1st Meeting of the Working Group on Tender Offer Rule and Large Shareholding Reporting Rule of the Financial System Council

Provisional translation

Secretariat Briefing Pack

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金融庁
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Background to the Discussion and Matters for Consultation

- At a joint session of the general meeting of Financial System Council and the meeting of Sectional Committee held on March 2, 2023, the following consultation was delivered: the tender offer rule and the large shareholding reporting rule should be reviewed based on the recent environmental changes in the capital market.

History of the rules

- In Japan, the tender offer rule was introduced in 1971 and the large shareholding reporting rule in 1990.
- Since then, each rule has been revised with reference to the rule in the U.S. and the U.K. in light of the environmental changes in the capital market, but no major revision has been made since 2006.

Background of the discussion

- Based on the following environmental changes in the capital market in recent years, various issues have been pointed out regarding the tender offer rule, the large shareholding reporting rule, and the transparency of beneficial shareholders.
  - ✓ Increase in cases of hostile M&A through on-market transactions
  - ✓ Diversification of M&A
  - ✓ Increase in passive investment
  - ✓ Expansion of collective and collaborative engagements
  - ✓ Growing importance of constructive dialogues between companies and investors

Matters for consultation

- Consideration of what the tender offer rule and the large shareholding reporting rule should be

Based on the recent environmental changes in the capital market, the tender offer rule and the large shareholding reporting rule should be reviewed in light of securing transparency and fairness of the market and promoting constructive dialogue between companies and investors.

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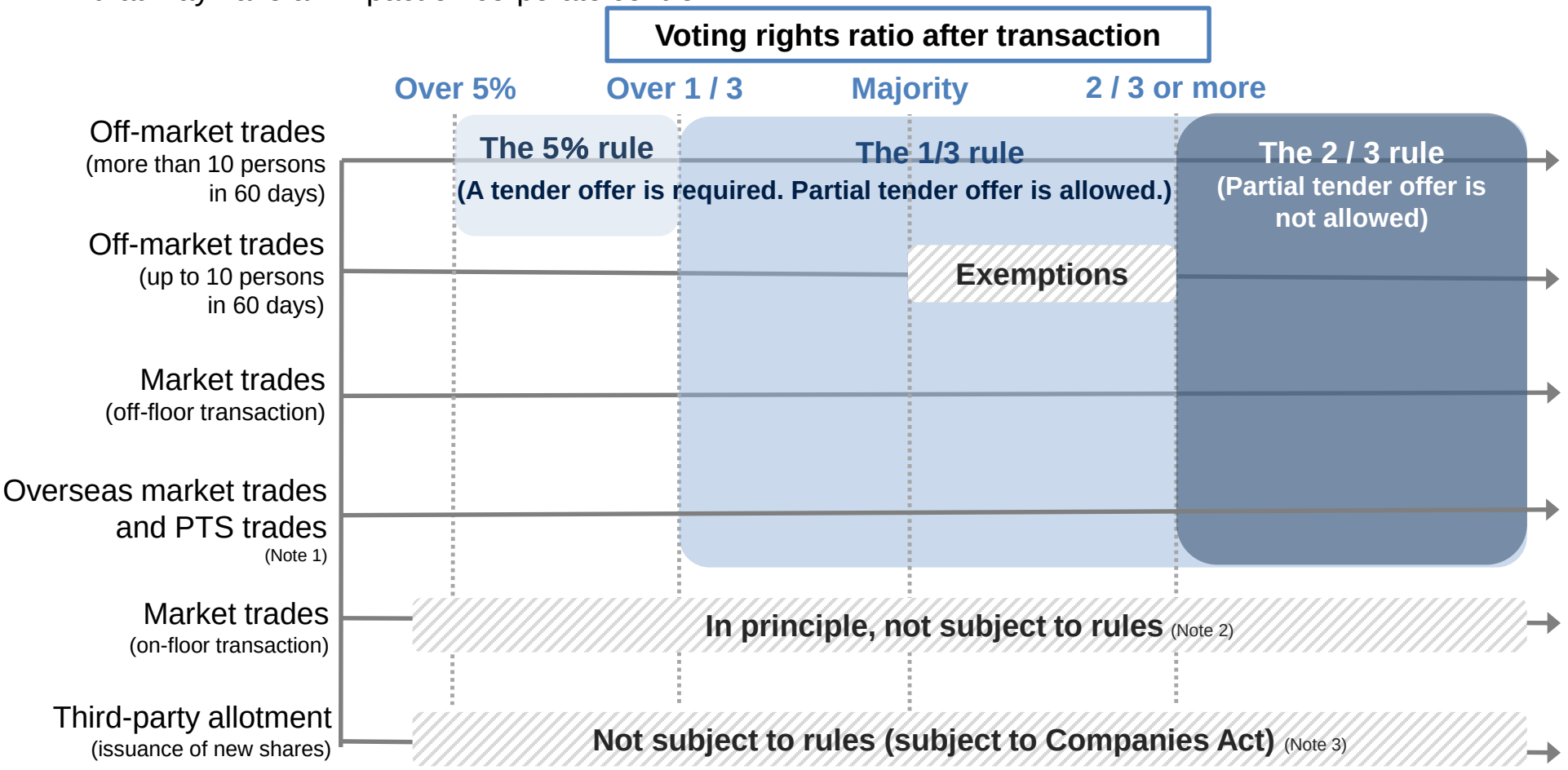
Transactions subject to the tender offer rule

- The tender offer rule forces a tender offer for the following transactions and requires (i) prior information disclosure and (ii) equal treatment of shareholders in order to ensure the "transparency and fairness" of securities transactions that may have an impact on corporate control.



(Note 1) Transactions that meet certain requirements are exempt from the application of the 5% rule.
(Note 2) Market trades (on-floor transaction) are subject to the tender offer rule only in the following cases:
(I) Rapid accumulation (where a total of over 10% of the shares are acquired within 3 months, including acquisition of over 5% of share through off-market transactions or on-market transactions (off-floor transaction), and the voting rights ratio of shares after the acquisition becomes over 1/3)
(ii) Purchase during the period for Tender Offer by other Tender Offeror (where a major shareholder whose voting rights ratio is over 1/3 purchases share, exceeding 5% during the period for Tender Offer by other Tender Offeror)
(Note 3) Shares acquired through third party allotment (issuance of new shares) are also counted in the determination of over 10% in (Note 2) (I) above.

Overview of the large shareholding reporting rule (1)

- The large shareholding reporting rule requires large shareholders to disclose the status of shareholdings in order to improve the transparency and fairness of the market by promptly providing the information.

General Reporting

Obligations of Large Shareholders

1. If an investor becomes a large shareholder (**more than a 5% shares**):
   - The investor must **submit a "large shareholding report" within five business days** of acquiring more than a 5% stake in a company.
2. If there are any significant changes, such as **a 1% or greater increase/decrease** in the percentage of shareholdings following the submission of the large shareholding report:
   - The investor must **submit a "change report" within five business days of the change**.

Special Reporting

Outline of the Special Reporting Rule

The rule allows institutional investors who repeatedly and continuously execute buy/sell transactions of shares in their daily operations to report under relaxed frequency of submissions.

<Details of the relaxation>

Only to **submit a "large shareholding report" and "change report" on the pre-registered bi-monthly reference date** and submit the report within five business days of the reference date.

Joint Holders

Treatment of Joint Holders

A shareholder is required to calculate its shareholding ratio by including the shareholding of a person that corresponds to any one of the following **("Joint Holder")**.

1. A person that **has agreed to obtain or assign shares in cooperation with the shareholder**
2. A person that **has agreed with the shareholder to jointly exercise voting rights** and other shareholder rights.
3. A person that has a special relationship with the shareholder, such as a certain capital relationship or a family relationship.

Overview of the large shareholding reporting rule (2)

Eligibility to use special reporting

☐ In order for institutional investors to use the special reporting, the following requirements must be met:

1. The investor's shareholding ratio does not exceed 10%.
2. **The purpose of shareholding is not to engage in the act of material proposal**.
3. It is necessary to register the reference date with the authority.

☐ **The act of material proposal** is:

The suggestion of **matters specified** in the relevant order as those that will cause material changes or materially influence the issuer's business activities at the general shareholders meeting of investee companies or to their **corporate directors**.

- **Corporate director**: A corporate director means a managing member, a director, an executive officer, an accounting advisor, a statutory auditor, or an equivalent thereof, and includes those deemed to possess control that is either equal to or surpasses the foregoing, regardless of name.
- **Matters specified**: The following matters concerning the issuer or its subsidiary

1. Disposal of and acceptance of assignment of important assets
2. Borrowing in a significant amount
3. Appointment or dismissal of Representative Directors
4. Material changes to the composition of corporate directors
5. Appointment or dismissal of managers or other important employees
6. Establishment, change, or abolition of branches or other important organizations
7. Share exchange, share transfer, company split or merger
8. Assignment, acceptance of assignment, suspension or abolishment of all or part of business
9. Material changes to the company's dividend policy
10. Material changes in policy regarding increase or decrease of capital
11. Listing or delisting
12. Material changes to the company's capital strategy
13. Dissolution
14. Declaration to commence bankruptcy proceedings, rehabilitation proceedings, or reorganization proceedings

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Market trades (on-floor transactions)

- It has been pointed out that market trades (on-floor transactions) should be subject to the tender offer rule.

Comments on the Current Rule

- The current tender offer rule does not apply to a market trade (on-floor transaction) unless it falls under so-called “rapid accumulation," given that a certain degree of transparency and fairness is ensured.
- On the other hand, recently, there have been cases of acquiring more than 1/3 of the voting rights through market trades (on-floor transaction). In such transactions, it has been pointed out that general shareholders are not given sufficient information or time necessary for investment decisions and that there are issues of coercion (see the decision of the Tokyo High Court below). Therefore, it has been pointed out that market trades (on-floor transactions) should be subject to the tender offer rule.

Report of Working Group on tender offer rule (2006)

"Basically, in market trades other than off-floor transactions, anyone can participate, the volume and price of transactions are publicized, and prices are formed by competitive trading methods. Depending on the type of transaction, there may be cases where the difference between market trades other than off-floor transactions and off-market trades is relative, but it is necessary to draw a line of regulations based on certain standards. The current rule that does not impose restrictions on tender offers on market trades other than off-floor transactions is considered to be reasonable to a certain extent."

Tokyo High Court, decision of November 9, 2021

“The appellants purchased shares whose ownership ratio of share certificates exceeds 1/3 in a short period of time through acquisition of shares on market trades that is not subject to the tender offer rule. Such purchase do not provide general shareholders with sufficient information and 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.”

Issues to be discussed

- What is your view on **making transactions for acquiring more than 1/3 of the voting rights through market trades subject to the tender offer rule**?

Third-party allotment (issuance of new shares)

- It has been pointed out that third party allotment (issuance of new shares) should be subject to the tender offer rule.

Comments on the Current Rule

- Under the current tender offer rule, the act of acquiring newly issued shares by third-party allotment is basically a problem to be resolved under the Companies Act and is not subject to the tender offer rule.
- On the other hand, it has been pointed out that transactions to acquire more than 1/3 of the voting rights through third party allotment should be subject to the tender offer rule since the act of acquiring treasury shares (issued shares) through third party allotment is subject to the mandatory tender offer rule and third-party allotment is also subject to the tender offer rule in European countries (Note 1).

Report of Working Group on tender offer rule (2006)

"With regard to third party allotment of shares, under the Companies Act, in cases of discounted issuance or issuance by using a method that is extremely unfair, there is a relief system such as an injunction, and it is considered that this issue will basically be resolved as a problem under the Companies Act."

Amendments to the Companies Act (2014)

[The following disciplines were newly established]
With respect to capital increase through third-party allotment by a public company in which the expected allottee will be the controlling shareholder (with the majority of voting rights), if a notice of opposition is received from shareholders representing at least 1/10 of voting rights within two weeks, as a general rule (Note 2), approval (ordinary resolution) at a general shareholders meeting must be obtained.

Issues to be discussed

◆ What is your view on **making transactions to acquire more than 1/3 of the voting rights through third-party allotment subject to the tender offer rule**?

(Note 1) In the UK, Germany, and France, when a company acquires more than 30% of the voting rights by acquiring newly issued shares, the company must, as a general rule, make a tender offer for all shares subject to the acquisition at or above the highest transaction price in a certain period in the past and purchase all the subscribed shares (Hidenori Mitsui, "European tender offer rule - from the viewpoint of comparison with Japan's tender offer rule," Shojihomu No.1910 (2010), p. 18).
(Note 2) This provision shall not apply if there is an urgent necessity to continue the business of the public company when the state of assets of the public company is significantly worsening (Article 206, Paragraph 2, Item 4 of the Companies Act).

The 1/3 rule threshold

- It has been pointed out that the 1/3 rule threshold should be lowered.

Comments on the Current Rule

- Under the current tender offer rule, in light of the fact that "1/3" is a basic ratio that can block a special resolution of a general shareholders meeting, if the voting rights ratio after the acquisition exceed "1/3," it is obligated to conduct a tender offer even if the purchase is made from an extremely small number of persons (so-called 1/3 rule).
- On the other hand, taking into account the actual ratio of voting rights exercised, it is possible to acquire veto rights for special resolutions at general shareholders meetings at a ratio lower than 1/3. Therefore, it has been pointed out that the threshold should be lowered from 1/3.

Report of Working Group on tender offer rule (2006)

(i) The "1/3" is consistent with the basic ratio that can block a special resolution under the Companies Act, and (ii) there is a problem that lowering the "1/3" threshold may hinder the smoothness of corporate restructuring activities. Considering the balance between these, we believe that it is basically appropriate to maintain the current "1/3" threshold.

Threshold for mandatory tender offer rule in other countries (Note 1)

U.S.	5% (no regulation equivalent to 1 / 3 rule)
UK	30% (Note 2)
Other	Germany and France are 30% (Note 3)

Issues to be discussed

◆ What is your view on **lowering the threshold for the 1/3 rule and the specific threshold**?

(Note 1) In the UK, Germany, and France, there is a rule that a tender offer must be conducted after acquiring the voting rights over the threshold, not at the time of acquiring the voting rights over the threshold (Hidenori Mitsui, "European tender offer rule - from the viewpoint of comparison with Japan's tender offer rule," Shojihomu No.1910 (2010), p. 18).
(Note 2) In the UK, the threshold of 30% seems to be adopted based on the idea that effective control can usually be obtained by acquiring more than 30% of the voting rights (Japan Securities Research Institute, "UK M&A System in UK Study Group Report" (June 30, 2009), p. 3).
(Note 3) In Germany, since the attendance rate of general shareholders meetings was generally 60% or less, 30% seems to be the threshold (Japan Securities Research Institute, "European M&A System Study Group Report" (September 13, 2010), p. 4).

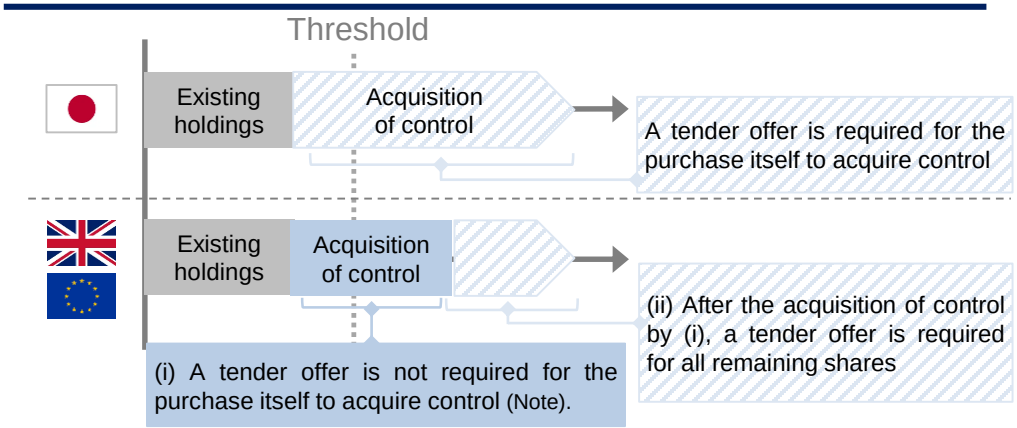
Conversion to the European Tender Offer Rule (ex-post approach)

- It has been pointed out that consideration should be given to converting to European-type rules.

Comments on the Current Rule

- The Japanese tender offer rule requires that a purchase itself that would result in the acquisition of voting rights in excess of the threshold be made by tender offer. On the other hand, the European tender offer rule (e.g. UK) does not place any restriction on the method of acquiring voting rights above the threshold but is an ex-post approach that requires all shareholders to make a tender offer thereafter.
- It has been pointed out that the scope of application of tender offer rules may differ between Japan-type rules and European-type rules (ex-post approach), and therefore the appropriateness of converting Japanese-type rules into European-type rules, including the ex-post approach, should be discussed.

Difference between Japanese rule and European rule



Characteristics of the European tender offer rule

The European tender offer rule is considered to ensure that minority shareholders have the opportunity to sell their shares at a fair price at the time of transfer of control. As a result, the European tender offer rule has the following features that are different from the Japanese tender offer rule.

- Ex-post approach (see left diagram)
- Partial tender offer is prohibited in principle
- Minimum price regulation
- Market trades and third-party allotment are also subject to the tender offer rule.

Issues to be discussed

◆ What is your view on **converting the tender offer rule to the European tender offer rule (ex-post approach)**?

(Note) Under the European-type ex-post approach, it is also permitted to conduct a purchase to acquire control in (i) above through a voluntary tender offer. Therefore, it has been pointed out that there are not a few cases in which a controlling interest is acquired by means of a voluntary offer in order to avoid the application of the mandatory tender offer rule, which is subject to strict regulation (Hiroyuki Watanabe, "Focal Point of Tender Offer Rule," Ozaki Yasuhiro et al., ed., "Tatsuo Uemura Koki(70th birthday) commemoration - Public Company Law and Legal Theory of Capital Markets" (Shojihomu Co., Ltd., 2019), p. 529). According to statistics from the UK's Takeover Panel, only four of the 57 takeover bids closed in the year to the end of March 2022 were made through mandatory tender offer (The Takeover Panel "2021-2022 Annual Report" (Jul. 15, 2022), at 15)).

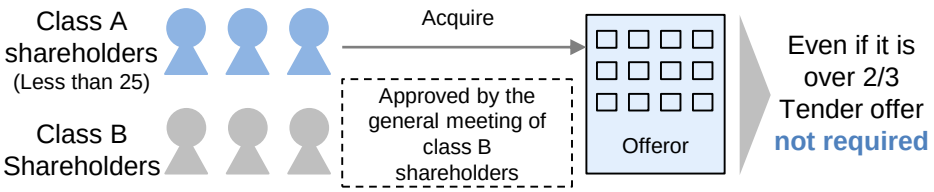
Opt-in / Opt-out System for Tender Offer Rule

- It has been pointed out that an opt-in / opt-out system for the tender offer rule should be established.

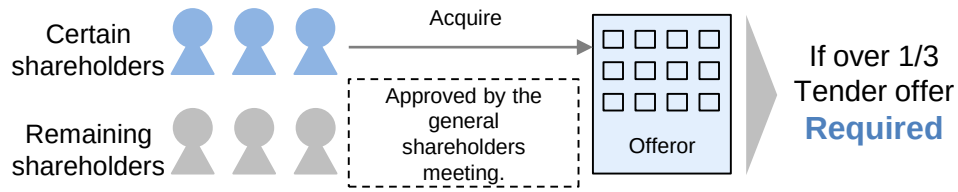
Comments on the Current Rule

- Under the current tender offer rule, a purchaser may make a purchase of shares of a company issuing multiple classes of shares, even if it is an acquisition of 2/3 or more of voting rights, without making a tender offer, provided that all of the class shareholders subject to the purchase (less than 25) agree to such purchase, and the purchase is approved by the general meeting of class shareholders not subject to the purchase. On the other hand, a purchaser who intends to purchase shares of a company issuing only one class of shares must make a tender offer as long as it is an acquisition of more than 1/3 of voting rights, even if the shareholders not subject to the purchase approve it at the general shareholders meeting.
- Regarding such differences, it has been pointed out that there should be no difference in the necessity of determining whether or not to apply the tender offer rule according to the intentions of shareholders even for companies that issue only one class of shares, and that it should be allowed to be exempted from the application of the mandatory tender offer rule when shareholders who are not subject to the tender offer approve the purchase at the general shareholders meeting.
- In addition, from the same perspective, it has been pointed out that the appropriateness of various tender offer rules (including each rules to be discussed this time) should be determined by the provisions of the articles of incorporation or approval of the general shareholders meeting.

More than one class of shares is issued



One class of shares is issued



Issues to be discussed

◆ What is your view **on the establishment and content of an opt-in / opt-out system for the tender offer rule** based on the provisions of the articles of incorporation and approval of the general shareholders meeting?

Measures against Coercive Tender Offer

- It has been pointed out that certain measures should be taken against a coercive tender offer.

Comments on the Current Rule

- In the case of a tender offer that is expected to reduce the corporate value of the target company after the acquisition of control, there is a problem in that general shareholders have an incentive to apply for the tender offer in order to avoid disadvantages due to the reduction in corporate value (so-called coercive tender offer). There is a risk that general shareholders may be forced to accept the tender offer price at an unreasonably low price, and that acquisitions that reduce corporate value will tend to be more successful. It has also been pointed out that these risks are more likely to occur in a partial tender offer (tender offer with an upper limit) than in a tender offer without an upper limit. (Note).
- In order to address the issue of the coercive tender offer, the following measures could be taken with reference to the Takeover Code in the UK.

Measures to eliminate or reduce the risk of coercion

I	A measure to lower the threshold (currently 2/3) at which a partial offer is allowed.
II	A measure that requires a tender offer period to be divided into (i) a normal tender offer period and (ii) an additional tender offer period, and if the tender offer is successful in (i), an additional tender offer period (ii) must be set (shareholders who apply in (i) cannot withdraw their application during the additional tender offer period in (ii)).
III	A measure that distinguishes between (i) intention to tender or not to tender in a tender offer and (ii) intention to vote for or against the tender offer, and allows the implementation of the tender offer only when the number of votes in favor exceeds the number of votes against in (ii) (or when there is a majority of votes in favor at a general shareholders meeting)

Issues to be discussed

◆ What is your view on the **implementation of measures to address the issue of coercive tender offer and the content of such specific measures**?

(Note) In the case of a tender offer without an upper limit, since the tender offeror must purchase all the tendered shares, in order to make it economically viable for the tender offeror, the tender offer price must be set lower (compared to the case of a partial tender offer), and it has been pointed out that it is likely to be possible for each shareholder to choose not to tender predicting that other shareholders will also not subscribe.

Tender Offer Injunction

- It has been pointed out that the rule regarding an injunction against a tender offer should be considered as ex-ante relief.

Comments on the Current Rule

- Under the current tender offer rule, there is no rule regarding an injunction against a tender offer. In addition, Article 192 of the Financial Instruments and Exchange Act provides that a court may issue an order of injunction or suspension of an act in violation of the Act upon petition by the authorities, but no petition has been filed in relation to a tender offer.
- It has been pointed out that the rule regarding injunction against tender offer should be established as ex-ante relief in tender offer, similar to the rule regarding an injunction of reorganization under the Companies Act.
- In such cases, it has been pointed out that (i) the grounds for injunction include not only cases of violation of laws and regulations but also cases where the tender offer is extremely unfair, and (ii) the holder of the rights to injunction may include not only the shareholders of the target company but also the target company (Note 1).

Order for injunction or suspension based on Article 192 of the Financial Instruments and Exchange Act

Holder of Right	Issued by the court upon petition by the authorities
Grounds for Injunction	Where there is an urgent necessity and it is necessary and appropriate for the public interest and protection of investors;
Subject to Injunction	Acts in violation of the Financial Instruments and Exchange Act or orders based on the Act;

Issues pointed out by the Companies Act Subcommittee of the Legislative Council (Note 2)

In practice, it is customary to conduct an investigation under Article 187 of the Financial Instruments and Exchange Act prior to a court injunction or suspension order under Article 192 of the same Act, which takes time. Therefore, it is quite possible that the settlement of the purchase will be completed before the injunction of the tender offer.

Issues to be discussed

◆ What is your view on **the establishment of tender offer injunction rule, as well as the grounds for injunction and the holder of the rights to injunction**?

(Note 1) Masanori Wakita & Ryo Chikasawa, "Prior corrections and remedies in M & A Involving tender offer," Shojihomu No. 2311 (2022), p. 82
(Note 2) Minutes of the 12th Meeting of the Companies Act Subcommittee, Legislative Council (as of August 31, 2011) Page 55

Ex-post Relief in Tender Offer

- It has been pointed out that ex-post relief for violations of the tender offer rule should be expanded.

Comments on the Current Rule

- Under the current tender offer rule, civil liability for damages, administrative monetary penalty, and criminal penalty are established as ex-post relief and sanction for the violation of the tender offer rule. However, there is no rule that enables the injunction of the exercise of voting rights for shares acquired in violation of the tender offer rule.
- On the other hand, it has been pointed out that if a violation of the tender offer rule occurs, shareholders' opportunities to sell their shares may be taken away, and it may harm the fairness of corporate control. Therefore, in order to ensure the effectiveness of the tender offer rule and to secure the interests of shareholders, ex-post relief such as injunction of the exercise of voting rights should be enhanced.

Discussions at the time of revision of the Companies Act in 2014

When the Companies Act was revised in 2014, a report prepared by the Legislative Council proposed a rule that would enable the injunction of the exercise of voting rights for shares acquired in violation of the tender offer rule. However, this rule was not included in the revised Companies Act for the following reasons (Note 1).

"It has been pointed out that the connection between the requirement of a violation of the tender offer rule under the Financial Instruments and Exchange Act and the legal effect of an injunction of the exercise of voting rights under the Companies Act is not sufficient (in particular, even if there is a violation of the tender offer rule, other shareholders may not necessarily immediately suffer specific disadvantages that cannot be recovered by a claim for damages. Moreover, beyond the recovery by money in a claim for damages, there may be no disadvantage enough to allow the injunction of the exercise of voting rights, which is a fundamental right of shareholders under the Companies Act). Therefore, it has decided not to include these provisions in the amended Act and the Development Act."

Issues to be discussed

◆ What is your view on **the enhancement of the ex-post relief for tender offer and its contents?**

(Note1) Saburo Sakamoto "Q&A for Revised Companies Act in 2014 [2nd edition]" (Shojihomu, 2015) p. 378

Flexibility and Operational Structure of Tender Offer Rule

- It has been pointed out that various regulations in the tender offer rule should be able to be applied flexibly in light of individual cases.

Comments on the Current Rule

- 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 such a system could lead to rigid operation of the system. Therefore, from a substantial perspective, a system that permits exceptional 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.

Regulations under the tender offer rule

- ✓ Regulations on mandatory tender offer
- ✓ Regulations on uniformity of tender offer price
- ✓ Regulations on purchase outside of tender offer
- ✓ Regulations on tender offer period
- ✓ Regulations on changes in terms and conditions of purchase
- ✓ Regulations on withdrawal of tender offer
- ✓ Regulations on partial tender offer

Other disclosure regulations that permit exceptional treatment on a case-by-case basis

- ✓ Shortening of the effective period of securities registration statements (the authorities may allow shortening of the effective period in certain cases)
- ✓ Extension of the deadline for submission of annual securities reports (the authority may extend the deadline in certain cases)
- ✓ Non-public disclosure of business secrets (the authority may choose not to make part of a statutory disclosure document available to the public)

Issues to be discussed

◆ With regard to various regulations under the tender offer rule, what is your view on **the establishment of a system that allows exceptional treatment on a case-by-case basis from a substantial perspective, as well as the content of the system and the operational structure that plays a substantial judgment function**?

Other Issues on the Tender Offer Rule (1)

☐ In addition, the following issues have been made regarding the tender offer rule

1 Uniformity of Tender Offer Price (Consent is obtained)

- In practice, there are cases where certain large shareholders agree to tender at a lower price than general shareholders. Under the current rule, the tender offer price must be the same for all shareholders (regulation of uniformity), so in such cases, it is necessary to conduct two tender offers for the large shareholders and general shareholders, respectively.
- However, conducting two separate tender offers increases administrative and time costs and creates a risk that a second tender offer will not be launched. **Therefore, it has been pointed out that the uniformity requirement should be relaxed to allow the tender offer price to be set at a lower level only for shareholders who have given their consent in one tender offer.**

2 Uniformity of Tender Offer Price (Different Classes of Shares)

- The tender offer price must be uniform for all shareholders. In this regard, there is an interpretation that it is necessary to set the tender offer price according to each type of shares, so that the tender offer price is substantially the same even when different types of shares are subject to the tender offer, but this interpretation is not necessarily clear in the legal text.
- For this reason, it has been pointed out **that it should be clarified whether or not uniformity in tender offer prices is required for different types of shares, and if so, how uniformity is determined**.

3 Extension of the Tender Offer Period

- Under the current rule, if a tender offeror voluntarily extends the tender offer period, it must not exceed 60 business days, including the initial period in total. In addition, if an amendment to the tender offer statement is submitted after the remaining 10 business days of the tender offer period, the tender offeror must extend the tender offer period until the day on which 10 business days have elapsed from the date of submission.
- It has been pointed out **that voluntary extension of more than 60 business days should be allowed in certain cases, and extension of less than 10 business days should be allowed when submitting amendment statements**, because there are cases where extension of the tender offer period beyond 60 business days is required while a judicial decision relating to tender offer defense measures is pending, and there are cases where 10 business days of an awareness and deliberation period is not required when submitting amendment statements after obtaining clearance under competition laws in Japan and overseas.

Other Issues on the Tender Offer Rule (2)

4 Scope of Formal Special Relationship

- Under the current rule, if there is a certain capital relationship (20% or more of voting rights) with the acquirer, regardless of the actual situation, it is considered to be in a "special relationship" according to formal standards (so-called "formal special relationship"). However, even if there is a certain capital relationship with the acquirer, the two parties do not necessarily have the same voting rights policy.
- For this reason, it has been pointed out that **a rule should be introduced whereby even a person who falls in a formal special relationship could be excluded from the "special relationship" under certain circumstances**.

5 Scope of Shares Subject to the Tender Offer

- Under the current rule, all equity securities, including depositary receipts such as ADRs (American Depositary Receipts), must be subject to the tender offer if the voting rights ratio after the tender offer exceeds two-thirds.
- It has been pointed out that **tender offer for depositary receipts such as ADRs should be excluded from the scope of shares subject to the tender offers in the above cases** because it may be practically difficult to purchase depositary receipts such as ADRs due to foreign laws and regulations.

6 Clarification of Prior Consultation Policy on Tender Offer Statement

- In practice, prior consultation is conducted at the Kanto Local Finance Bureau in cooperation with the FSA when submitting a tender offer statement.
- With regard to such prior consultation, it is required to state the strategy (the basis for the proposed price) in the negotiation phase in the tender offer statement. Questions have been raised regarding this practical issue, and it has been pointed out that **the administrative guidance policy should be explained to companies and lawyers.**

7 Terms of Purchase Change / Withdrawals

- Under the current rule, even if a target company pays dividends during a tender offer period, the tender offeror cannot lower the tender offer price and can only withdraw the tender offer when the amount of such dividends exceeds a certain level.
- It has been pointed out that such a rule may make the tender offeror unreasonably bear the risk of dividends, and therefore, if dividends are distributed during the tender offer period, **the tender offeror should be allowed to lower the tender offer price by the amount equivalent to the dividends**.
- In connection with that, it has also been pointed out that **the grounds for withdrawal of a tender offer may be too strict.**

Contents

Scope of the Act of Material Proposal

- It has been pointed out that the scope of "the act of a material proposal" is unclear so that it becomes an obstacle to effective engagement between companies and investors.

Comments on the Current Rule

- Under the large shareholding reporting rule, a special reporting rule has been established for institutional investors to ease the frequency of submission. However, in order to be eligible for the rule, it is necessary that the purpose of shareholding is not to engage in "the act of a material proposal" to investee companies.
- Although the interpretation of "the act of a material proposal" was clarified when formulating the Stewardship Code, it has been pointed out that further clarification is necessary in order to promote effective engagement.

Based on the arrangement by the clarification of legal issues related to the development of the Japan's Stewardship Code(2014) (Note)

1	Request explanation of management policies.	May not be considered "Material Proposal"
2	Explanation for a specific plan for exercising voting rights	
3	Request for an explanation of the stance given on ②	
4	Ask questions at a general shareholders meeting	
5	Request for resolution of specific matters at a general shareholders meeting	May be considered "Material Proposal"
6	Request changes in business policies	*⑥ may be less likely to be a "Material Proposal" depending on the situation.

Main issues to be addressed

This arrangement has become a certain interpretation guideline. However, the following points are raised.

- The subject of the material proposal is comprehensive and as **the proposal relates to capital policy or business strategy, it may be regarded as a material proposal.**
- Issues can only be communicated indirectly through inquiries with the company, and **proposals cannot be communicated directly, so the company cannot understand the intention.**

Issues to be discussed

◆ What is your view on **limiting or clarifying the scope of "the act of a material proposal "** in order to promote effective dialogue between companies and investors?

Scope of the Joint Holders

- It has been pointed out that the scope of "joint holders" is so unclear that it becomes an obstacle to collective or collaborative engagement.

Comments on the Current Rule

- Under the large shareholding reporting rule, shareholders are required to calculate their shareholding ratio including the shareholdings of "joint holders."
- At the time of formulating the Stewardship Code, the interpretation of "joint holders" was clarified. However, in light of the recent increase in collective or collaborative engagements, it has been pointed out that the scope of "joint holders" needs to be further clarified.

Based on the arrangement by the clarification of legal issues related to the development of Japan's Stewardship Code(2014) (Note)

In principle, the following cases may not be considered "joint holders":

- ✓ The agreement between an investor and another investor remains within the scope of shareholders' general activities that are unrelated to the exercise of legal rights.
- ✓ In the situation where an investor in discussions with another investor communicates their plan for the exercise of voting rights and finds that the plan is the same as the other investor.

Main issues to be addressed

This arrangement has become a certain interpretation guideline. However, the following points are pointed out.

- ➢ There is a concern that if an investor who participated in the collective or collaborative engagement submits a shareholder proposal, and then the other investor agrees to it, the other investor may be considered as a "joint holder";
- ➢ The concept of "joint exercise of voting rights" can be read as a very comprehensive regulation, with no limitations on the purpose of controlling management.

Issues to be discussed

◆ Given that it has been pointed out that the interpretation of "joint holder" is unclear when conducting collective or collaborative engagements, what is your view **on limiting or clarifying the scope of "joint holders"**?

Treatment of Derivatives

- It has been pointed out that derivatives transactions should be subject to the large shareholding reporting rule.

Comments on the Current Rule

- Under the current large shareholding reporting rule, holding long positions of equity derivatives such as total return swaps (Note 1) and CfD (Note 2) is not considered to be subject to the large shareholding reporting rule, unless there are special circumstances such as in which settlement by delivery of shares is expected at the end of derivative transactions.
- It has been pointed out that the rule should be revised so that long positions of equity derivatives, which are not covered by the current rule, will be subject to the large shareholding reporting rule from the viewpoint of increasing the transparency of information that may affect the supply and demand of shares and control over shares and improving the governance of listed companies through deepening dialogue with major beneficial shareholders.

Treatment of derivatives transactions in other countries

U.S. 

SEC proposed amendments in February 2022 (not yet finalized) that would provide that a holder of a cash-settled derivative security(Note 3) will be deemed to be a beneficial owner if the derivative is held with the purpose or effect of changing or influencing the control of the issuer. .

UK 

(a) Financial instruments that give unconditional rights to acquire shares with voting rights and (b) other financial instruments which are referenced to shares and with an economic effect similar to (a), whether or not they confer a right to physical settlement, shall be included in the calculation of the holding ratio.

Other 

Derivatives disclosure requirements have also been introduced in France, Germany, Hong Kong and Switzerland, following the UK (Note 4).

Issues to be discussed

◆ What is your view on **including the holding of long positions in equity derivatives, such as total return swaps and CfDs, in the scope of application of the large shareholding reporting rule**?

(Note 1) It means a transaction where returns including capital gains and income gains on underlying assets are exchanged for predetermined interest rates and all cash flows generated from underlying assets, such as stock returns and dividends, are exchanged for fixed interest rates or floating interest rates.
(Note 2) An abbreviation of Contract For Difference, which is a transaction to settle the difference that occurred from the beginning of the transaction to the end of the transaction.
(Note 3) It is proposed that the holding status of securities-based swaps based on shares as underlying assets should be disclosed based on Rule 10B-1, which is separately proposed to be newly established, instead of the large shareholding reporting rule.
(Note 4) Izumi Kawashima, "Laws and Regulations on Hidden Ownership through Equity Derivatives - Trends in Disclosure Regulations in the U.K. and the U.S.," Waseda Social Science Research Institute Vol. 14, No. 1 (2013), p. 37

Ensuring the effective implementation of the Large Shareholding Reporting rule

- It has been pointed out that the effective implementation of the large shareholding reporting rule has not been ensured.

Comments on the Current 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.

Submission of the large shareholding report	
Number of submissions of the large shareholding report (Note 1)	Approx. 14,000 cases per year
Number of late submissions (Note 2)	Approx. 1,500 cases per year
Number of administrative monetary penalty payment orders (Note 3)	Total 8 cases

Main reasons for late submission (Note 4)

1. Ignorance and insufficient understanding of laws and regulations
2. Not familiar with EDINET operation
3. Delay in fact-finding

Issues to be discussed

◆ What is your view on **the necessity and content of measures to ensure the effective implementation of the large shareholding reporting rule**?

(Note 1) Average from 2019 to 2022.
(Note 2) Average number of reports submitted after the due date from 2019 to 2022.
(Note 3) Number of cases from 2008 to 2022.
(Note 4) Based on interviews conducted by local finance bureaus with persons whose submission of a report was delayed.

Other Issues Regarding the Large Shareholding Reporting Rule

- In addition, the following issues have been pointed out regarding the large shareholding reporting rule.

1 Treatment of Shares with Call / Put Options

- Under the current rule, in the calculation of the shareholding ratio, the number of shares acquired through the exercise of share options is treated as a numerator, whereas the number of shares with call or put options is treated as a numerator.
- With regard to such treatment, it has been pointed out that **the number of shares acquired through the exercise of call or put options should be treated as a numerator.**

2 Clarification of Description

- Under the current rule, a large shareholding report is required to describe the "purpose of holding" and "material contracts such as collateral contracts related to the shares." However, in practice, the content and method of description are not necessarily clear,(Note) so it has been pointed out that the description differs depending on the person who submits the report.
- In light of such situation, it has been pointed out that **it is necessary to clarify the content and method of descriptions, such as "purpose of holding" and "material contracts such as collateral contracts related to the shares**."
- It has also been pointed out that **consideration should be given to reviewing the content of the statements, taking into account the possibility that one of the causes of the delay in submission was the complexity of the current methods of description**.

(Note) Under the current rule, regarding the description of "purpose of holding," it is provided that "the purpose and contents thereof, such as “net investment,“ “strategic investment“ and “act of material proposal” shall be described specifically as much as possible, and if there are multiple purposes, all of them shall be described." (Instructions on Preparation (10) of Form 1 of the Cabinet Office Ordinance on Disclosure of Status of Large Shareholding.) In addition, regarding the description of "material contracts such as collateral contracts related to the shares," it is provided that "if there are lease agreements, collateral agreements, sell-back agreements, sales precontracts, or other material contracts or arrangements, the contents of the said contracts or arrangements such as the type of the contract, the counterparty to the contract, and the quantity of shares subject to the contract shall be described. If shares are held by an operating partner of a partnership or association or are jointly owned, such fact shall be described." (Instructions on Preparation (14) of Form 1 of the Cabinet Office Ordinance on Disclosure of Status of Large Shareholding.)

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Transparency of Beneficial Shareholders

- It has been pointed out that a system that enables the identification of "beneficial shareholders" should be considered.

Comments on the Current Rule

- Under the current rule, companies and shareholders can ascertain the status of nominal shareholders through disclosure of the status of shareholders, such as the shareholder registry under the Companies Act and 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 are not nominal shareholders but 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 (over 5%).
- From the viewpoint of promoting dialogue between companies and shareholders/investors and building mutual trust, it is pointed out that practical considerations should be made with reference to the systems in other countries so that companies and other shareholders can efficiently identify the beneficial shareholders and the number of shares held by them.

Transparency Regimes for Beneficial Shareholders in Other Countries (Note)

U.S.

- An institutional investment manager that exercises investment discretion over $100 million or more in securities that trade on a national securities exchange must report details of its holdings including the name of the issuer and class, the CUSIP number, the number of shares and the total market value quarterly on Form 13F with SEC. Form 13F fillings are publicly disclosed on EDGAR database.

UK

- A public company may give notice to any person whom the company knows or has reasonable cause to believe to be interested in the company's shares with voting rights issued to confirm the fact.
- Those who received such notice are required to confirm whether or not it is the case, and if he or she holds or has held any such interest, to give further information including the information enough to identify persons interested in the shares in question and the number of shares within such reasonable time as may be specified in the notice.

Issues to be discussed

◆ What is your view on **the necessity and content of measures to enable the company and other shareholders to effectively identify beneficial shareholders**?

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Questions for Discussion

- With regard to the tender offer rule, the large shareholding reporting rule, and the transparency of beneficial shareholders, are there any excesses or deficiencies in the matters listed in "A) tender offer rule," "B) large shareholding reporting rule," or "C) transparency of beneficial shareholders" as issues to be discussed in light of recent environmental changes in capital markets? In addition, with regard to these issues, what should be noted in particular and what is the order of priority for each issue?

- In addition to the above, what points should be considered and taken into account when conducting deliberations?