because anyone can participate in them, the transaction volume and prices are publicly disclosed, and the prices are formed through competitive trading methods.

On the other hand, in recent times, there have been cases in which more than one-third of voting rights were acquired in a short period through market trades (on-floor transactions). It has been pointed out that sufficient amounts of information and time required to make an investment decision are not provided to general shareholders in transactions like these, which may have a material impact on corporate control.[2]

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[1] With regard to a shift to a European-style rule, this working group considered whether tender offers should be required at least for cases in which more than one-third of the voting rights are acquired through third party allotment (issuance of new shares). While there were opinions in support of this from the perspective of giving exit opportunities for minority shareholders at the time of transfer of control, some pointed out that, in order to ensure that fund procurement by companies are not hindered, a structure to flexibly allow exceptions (an organization that has expertise and flexibility) would be necessary. We, therefore, did not reach the conclusion that tender offers should be required for cases in which more than one-third of voting rights are acquired through third party allotment (issuance of new shares).

[2] The Nov. 9, 2021 Tokyo High Court ruling said of a transaction that acquired more than one-third of voting rights through market trades (on-floor transactions): “The appellants purchased shares through

For securities transactions that may have a material impact on corporate control, in order to ensure that investors are provided with appropriate opportunities to make investment decisions from the perspective of transparency and fairness, it is important that prior disclosure regarding the purpose, quantities, prices and other information of the transaction, period for consideration, and equal treatment for shareholders should be secured. From this point of view, market trades (on-floor transactions) cannot be considered to have transparency and fairness required for securities transactions that may have a material impact on corporate control because the above-mentioned elements are not secured.

For this reason, market trades (on-floor transactions) should be made subject to the application of the one-third rule from the perspective of ensuring transparency and fairness of securities transactions that may have a material impact on corporate control.

(2) Interthreshold transactions

If market trades (on-floor transactions) are subject to the one-third rule as stated in the above (1), then tender offers would be required for all purchases that result in the voting rights ratio exceeding one-third, in principle.

Under the current rule, when a person whose voting rights ratio exceeds 50%, its share purchases through off-market trades within the scope in which the ratio does not reach two-thirds are exempted from the one-third rule unless the share purchases are not from many people (more than 10 people over 60 days). On the other hand, when a person whose voting rights ratio exceeds one-third, its share purchases within the scope in which the ratio does not exceed 50% through off-market trades are not exempted from the applicable scope of the one-third rule.

There were views that, although such interthreshold transactions may have a degree of impact on corporate control, requiring tender offers for all purchasing instances, including small-size ones, would make it an excessive rule vis-a-vis the purposes of the one-third rule. Respecting such views, the rule should not become excessive for interthreshold transactions in view of the purposes of the rule, while also considering the impact of the interthreshold transactions on corporate control.

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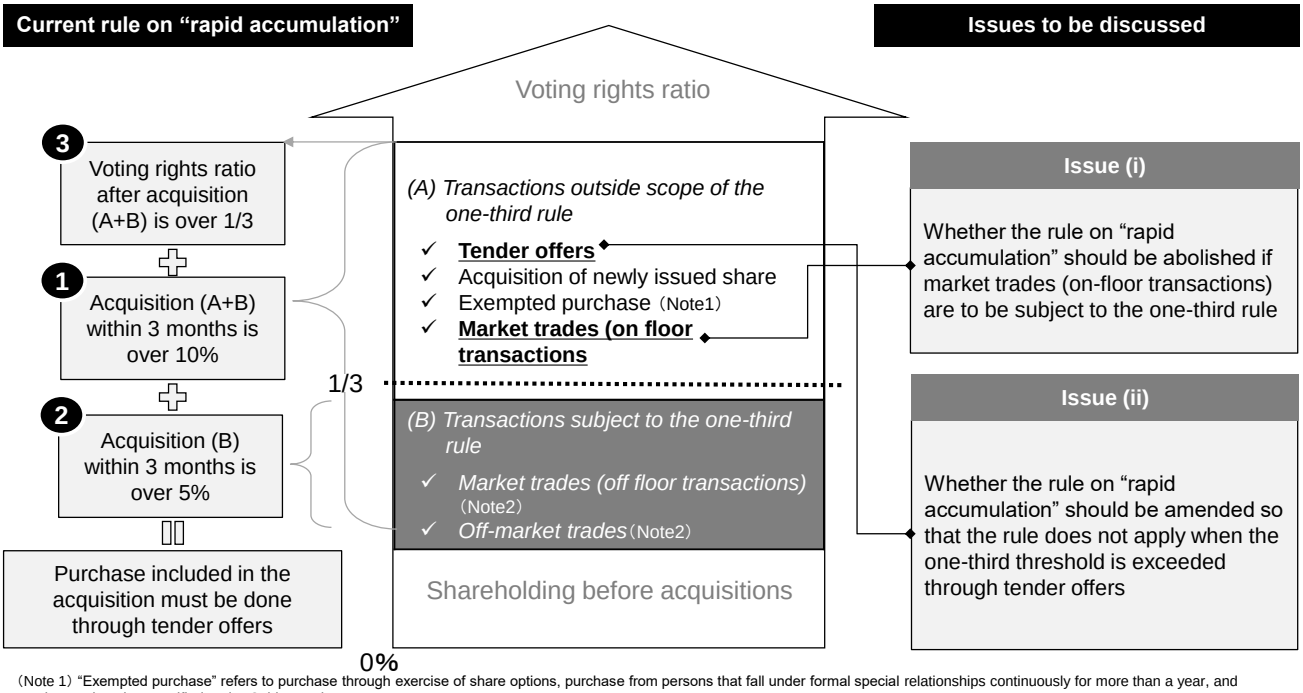
acquisition of shares on market trades that is not subject to the tender offer rule and exceeded their voting rights ratio of one-third in a short period of time. Such purchase does not provide general shareholders with sufficient information or time necessary for investment decisions and tends to make general shareholders take actions to avoid such risks if they think that the corporate value of the company may be damaged by the acquisition of control by the purchaser. Therefore, such purchase is recognized to have an incentive to sell or pressure to sell (coercion) for general shareholders." In this case, 39.94% of voting rights were acquired through market trades (on-floor transactions) over a period of about three months.

(3) Rules on “rapid accumulation”

In relation to the issues referred to in (1) above, this working group considered the following points regarding rules on “rapid accumulation”:[3]

i. Whether the rule on “rapid accumulation” should be abolished if market trades (on-floor transactions) are to be subject to the one-third rule

ii. Whether the rule on “rapid accumulation” should be amended so that the rule does not apply when the one-third threshold is exceeded through tender offers



（Note 1）“Exempted purchase” refers to purchase through exercise of share options, purchase from persons that fall under formal special relationships continuously for more than a year, and purchase otherwise specified under Cabinet orders.
（Note 2）Excluding tender offers and exempted purchase.

With regard to i of these, a typical scenario in which the rule on “rapid accumulation” is applied was one in which voting rights exceeding one-third are acquired without making a tender offer by first acquiring a large number of shares that do not reach one-third of voting rights through off-market trades or market trades (off-floor transactions) and then immediately acquiring shares through market trades (on-floor transactions). However, there was a view that there would be no need to maintain the rule on “rapid accumulation” if market trades (on-floor transactions) are subject to the one-third rule, as tender offers are required by the one-third rule even in such a scenario. On the other hand, there was a view that, even if the one-third rule applies to market trades (on-floor transactions), there can be a scenario in which more than one-third of voting rights are acquired without making tender

[3] The rule on “rapid accumulation” refers to the rule that applies to cases in which (1) over 10% of voting rights are acquired within 3 months, (2) the shares acquisitions in (1) include acquisition of over 5% of voting rights through off-market trades or off-floor transactions (excluding tender offers and exempted purchase), and (3) voting rights after the acquisitions exceeds one-third, and requires that the purchase included in them must be through tender offers.

offers through combination with third-party allotment (issuance of new shares) and exempted purchase and a view that abolition of the rule on “rapid accumulation” may make the scope of transactions regarded substantially as a whole unclear and cause a chilling effect. This working group, therefore, did not reach the conclusion that the rule on “rapid accumulation” should be abolished.

With regard to ii, the rule on “rapid accumulation” was originally introduced for the purpose of regulating transactions in which voting rights exceeding one-third are acquired without making tender offers by combining multiple trades. In view of this purpose, some pointed out that there is no need to apply the rule to cases in which the one-third threshold is exceeded through tender offers. There were also opinions that acquisition transactions in which a purchaser gains a toehold for acquisition through market trades (on-floor transactions) and then begins a tender offer should not be hindered. On the other hand, there were opinions that the practice of acquiring large amounts of shares that do not reach one-third of voting rights through off-market trades or market trades (off-floor transactions) and then immediately starting a tender offer is questionable from the perspective of transparency and fairness. This working group, therefore, did not reach the conclusion that the rule on “rapid accumulation” should be amended so that the rule does not apply when the one-third threshold is exceeded through tender offers.

The current rule on “rapid accumulation” classifies transactions into (A) those not subject to the one-third rule and (B) those subject to the one-third rule, and regulates the cases in which voting rights exceed one-third by acquiring over 10% voting rights in transactions in (A) and (B), including more than 5% voting rights acquired through transactions in (B), within three months. The current rule on “rapid accumulation” positions market trades (on-floor transactions) as transactions in (A). However, it is appropriate to regard market trades (on-floor transactions) as transactions in (B) when market trades (on-floor transactions) are to be subject to the one-third rule.

3. Measures against Coercive Tender Offer

Under the current tender offer rule, partial tender offers (tender offers with an upper limit) are allowed except in cases in which voting rights become two-thirds or more after the tender offer. On the other hand, with regard to partial tender offers, it has been pointed out that there is a problem in that, if they are expected to reduce the corporate value of the target company after the acquisition of control, general shareholders, even if they are dissatisfied with the tender offer price, may have an incentive to apply for the tender offer just to avoid disadvantages that may arise from reduced corporate value (known as the

"problem of coercion").

Furthermore, with regard to partial tender offers, as, in addition to the problem of coercion, proportional distribution is used in settlement even though a conflict-of-interests structure may emerge (or may change) between controlling shareholders and general shareholders due to changes in controlling shareholders, it has been pointed out that sale of all tendered shares is not guaranteed and sufficient selling opportunities are not provided to general shareholders.

Furthermore, with regard to partial tender offers, as, in addition to the problem of coercion, proportional distribution is used in settlement even though a conflict-of-interest structure may emerge (or may change) between controlling shareholders and general shareholders due to transfer of corporate control, it has been pointed out that the sale of all tendered shares is not guaranteed and sufficient selling opportunities are not provided to general shareholders.

In addition to these views, because of the fact that partial tender offers are banned in principle in European countries and tender offers are rarely conducted without delisting in the United States, there were many opinions of support for banning partial tender offers in principle or restricting their permissible scope. On the other hand, there were opinions that banning partial tender offers may accompany the effect of hindering desirable M&A deals. There were also opinions that how to address conflict-of-interest structures between controlling shareholders and general shareholders should be discussed taking into consideration measures. Therefore, whether or not partial tender offers should be banned should continue to be discussed, along with verification of the hindering effect on desirable M&A deals, among others.

On the other hand, in view of the above-mentioned problems contained in partial tender offers, a tender offeror (and a target company that is in favor of the partial tender offer) should at least try to win the understanding of general shareholders for the partial tender offer. We should work out measures to encourage tender offerors to do such efforts. Specifically, we can assume measures against tender offerors that carry out partial tender offers to strengthen the discipline of disclosure on tender offer statements and fulfill their accountability for measures to address the conflict-of-interest structure with minority shareholders that arise after partial tender offers and measures to address opposition from general shareholders.[4]

And, as coercion and other similar problems may occur in some cases of tender offers without an upper limit, in order to resolve such problems, it was pointed out that a rule

[4] In addition, considering that a partial tender offer is allowed in the U.K. only if (1) the Takeover Panel approves it and (2) the majority of independent shareholders are in favor, we considered the measure of requiring general shareholders meetings to confirm shareholder intentions for partial tender offers opposed by a specified extent of shareholders. Although opinions differed as to specific methods of confirming shareholder intentions, there were many affirmative opinions for taking such a measure.

should be established to require an additional tender offer period (subsequent offering period) be set after a tender offer is completed successfully.

While there were opinions that such a rule will contribute to the profits of investors who try to decide whether to apply for the tender offer based on whether the tender offer is successfully completed, there were also opinions that it will significantly reduce the possibility for the tender offer to be successful in cases in which there are many investors who try to postpone the decision on whether to apply. In addition, some are concerned that it may conversely induce coercive tender offers that do not set lower limits or set low lower limits for tender offers in anticipation of the presence of many such investors.

However, there is no need to ban tender offerors from voluntarily setting additional tender offer periods (subsequent offering period). It will be appropriate to design the rule in a way that allows tender offerors who wish to set additional tender offer periods to do so voluntarily in order to resolve the problem of coercion.

4. One-third rule threshold

Under the current tender offer rule, in light of the fact that one-third is a basic ratio that can block a special resolution of a shareholders meeting, if the voting rights ratio exceeds one-third after the acquisition, it is obligated to make a tender offer even if the purchase is made from an extremely small number of people (known as the “one-third rule”).

On the other hand, the threshold at which a tender offer is required is set at 30% in tender offer rules of many other countries. Furthermore, taking into account the actual ratios of voting rights exercised[5] at Japan’s listed companies, holding voting rights of at least 30% is surmised to enable the blocking of a special resolution of a shareholders meeting at many listed companies and to have a significant effect on an ordinary resolution of a shareholders meeting.

As the purpose of the tender offer rule is to ensure the transparency and fairness of securities transactions that may have an impact on corporate control, we believe it is appropriate to lower the threshold of the one-third rule to 30% in light of the levels in foreign countries and the actual ratios of voting rights exercised mentioned above.[6]

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[5] According to the material prepared by the Financial Services Agency based on the data compiled by the Trust Companies Association of Japan (see page 17 of the second Secretariat Briefing Pack of this Working Group), the actual ratios of voting rights exercised (excluding the portion exercised on the day) were less than 90% for 95% to 97% of the Tokyo Stock Exchange-listed companies that had no controlling shareholders and less than 60% for nearly half of those companies.

[6] Note that a potential option, in line with the lowering of the one-third rule threshold to 30%, is to lower the threshold of the all purchase obligation (two-thirds) in light of the actual ratios of voting rights exercised. However, although the threshold of the all purchase obligation was set with such factors as the fact that the ratio of voting rights required to squeeze out minority shareholders is two-thirds in mind, we believe that the actual ratios of voting rights exercised in normal times are not always a reliable

5. Purchase from customers by financial instruments business operators (broker-dealers)

The current tender offer rule stipulates that purchase from a large number of people (more than 10 over 60 days) that results in a voting rights ratio in excess of 5% must be made through tender offers (known as the “5% rule”). The reason why tender offers are required even though the voting rights ratios are relatively low is believed to be mainly because of the aim of protecting shareholders (who are solicited to sell) from selling pressure that may arise from the “one vs. many” transaction structure.

With regard to the current 5% rule, it was pointed out that, as it in a way excessively restricts sale and purchase transactions by financial instruments business operators (broker-dealers) who trade shares repeatedly and continuously in their daily operation, the scope of transactions not subject to it should be clarified within the scope deemed appropriate in light of the above-mentioned purpose. Specifically, it was pointed out that, of the purchase made from customers by financial instruments business operators (broker-dealers) using their own accounts for the purpose of maintaining liquidity for customers, the transactions falling under i or ii below should be clarified not to be subject to the 5% rule.

i. Purchase of shares less than one unit
ii. Purchase from customers of institutional investors that are planned to be sold immediately

The transactions falling under i or ii can be regarded as being carried out by securities companies substantially for the purpose of mediating customer transactions. Furthermore, excluding these transactions from the applicable scope of the 5% rule basically would not entail a risk of damaging the interests of shareholders (who are solicited to sell).

Therefore, within the appropriate scope in light of the purpose of the 5% rule and within the scope that does not enable circumvention of the purpose, it should be clarified that the transactions falling under i or ii above are not subject to the 5% rule.

6. Making tender offer rule more flexible; its operational structure

The current tender offer rule sets forth various regulations on the terms and conditions of tender offers, but there is no system that permits exceptional treatment of these various regulations on a case-by-case basis from a substantial perspective.

It has been pointed out that the current system could lead to excessively rigid operation of the system. Therefore, from a substantial perspective, a system that permits exceptional

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benchmark as many minority shareholders may cast votes in opposition in cases in which a person whose voting rights ratio is below two-thirds tries to squeeze out minority shareholders.

treatment on a case-by-case basis should be established, and an operational structure in which the authorities are responsible for such a substantial judgment function should be developed.

In the United Kingdom, for example, the Takeover Panel is established as a body for tender offer rule supervision and making judgment on rule exceptions. The Takeover Panel has a broad range of authority, including the authority to set rules (the Takeover Code), the authority to make exemptions for the application of the rules and revise them, the authority regarding interpretation, application and execution of rules, and the authority to sanction rule violations. Furthermore, both the panel members and the panel executive staff are individuals with highly specialized skills, including staff at financial institutions, company executives, attorneys, and accountants. In Germany, BaFin has the authority to make exemptions from the requirement to make tender offers and the authority to ban tender offers. In France, AMF has the general supervisory authority to, for example, approve tender offer statements and to request changes in tender offer plans and screen the consideration to shareholders forced out in a shareholder squeeze-out. It sometimes intervenes in individual cases and shows its own interpretation when it determines that the actions of the parties violate the basic principles of listed-company M&A.

There were opinions that, in order to achieve flexibility in the tender offer rule in Japan, a structure that borrows from the U.K.'s Takeover Panel (structure with expertise and independence) should be introduced. On the other hand, there were opinions that it would be difficult to immediately introduce such a structure and opinions that it would require careful consideration to determine whether a similar structure would work in Japan.

Still, even without going so far as introducing a structure borrowing from the U.K.'s Takeover Panel, we believe it is possible to achieve the flexibility by strengthening the current authority's structure if the current rule would be relaxed. This will make it possible to introduce a degree of flexibility. Thus, for a starter, a structure that allows cases to be exempted from application of the following regulations should be introduced if, for example, the authorities' approval is gained, for individual cases about the below regulations, assuming that the authority will continue to work to strengthen the structure.

- Regulations on the ban on purchase outside of a tender offer during the tender offer period
- Regulations on the scope of concert parties based on special relationships (including exclusion from concert parties in specified cases[7] even in cases in which there is a specified capital relationship)

[7] For example, we can assume a scenario in which a buyer who has acquired a specified amount of shares against the wishes of the company can be excluded from the company's concert parties after considering the actual relationship between the buyer and the company.

- Regulations on the tender offer period (including, in certain cases,[8] allowing voluntary extension of more than 60 business days or making unnecessary or shortening obligatory extension periods resulting from correction in tender offer statements)
- Regulations on changes in terms and conditions of a tender offer
- Regulations on the withdrawal of a tender offer
- Regulations on the all purchase obligation and all solicitation obligation (including, in certain cases,[9] the exclusion of overseas depositary receipts from the scope of securities subject to the all solicitation obligation)

7. Advance notices planned on tender offers

In practice, when plans to make tender offers are announced, it is common for a specific start date (typically the next business day) to be indicated in the announcement, but there are also cases in which only the fact that the tender offeror plans to (or may) make a tender offer is announced without indicating a specific start date (known as the “advance notices on planned tender offers”).

Such advance notices on planned tender offers are necessary in certain cases, including cases in which clearance under competition laws is necessary for tender offers, but it was pointed out that there are undesirable aspects from the perspective of stability of the market.

Among such cases, the Financial Services Agency has already clarified that cases in which announcement is made on the possibility of conducting tender offers even though there are no reasonable grounds for actually making tender offers may constitute the spreading of rumors or market manipulation.

On the other hand, even in cases in which there are reasonable grounds for making tender offers, if no tender offer is commenced for a long period, it may destabilize the market. Therefore, in order to maintain the stability of the market, guidelines by the authorities should be prepared to indicate the way of disclosure for when giving advance notices on planned tender offers (e.g. indication of preconditions for making tender offers and planned start dates, disclosure regarding the progress after announcement).

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[8] For example, we can assume a scenario in which a voluntary extension of more than 60 business days, after considering the content of the anti-takeover measures and the situation of the trial regarding injunction against the anti-takeover measures, is allowed until the court trial is concluded, and a scenario in which the obligatory extension periods, in cases in which there was correction in tender offer statements because clearance under competition laws was obtained, after considering the degree of probability that such clearance was expected to be obtained, are made unnecessary.

[9] For example, we can assume a scenario in which the depositary receipts are excluded from the scope of the all solicitation obligation after consideration of the conversion possibility of the depositary receipts to target-company shares in cases in which overseas depositary receipts cannot be acquired in the form of depositary receipts due to the laws and regulations of other countries or absence of a financial instruments business operator etc. that can handle the depositary receipts as a tender offer agent.

8. Other issues

In addition to the above, this working group discussed the following issues regarding the tender offer rule and reached the conclusion that all of them should be appropriately addressed, as follows.

i. There is an issue in relation to the regulations on uniformity of tender offer prices that a tender offer must be conducted twice as the tender offer price cannot be classified in a single tender offer even in cases in which certain large shareholders agree to tender at a lower price than general shareholders. A rule should be established for such cases to make it possible for these transactions to be conducted in a single tender offer.

ii. With regard to regulations on uniformity of tender offer prices, there is an issue of ambiguity as to whether uniformity in tender offer prices is required in cases in which different classes of shares or different types of securities are subject to tender offer, and, if it is, how uniformity should be judged. These should be legally clarified.

iii. The authorities' review policy should be clarified on the issue of lack of clarity in the authorities' review policy for advance consultation on tender offer statements.

iv. There is an issue that tender offer prices are not allowed to be lowered even in cases in which the target company paid out dividends during the tender offer period. Tender offer prices should be allowed to be lowered in such cases.

v. With regard to the issue that the grounds for withdrawal of a tender offer is too strict, the grounds for withdrawal of a tender offer should be expanded.

vi. The question of what sort of share acquisition constitutes "purchase" subject to the tender offer rule is partially dependent on interpretation, but the borderlines are unclear and predictability is not always ensured. The scope of "purchase" should be legally clarified to the extent possible.

vii. The content of tender offer explanations is nearly exactly the same as the content of tender offer statements, and the administrative burden related to issuance and correction of tender offer explanations is too heavy for its benefits. For this issue, simplification of the content of tender offer explanations should be made possible by including a note that leads the reader to refer to the tender offer statement.

viii. Examine what information should be disclosed to investors on tender offer statements afresh and revise stated items as necessary.[10]

[10] For example, the submission status of large shareholding reports while rapid accumulation is underway on- and off-market is an important piece of information in cases of tender offers. It is possible to include such information as part of items to be stated in the tender offer statement.

9. Issues going forward

In addition to the above, this working group discussed whether ex-ante and ex-post relief in tender offer should be established.

Specifically, we discussed the introduction of a system of granting the target company and its shareholders the right of injunction to halt a tender offer that violates laws and regulations or uses very unfair means as an ex-ante relief system regarding tender offers, and, as ex-post relief systems, the introduction of a system to suspend the voting rights of shares acquired in violation of the tender offer rule and a system that imposes an order to sell these shares.

With regard to these, there were opinions in favor of the introduction from the perspective of ensuring the effectiveness of the tender offer rule and protecting the rights of shareholders. On the other hand, problems related to the connection between requirements and impacts and concerns regarding the risk of abuse of the systems were raised. There were also opinions that, if a structure that borrows from the U.K.'s Takeover Panel is to be introduced, judgment is best left to such a body.

Based on the above, this working group did not reach the conclusion that ex-ante and ex-post relief systems should be immediately introduced, but it may continue to discuss these points as necessary.

Under the current tender offer rule, administrative correctional measures using such means as issuance of orders for correction by the authorities and the filing of a petition for an emergency injunction are in place for violations of the tender offer rule. It is desirable that the authorities appropriately use these means. A specific example is to take appropriate measures to address cases in which tender offers are set to be made without complying with the large shareholding reporting rule, as described in "II. 4. Ensuring effective implementation of large shareholding reporting rule" below.

II. The large shareholding reporting rule

The large shareholding reporting rule is a rule that requires the disclosure of certain matters on large shareholders for the purpose of enhancing the transparency and fairness of the market and ensuring investor protection by quickly providing information regarding large shareholdings to investors, as such information is important from the perspective of "impacts on the management" and "supply and demand in the market."

Specifically, the following are required:

- When a person becomes a large shareholder (i.e. person whose ownership ratio is over 5%), they must submit a large shareholding report within five business days of that date and, if subsequently a material change takes place, such as an increase or decrease in the ownership ratio of 1% or more, they must submit a change report within five business days of that date, in principle (known as the "general reporting rule").
- A relaxation measure is taken by stating that it is sufficient for institutional investors to judge whether it is necessary to submit a large shareholding report or a change report based on the reference dates pre-registered twice in a month and submit a large shareholding report or a change report within five business days of the reference date (known as the "special reporting rule").
- Shareholders must aggregate the ownership ratios of joint holders in calculating its ownership ratio

Wide-ranging issues have been pointed out about the large shareholding reporting rule in recent times as environmental changes have emerged in the market, including an increase in passive investments, expansion of collective or collaborative engagement[11], and greater importance of constructive dialogue between companies and investors. Based on these issues, we considered the necessity and content of the review for the large shareholding reporting rule as follows.

1. Scope of the act of material proposal

For institutional investors to use the special reporting rule, the purpose of shareholding must not be to engage in the act of material proposal.

When the Stewardship Code was established in 2014, the interpretation of the scope of the act of material proposal was clarified to a degree, but it was pointed out that the rule

[11] Refers to the effort to engage in dialogue with individual companies in collaboration with other institutional investors

remains unclear or general and must be clarified or limited further in order to promote effective engagement between companies and investors.[12]

Originally, the rule regarding the act of material proposal was focused on the act's impacts on management. This rule requires institutional investors whose purpose is to engage in the act of material proposal to disclose necessary information promptly under the general reporting rule, rather than the special reporting rule from the perspective of impacts on management. The attention of the current scope of the special reporting rule is mainly focused on the content of the act of proposal. If the purpose of shareholding is to propose a specified content, prompt information disclosure is required under the general reporting rule.

In this regard, in cases in which acts relating directly to corporate control, including the nominating of directors and acquisition of voting rights representing more than a specified ratio, are the purpose, such an act itself has a significant impact on management, and prompt information disclosure should be required. On the other hand, in cases in which acts of proposal on matters not relating directly to corporate control, including changes regarding dividend policies and capital policies, are the purpose, it is difficult to say that conducting acts of proposal alone will immediately have a significant impact on management.

Therefore, it is appropriate to have discipline that broadly falls under acts of material proposal for cases in which acts relating directly to corporate control are the purpose, and, for cases in which acts of proposal not relating directly to corporate control, focus on the way in which acts of proposal are conducted and have discipline that falls under acts of material proposal only for cases in which conducting acts of proposal in ways that do not leave their adoption or refusal up to the management team.[13]

2. Scope of joint holders

Under the current large shareholding reporting rule, people who have agreed with shareholders to jointly exercise voting rights and other shareholders' rights fall under joint holders, without exception.

Rules of other countries include safe harbor rules, etc. regarding collective or collaborative engagement in view of the risk that discipline similar to joint holders (special relationships) as defined under the large shareholding reporting rule and the tender offer

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[12] Specifically, investors who hold shares of many companies, including mainly passive investors, tend to practice engagement while trying not to fall under the act of material proposal in order to avoid a situation in which they cannot use the special reporting rule. It was, therefore, pointed out that such a way of engagement may limit the depth of dialogue called for by the Stewardship Code.

[13] For example, we can assume a case in which a proposal is made with the suggestion or implication that the shareholders' right to propose will be exercised or additional shares will be acquired.

rule may hinder collective or collaborative engagement.

The above joint holder concept in Japan is not immediately applicable to cases of collective or collaborative engagement, as it is stipulated to be applied to cases in which there is an agreement on voting rights and other shareholders' rights (unlike comparable rules in other countries). On the other hand, it has been pointed out that the concept has a chilling effect on collective or collaborative engagement as an implied agreement may be included in the above agreement.[14]

Thus, in order to reduce such a chilling effect, it is appropriate to exclude, for example, institutional investors, whose aim of agreement is not to jointly engage in the act of material proposal and who are in agreement regarding the exercise of voting rights that is not continuous, from the scope of joint holders, in view of the fact that the above joint holder concept is a discipline that pays attention to the impact on the management (see "4. Ensuring effective implementation of large shareholding reporting rule" below regarding the provisions that deem people, in cases in which certain formal facts exist, as joint holders in order to resolve the issue of the difficulty of the proving work related to recognizing joint holders, from the perspective of maintaining the effectiveness of the large shareholding reporting rule).

3. Treatment of derivatives

Under the current large shareholding reporting rule, it is believed that having a long position of cash-settled equity derivatives alone basically does not constitute a reason to be subject to the large shareholding reporting rule.

If prioritizing the fact that the large shareholding reporting rule is a rule that requires large shareholders to disclose information, focusing on the influence on the management, the degree of necessity to require information disclosure is not high on cash-settled equity derivatives which are aimed mainly at gaining economic profit and do not accompany shareholder rights, including voting rights.

On the other hand, even among cases of cash-settled equity derivatives, there are those in which a change to physically settled equity derivatives is assumed and those in which engagement with issuer companies is practiced while claiming to have such a position, and it has been pointed out that information disclosure should be required for these cases under

[14] Specifically, the work of exchanging information on ownership ratios with the joint holder needs to be performed frequently to determine if submission of a large shareholding report or a change report is required in cases in which investors have fallen under joint holders, and it was pointed out that sufficient consideration needs to be given to avoid falling under joint holders as there is a risk that the load of such work may become excessively heavy, as well as the risk arising from communicating their own ownership ratios to another party, for institutional investors who trade shares repeatedly and continuously in daily business operation.

the large shareholding reporting rule.

As the above cases can be deemed as entailing a potential impact on management already at the time of starting cash-settled equity derivative transactions and as having an effect of circumventing the large shareholding reporting rule, it is appropriate to include such equity derivatives[15] in the applicable scope of the large shareholding reporting rule.

4. Ensuring effective implementation of large shareholding reporting rule

With the amendment of the Financial Instruments and Exchange Act in 2008, non-submission of the large shareholding report and false statements were subject to the administrative monetary penalty rule from the viewpoint of deterring violations of the large shareholding reporting rule. However, there has been a number of cases in which the submission of reports has been delayed, and it has been pointed out that the effective implementation of the large shareholding reporting rule has not been ensured. In particular, it was pointed out that, in recent times, there have been cases in which multiple people in tacit collaboration are suspected to have acquired shares taking advantage of the difficulty of the proving work related to recognizing joint holders.

One of the factors that have contributed to recent delays in the submission of large shareholding reports is believed to be the instances of enforcement of large shareholding reporting rule by the authorities remaining few and far between. It is important, first of all, to strengthen the authorities' enforcement of large shareholding reporting rule.

Although it is not realistic to aim to enforce large shareholding reporting rule in all instances, aggressive measures should be taken on instances that may affect the fairness of the market, including non-submission instances that are suspected to be intentional or significant submission delays. In addition, from the perspective of promoting such aggressive responses, provisions that regard people, in cases in which there are certain formal facts, as joint holders[16] should be stipulated as a way to resolve the difficulty of the proving work related to recognizing joint holders.[17]

Furthermore, for cases in which tender offers are attempted without complying with the large shareholding reporting rule, appropriate measures should be taken, including requiring the submission of a large shareholding report or correcting one at the time of

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[15] Examples would be those aimed at (1) acquiring shares from the counterparty, (2) exerting a degree of influence on the exercise of voting rights regarding shares held by the counterparty, and (3) conducting acts of material proposal to the company while claiming to have a position such as in (1) and (2).

[16] The current large shareholding reporting rule has provisions that call for people who have specified capital relationships, family relationships, or other special relationships to be regarded as joint holders.

[17] For example, they may be examined with a focus on officer concurrent position relationships and funding relationships.

advance consultation on tender offer statements. In addition, to provide for cases in which a violation of the large shareholding reporting rule comes to light after the submission of a tender offer statement, a framework that makes it possible to take corrective measures, including administrative orders for correction, when such cases arise, should be introduced.[18]

In this regard, that there were opinions that, in order to ensure the effectiveness of the large shareholding reporting rule, it would be most effective to introduce a system of suspending voting rights on the shares held by a violator of the large shareholding reporting rule, borrowing from examples in European countries. With regard to such a system, there are issues similar to those discussed regarding the tender offer rule (see “9. Issues going forward” in “I. The tender offer rule”). Although this working group did not reach a conclusion that such a system should be introduced immediately, it is possible to continue discussing this point as necessary, paying attention to the status of improvement achieved through strengthening the measures discussed above.

5. Other issues

In addition to the above, this working group discussed the following issues regarding the large shareholding reporting rule and reached the conclusion that all of them should be appropriately addressed, as follows.

i. There is an issue in that the numbers of shares after the conversion of shares with call or put options are not being reflected in the calculation of ownership ratio. For this issue, the number of shares before or after conversion, whichever is greater, should be used to calculate the ownership ratio.

ii. With regard to the information required to be provided in the large shareholding report, including "purpose of shareholding," “material contracts such as collateral contracts related to the shares,” the content to be provided and the method for describing are not necessarily clearly defined, and each submitter provides information in different ways. There is an issue of a possibility that the complexity of the current method for describing may have become a factor that has caused delays in submission. To address these issues, the content of information to be provided and the method for describing in the large shareholding report should be clarified and revised.

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[18] If the status of submission of large shareholding reports is included in the items to be included in the tender offer statements (see viii of “7. Other issues” in “I. The tender offer rule” above), it is possible to introduce measures through correction in tender offer statements, in cases in which violation of the large shareholding reporting rule comes to light after the fact. The current rule stipulates that, once an administrative order for correction is issued, the tender offeror is not allowed to undergo the application process for the tender offer until the statement corrected according to the order for correction is submitted.

iii. People who have a specified capital relationship are regarded as joint holders even if they each have their own independent policies regarding voting rights and other shareholders' rights. If, for example, the authorities' approval is gained, a system that excludes them from joint holders in specified cases[19] should be introduced.

[19] For example, we can assume cases in which an asset manager and its parent financial holding company (and its subsidiaries) are excluded from joint holders after considering if a structure is in place that allows them to make judgments on the exercise of voting rights and other shareholders' rights separately and independently.

III. Transparency of beneficial shareholders

Under the current rule, companies and shareholders can ascertain the status of nominal shareholders through the disclosure of the shareholder registry under the Companies Act and the status of large shareholders in annual securities reports. On the other hand, there is no system under which companies and shareholders can ascertain the status of beneficial shareholders (shareholders who have the authority to give instructions on voting rights or the authority to invest in the relevant shares), except for those who are subject to the large shareholding reporting rule (holding over 5%).

Thus, from the viewpoint of promoting dialogue between companies and shareholders/investors, it was pointed out that practical considerations for beneficial shareholders should be made with reference to the systems in other countries so that issuer companies and other shareholders can efficiently identify the beneficial shareholders and the number of shares held by them.[20]

In other countries, there are mainly:

- systems that require institutional investors that hold specified amounts of assets to disclose their holdings statements at regular intervals, as in the United States, and
- systems that require beneficial shareholders and nominal shareholders to respond when they are asked questions by companies on the status of their holdings and information on beneficial shareholders, as in European countries.

The system in the U.S. is believed to be a system that contributes to improving market transparency as it enables any person, not just companies and other shareholders, to view institutional investors' statements on their holdings. However, there were opinions that it is an excessive regulation vis-a-vis the purpose of promoting dialogue between companies and shareholders/investors and opinions that information necessary for companies may not be disclosed depending on how the system is designed.

By contrast, the system in European countries communicates the information on the status of holdings of beneficial shareholders to issuer companies and, we believe, is more suitable for the purpose of promoting dialogue between companies and shareholders/investors.[21]

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[20] In recent times, the importance of constructive dialogue between companies and investors has rapidly increased and there are issues regarding the effectiveness of the large shareholding reporting rule (see "4. Ensuring effective implementation of large shareholding reporting rule" in "II. The large shareholding reporting rule"). There were opinions that, in light of these situations, the absence of a system that enables companies and shareholders to get to know beneficial shareholders and the numbers of shares held by them is an urgent issue for Japan's capital market.

[21] On the other hand, there were opinions that the introduction of a system designed after the U.S. system as the model should remain to be discussed from the viewpoint of the importance of improving market transparency.

Therefore, going forward, relevant authorities should work on initiatives to develop appropriate rules, using the system in European countries as guides. Specifically, first of all, calling on institutional investors to respond when issuer companies ask them about the status of their holdings by clearly stating principles of conduct for institutional investors as soon as possible and subsequently making such responses mandatory under law should be considered.[22]

In addition, discussion of rules and their application to improve the efficiency of these beneficial shareholders' grasping processes is desirable.

[22] Along with this, there were opinions that the way disclosure of information about beneficial shareholders obtained by companies, for example, made through annual securities reports, should be considered.

Conclusion

This concludes the report summarizing and sorting out the content of deliberations that this working group has conducted since June 2023. Going forward, with regard to the tender offer rule and the large shareholding reporting rule, relevant authorities should swiftly consider a draft amendment to the Financial Instruments and Exchange Act based on the content of this report, and prepare governmental orders that will subsequently become necessary. In addition, with regard to the transparency of beneficial shareholders, it is desirable that relevant authorities should have discussions and then swiftly examine together the measures required to introduce rules.