Mizuho Custody Newsletter

January 2022 | Japan

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I. Market News

1. The number of IPO grew in 2021

In 2021, the number of initial public offering (IPO) reached the second highest level since 2006, reports Nikkei Shimbun, Japan's leading financial daily.

There were 125 new listings in 2021, an increase by 32 from the previous year and the highest since 2006 when there were 188 cases. This was driven not only by the rise of the companies dealing with cloud and artificial intelligence due to growing demand for digitalization under the coronavirus crisis. One of the traits seen in 2021 was that many of the listings were by ESG-related companies.

"We wanted to impart to both foreign and domestic investors that we were a company specialized in renewable energy," says the CEO of a renewable energy company, explaining why the company went public under the framework of "Green IPO" referring to the Green Bond Principles of the International Capital Market Association (ICMA). The company plans to invest all of the proceeds raised in the listing in renewable energy-related projects and has obtained a third-party evaluation. This is an extremely rare initiative in Japan.

A company which designs renewable energy and energy-saving equipment, and another company which manufactures and sells chemical products have obtained third-party evaluations in accordance with the Green Bond Principles and the Social Bond Principles. Such evaluations will benefit the companies to get more financial resources than before, under the circumstance that ESG has been attracting investors' attention worldwide.

It is also noteworthy that more companies related to foreign businesses were listed on the Tokyo Stock Exchange ("TSE") than usual. These companies are defined as "cross-border companies" by the TSE. It includes companies registered or previously registered in foreign countries, Japanese companies with foreigners as the top management, and Japanese subsidiaries of foreign-domiciled companies.

In June, a Singaporean company was listed on the TSE Mothers market via Japanese Depository Receipts ("JDR"), a system that allows to treat overseas stocks as domestic ones. Listing via JDR took place for the first time in the past four years. The CEO of the company said "TSE appears to be less volatile than other markets" aiming to benefit from the stability.

A Taiwanese company developing artificial intelligence acquired Japanese registration and went public in March. Two Japanese companies having foreign nationals as their top executive also went public.

There are IPOs by 5 cross-border companies in total, which is the highest in the last 10 years, according to TSE. TSE believes that its variety of investors and stability of their markets have been attracting companies into their markets.

On average, it takes 19 years for the company to go public since its establishment, which is up about 1 year from the previous year. On the other hand, about 40% of the companies were established after the global financial crisis in 2008, which shows that the generational change among listed companies has been steadily progressing.

The CEO of a data service company that went public only three years after its foundation says "Privately held companies without any track record may be less prone to risk taking by large corporates. We would like to expand our business by taking advantage of the listing."

On the side of business performance, many loss-making companies went public. Deputy general manager at a domestic securities firm says "Investors have learned that businesses like SaaS (which provides software via the cloud) are prone to make losses as they need to invest first."

The number of IPOs recorded second high in 15 years from its previous record, but it is still lower than the number of IPOs overseas. The U.S. had about 1,000 in 2021, while Japan had only about 10% of it. Japan needs more start-ups and entrepreneurs to get off the hook of the long-lasting sluggish economy.

Information compiled from Nikkei Shimbun & Mizuho research

2. Asset management firms vote agaist the election of directors, if no improvement made on ESG

Domestic asset management firms intend to deepen the dialogue with their investees by shedding more lights on the election of directors, reports Nikkei Shimbun, Japan's leading financial daily. From 2022, they will stipulate in their voting standards to vote against the election of directors at shareholders meetings, if there are no improvements in disclosures on ESG. As they declare to proceed decarbonization on their portfolio, they will also urge the companies to get more active on ESG.

For example, asset management firms request companies to disclose their greenhouse gas emissions and reduction targets. Although they would set no quantitative standard to vote against the election of directors, companies' preparedness for climate risks could be a factor of decision making for their voting.

One of the major asset management firms has adopted a new policy to oppose proposals of election of directors, if it recognizes the company's disclosures on climate change, environment and society are insufficient and no improvement are made through dialogues with the company.

They voted in favor of all shareholder proposals related to climate change at AGMs in June 2021. From this year, they will encourage companies that they invest in to take more active measures by going far as to imply casting a nay vote to the appointment of directors.

Another asset manager would oppose for the appointment of directors, if improvement was not seen for ESG, etc., through dialogues. In November 2021, they established an Engagement Promotion Office. They brought experts on corporate research, ESG, etc., from various departments, and have set policies and goals on dialogues with investees.

What is behind is the wave of decarbonization to which asset managers themselves are exposed. Major Japanese asset managers are members of "GFANZ (Glasgow Financial Alliance for Net Zero)", a coalition of financial institutions that aims to achieve net-zero greenhouse gas emissions on the companies in which they invest by 2050.

The measures that asset managers can take for investees are, (i) to encourage companies to decarbonize through dialogue, and (ii) divestment from the companies with high emissions.

While an asset manager who is good at active investment says divestment should not be abandoned as their options, many asset managers have passive investment products as a mainstream, which is closely linked to stock price indices. Since they cannot choose stocks that they invest in, they have no choice but to urge companies to change through dialogues.

In addition to deepening the level of the dialogue, another asset manager is going to request the companies to take concrete measures for climate change. They would oppose to the appointment of board members, if disclosure would be insufficient based on frameworks such as Task Force on Climate-related Financial Disclosures ("TCFD"), which comprises of financial regulatory authorities of major countries, or if progress in reducing greenhouse gas emissions had not been made for several years.

Tokyo Stock Exchange will reorganize its markets in April 2022. Companies listed on the most prestigious "Prime Market" need disclosure in line with TCFD. New voting standards of domestic asset managers will also be presented in this spring. Companies will be required to respond more positively to ESG initiatives and disclose information from the viewpoint of both institutional shareholders and market system.

Looking abroad ahead, a major U.S. investment manager voted in favor for 75% of environmental proposals in 2021. Asset management industry in Japan is clearly following the global trend in which ESG is a core theme for global asset management industry as a whole.

Information compiled from Nikkei Shimbun & Mizuho research

3. Foreign investors increase to hold JGBs

Foreign investors have been getting more influential on Japan's bond market, reports Nikkei Shimbun, Japan's leading financial daily. As of end of September 2021, overseas investors held 13% of Japanese government bonds ("JGBs") issued, increasing 230 percent during the past 20 years. While bond prices fell (interest rates rose) as countries began quantitative easing tapering, Japan maintained large-scale easing policy which has stabilized interest rates. They purchase JGBs due to the low risk of falling prices. However, continuous purchase by overseas investors may heighten the risk of a sharp rise in interest rates.

According to the Ministry of Finance's report on inward investment in securities announced on 12 January, net purchases by overseas investors in Japanese bonds for the whole year of 2021 was JPY 12.42 trillion, the record high. In particular, the sector net purchased a total of JPY 4.8 trillion during the period from October to December, suggesting that the ownership ratio of JGBs by overseas investors may have jumped up further.

"With the outlook for U.S. monetary policy remaining uncertain, many investors ordered to buy JGBs for their less volatile interest rates," said a trader at a domestic securities firm.

The Federal Reserve Board (FRB) and other central banks are seeking tapering of quantitative easing which was introduced in response to the coronavirus outbreak. The market has been coming to be aware of tightening monetary policy, where interest rates rise and bond prices fall.

On the other hand, it is believed that JGBs have very limited risk of a sharp fall in bond prices, due to Bank of Japan's clear intention to continue monetary easing, and long-term interest rates have been controlled to stay at the range of plus or minus 0.25%.

There is little change in the yield curve due to long and short interest rate operations. If the yield curve does not change significantly, a "roll-down effect" can be expected in which bond prices rise along with a decrease in the duration unless the bonds are sold.

While yields of medium-term JGBs have been in negative territory and the yield of 10 year bonds, the benchmark of long-term interest rate has been as low as 0.1%, a strategist at a major brokerage firm said "Such feature of JGBs seem to look more attractive for investors seeking benefit from the roll-down effect."

According to Bank of Japan ("BOJ"), foreign investors hold JGBs and treasury bills in the amount of JPY 164 trillion, as of the end of September 2021. "The impact on domestic interest rates would be significant if foreign hedge funds would drastically change their positions," says a trader at a foreign securities firm.

In March 2020, when the global pandemic accelerated investors' exodus to more safety assets, foreign investors sold Japanese bonds JPY 4.57 trillion on net, which pushed long-term interest rates up by 0.25% in 2 weeks. "Unlike domestic investors, overseas investors trade agilely in response to market movements, and interest rates tend to fluctuate if they hold more bonds," says a chief interest rate strategist at a leading brokerage firm.

Japan's long-term interest rates have been rising since the beginning of the year 2022, affected by the U.S. market. Investors are coming to be aware when BOJ would end the current quantitative easing policy given the fact that BOJ Governor Haruhiko Kuroda's term expires in April 2023. It is uncertain whether overseas investors will continue to purchase JGBs beyond 2022, but some market participants anticipate a situation where the resilience of the domestic bond market would face challenges.

Information compiled from Nikkei Shimbun & Mizuho research

4. More than 80% of the companies listed on the 1st Section of the TSE moves to the Prime

Market

On January 11, Tokyo Stock Exchange ("TSE") announced which company would go to which market following the implementation of the stock market restructuring on 4 April. 1,841 companies will be listed on the Prime market, which will be the most prestigious market. More than 80% of the companies listed on the 1st Section will move to the Prime market, while just less than 20% of them will move to other markets. The market restructuring has an aim to prompt reshuffle of the companies listed in the market to happen more often by tightening the listing standards. However, about 300 companies are supposed to be listed on the Prime market via transitional mitigation measures that allow them to be on the Prime market in spite that they have failed to meet the standard, leaving some challenges for revitalization of the stock market in Japan, reports Nikkei Shimbun, Japan's leading financial daily.

Over 600 companies listed on the 1st Section that did not meet the standard of the Prime market were divided into two ways.

296 companies are going to be listed on the Prime market by submitting a plan document for meeting the listing standard to TSE, defined as the mitigation measures. TSE has not announced when they would have to achieve the goal for now. TSE plans to make the decision after reviewing the contents of the plan documents with experts. Some companies assume to take 10 years to reach the goal.

The rest of them, 321 companies will go to the Standard market. Main reasons of their decision are, for example, that they failed to meet the listing requirement on tradable shares ratio since their parent company is their large shareholder, or that they focus on domestic business and therefore the Standard market would fit their strategy better than the Prime market. 23 companies listed on the 1st Section chose the Standard market nevertheless they meet the standard of the Prime market.

The number of companies listed on the 1st Section increased by 30% during the past 10 years. On the other hand, in the U.S., the figure fell about 40% from its peak in the late 1990s. As low-profit companies were forced to exit the market or were acquired, this active reshuffling in the premier market has been underpinning to keep the market active.

TSE has two aims in the market restructuring project. One is the "clarification of market concepts" which facilitates the companies to find the best market for each of them by showing them clear definition of each market, and the other is the "motivation to improve corporate value", which impose them to continue meeting the standard of the most prestigious market and eventually requires companies to make continuous efforts to stay in the premier market.

TSE reviews its core market structure for the first time in 60 years since 1961, when it established the 2nd Section. The primary aim of the review is to resolve issues left over since the merger of TSE and Osaka Securities Exchange (current Osaka Exchange ("OSE")) back in 2013. As 1st Section, 2nd Section, and Mothers of the TSE and JASDAQ of the OSE were not reorganized after the merger, markets with similar concepts remained in the merged entity. In the 1st Section, the number of companies increased without a clear concept due to the looser standard that apply to companies moving from a lower market to the 1st section.

TSE slims down the market structure into "three markets formation" to clarify the concept of each market. Prime market is for companies that have high liquidity, high governance and growth strategy based on constructive dialogue with foreign investors. Standard market is for companies that have reasonable level of liquidity and basic governance. Growth market is for companies that have plans to realize a high growth and could obtain a high evaluation from the market.

The core listing standard is the market capitalization of tradable shares that investors can actually trade. For the Prime market, it is JPY 10 billion or more. For the Standard market, it is JPY 1 billion or more and for the Growth market, it is JPY 0.5 billion or more. Tradable shares ratio has to be at least 35% for the Prime market, and at least 25% for the Standard market and the Growth market. Each market has its own standards for the number of shareholders, financial condition and earnings.

TSE introduces stricter delisting standards than those of the markets overseas. TSE applies the same standards for both initial listing and listing maintenance so that companies have to make more efforts than ever to stay listed on the new market. While the 1st Section required market capitalization of JPY 25 billion or more for initial listing, delisting threshold was JPY 1 billion. TSE will no longer allow automatic change of market if a company becomes unable to meet the listing standards. If they find it difficult to achieve the listing standards during the grace period, they will have to re-select a new market, apply for listing and obtain approval.

TSE also revised the issue that the listing standards for the 1st Section differ for direct listing and transfer from within. In the case of a transfer to 1st Section from 2nd Section or Mothers, the required market capitalization was JPY 4 billion, which was much less than the JPY 25 billion required for a direct listing or changing the market from JASDAQ.

The companies listed on the Prime market are required to have a sophisticated management structure and information disclosure under the Corporate Governance Code, which was revised in June 2021. At least one third of board members should be outside directors. They are also required to disclose information on climate change risks based on recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), which is an international framework. Disclosures in English are also required for financial results and timely disclosures. Non-compliance to the requirement will not immediately result in violation of the listing standards, but will require an explanation of the reason.

Some market participants recognize there should be further rooms for improvement in the new market structure, because TSE has not announced when the mitigation measures would end. An audit firm says "There are only a few companies that has formed a clear strategy for future growth." Other market participants call for stricter requirements, as mentioned by the chairman of the Japan Association of Corporate Directors, "It would not make any sense in creating a new market segment unless only about 100 excellent companies are selected to list on the Prime market, and the rest of the companies continue making efforts to go up to the Prime market. It is necessary to further strengthen the level of the governance."

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

New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
Feb-03	Recovery International	JP3969900004	M
Feb-04	SEYFERT	JP3415700008	J
Feb-09	LIGHTWORKS	JP3965900008	M
Feb-17	EDGE Technology	JP3164440004	M
Feb-22	CaSy	JP3208800007	M
Feb-22	Nhosa	JP3759100005	J
Feb-24	BeeX	JP3799690007	M
Feb-25	MERCURY REALTECH INNOVATOR	JP3860120009	M
Mar-02	Bewith	JP3799670009	T
Mar-03	IMAGE MAGIC	JP3149350005	M
Mar-04	TRIPLEIZE	JP3637050000	M

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

***Board lot size is unified to 100*

III. Foreign Ownership Limit Ratio

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