Mizuho Custody Newsletter

May 2022 | Japan

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I. Market News

1. ESG investors getting vocal and more influential

As June, the high season for shareholders meetings in Japan, comes close, activist shareholders are getting the market's attention on what proposals they would bring up at AGMs, reports Nikkei Shimbun, Japan's leading financial daily. While quick measures to return profits to shareholders such as dividend increase have still been actively proposed, proposals in line with ESG, including those aimed at addressing climate change, are also commonly brought up at AGMs. Although these proposals have contributed less for pushing up share prices than calls for shareholder returns, not a few of their proposals eventually led some companies to reform themselves. If companies underestimate their voices, they may have to pay the price for misunderstanding influence of ESG funds.

"We anticipate early withdrawal from fossil fuels toward a decarbonized society to improve corporate value." On 13 April, an Australian and Japanese nongovernmental organization (NGO) announced that they would submit shareholder proposals to four Japanese companies asking them to form and present a road map for achieving net-zero emissions of greenhouse gases.

A number of asset management firms have been revising their voting standards in an effort to address ESG issues. One of the UK's largest asset managers set out a policy that, from 2022, it would vote against election of the chairman of the board of directors for companies that failed to improve the transparency of remuneration.

A major asset management company in Japan also revised its voting standards in March that would require companies to set the ratio of outside directors to one third or more from the previous 25% or more. In addition, it requires at least one female director for issuers that constitutes Tokyo Stock Price Index (TOPIX) 100, and is considering to apply the requirement to all issuers listed on the Prime market of the Tokyo Stock Exchange (TSE) from next fiscal year.

ESG-related exchange traded funds ("ETF") are also attracting attention from overseas investors. In late April, a major Finnish pension insurance firm invested EUR300 million into a Japan ESG Core Index ETF.

"We have been looking for sustainable ESG investment opportunities," says the person in charge of the firm. A senior manager at the asset management firm in charge of the ETF said, "We hope it would expand investment to ESG related products."

Western countries are going far ahead of where Japan currently is. The number of ESG-related shareholder proposals in the United States exceeded 500 in 2021, making it the record high. With regard to proposals on greenhouse gas emissions, they are getting more specific and stricter, such as requiring specific numerical targets and disclosure of emission level of their business partner companies. Proposals for issues in the "Social area" are also increasing.

In Japan, the reaction in the stock market are not all positive. Share prices of companies that receive shareholder return proposals often go up, but for ESG related issuers, investors firstly question about feasibility. A senior researcher at a research institute says, "In Western countries, it is getting common for companies to use "advisory resolutions" to confirm the consensus of shareholders, but in Japan, companies need to change their articles of incorporation, which makes ESG related proposals more difficult to carry them out."

However, in 2021, a trading firm, which faced a shareholders proposal to respond to climate change, announced a policy to reduce its involvement in coal-related businesses. If ESG funds will enhance corporate value, which could attract more investment capital, individual investors would also have to pay more attention to the outcome of shareholder proposals.

Information compiled from Nikkei Shimbun & Mizuho research

2. The government's new guideline on disclosures on human capital

The government will call for companies as early as this summer to disclose 19 management information items related to human resources investment, such as the status of employees' skill development and ensuring diversity, reports Nikkei Shimbun, Japan's leading financial daily. The government intends to provide information with investors to judge whether a company properly invests its employees as "human capital" that generates value. Part of such information will be required to be included in the securities report (Yuukashoken Houkokusho) as early as in FY2023. The government aims to boost growth potential of Japanese companies by enhancing quality of intangible assets through encouraging issuing companies to invest more in human resources in line with the tightened disclosure requirements on such area.

The concept that recognizes employees as their investment target as human capital is now being commonly shared by many senior managers of companies. In the past, companies used to recognize personnel expenses as costs, when many employees were assigned to work at production lines.

Amid the ongoing digitalization of economy, ideas from employees can benefit companies. More and more investors are getting interested in how companies invest in human resources, which they cannot see just from the figures of financial statements. It is expected that an increasing number of companies will describe more about their policies and activities on human capital in their integrated reports, at the request of the government.

Cabinet Secretariat will draw up guidelines on how companies should disclose details on their investment in human capital as early as this summer. The first draft to be compiled by the end of June is supposed to list up 19 items to be informed to investors. The main items will be on human resources training such as development of employee skills and hiring policy to ensure employee diversity.

Companies are asked to select items that fit their strategy and to disclose specific numerical targets and examples. For instance, the guideline would encourage companies' disclosure on specific calculation standards to measure differences among companies, such as gender ratio of employees and the ratio of female executives which shows level of diversity at each company. The guideline would require companies to describe in detail on the training methods of employees that may differ by each company.

Financial Services Agency ("FSA") plans to oblige companies to include some information on human capital in the securities report (Yuukashoken Houkokusho) as early as in FY2023. Items to be included could be the rate of childcare leave taken, the gender pay gap, and the ratio of female managers. Cabinet Secretariat will call the companies to disclose a wide range of information on their human capital separately from the FSA's policy.

Western companies are ahead of Japanese companies in terms of information disclosure on human capital. In the United States, the Securities and Exchange Commission (SEC) obliged companies to disclose human capital information in August 2020. Companies are required to disclose indicators that they put emphasis on and disclose their target level on the indicators. The European Union (EU) made it mandatory in 2014 for companies with 500 or more employees to disclose on human capital.

Currently, only a few Japanese companies meet the level the investors want them to. According to a survey by a university and a trust bank, 67% of investors want disclosure on how companies will ensure diversity in the management and core human resources. In fact, only 19% of companies listed on the Prime market and 5% of those on the Standard market have met such demands.

Japanese companies' tardiness in investing in human capital is one of the factors that undermines their competitiveness in global markets. According to an intellectual property valuation firm, in 2020, on the assumption that the value of intangible assets of major companies are calculated by subtraction of assessed value of tangible assets from the market capitalization, the ratio accounts for 90% among companies in the United States, and only 32% for Japan. The result implies that U.S. companies' continued investment in human resources help enhance their intangible assets, which eventually push up their share prices.

Japanese Prime Minister Fumio Kishida said, in his general policy speech in December 2021, "The government would encourage companies' non-financial information disclosure so that the market could see more about their human resource investment." The market would not appreciate it, if the disclosure in this regard would be made just for the sake of formalities. Companies are required to make efforts to communicate what they are doing in this regard clearly to investors.

Information compiled from Nikkei Shimbun & Mizuho research

3. Preparation of Annual Securities Reports (Yuukashoken Houkokusho) in English may become mandatory

There have been growing demands for companies listed on the Prime market at the Tokyo Stock Exchange ("TSE") to prepare Annual Securities Reports (Yuukashoken Houkokusho) in English, according to Nikkei Shimbun, Japan's leading financial daily. Currently, only about 10% of them issue the Annual Securities Report ("ASR") in English, which is a common complaint of foreign investors. The ASRs contain detailed information on company's finances and business operations that are essential for companies' analysis. Financial Services Agency ("FSA") is considering to make it mandatory in phases, with intent to attract investments from overseas.

According to the TSE, foreign investors held about 30% of listed shares in Japan as of the end of March 2021. It is the largest share, along with local financial institutions such as life insurance companies and banks.

According to a survey conducted by TSE targeting overseas investors, 80% of the respondents, the largest number, wanted quarterly reports (Kessan Tanshin) be issued in English, and 70% of them wanted ASR in English. One of the respondents said, "Explanatory notes of ASRs are essential to properly assess a company's financial position."

The reality is far from what investors exactly want. At the end of 2021, 14% (260 companies) of the companies that selected the Prime market created ASR in English, including those planning to do so. This is lower than 73% (1,348 companies) for the quarterly reports (Kessan Tanshin) and 71% (1,313 companies) for the notice of convocation of general shareholders meetings. TSE has been urging companies to create disclosure reports in English, but few of them are willing to translate the whole volume of their ASR into English, since it contains massive amount of information, which seem to be heavy burden on them.

At a meeting of the Working Group of the Financial System Council held by the FSA in mid-April, a number of participants raised concerns about a time lag between disclosure in Japanese and one in English. Some participants proposed to make English disclosures mandatory for all the companies listed on the Prime market. In a draft report to be compiled as early as in May, the FSA plans to include measures to promote disclosure in English.

Business communities in Japan are anxious about heavy burden the English disclosure obligation could cause on them. At the meeting, one company executive said, "Mandatory simultaneous disclosure in two languages could result in slowdown of information disclosure, which does not seem to benefit overseas investors."

Japan lags behind countries such as Taiwan and Singapore in information disclosure in English. Being aware of difficulties of simultaneous Japanese-English disclosure of ASRs, the FSA plans to promote companies to conduct information disclosure in English in phases.

Specifically, the FSA would require issuers to take actions for disclosure on items, such as MD&A (management's discussion and analysis of financial conditions and results of operations), business risks, and the status of shareholders including cross-shareholdings, which are of interest to overseas investors. Looking at the situation of the disclosure in ASRs at the fiscal year ending in March 2022, the FSA is expected to consider introduction of mandatory issuance of ASR in English covering some parts of the original report, when the number of companies making disclosures in English reaches FSA's target level.

However, some items still remain as issues to be addressed, even if English disclosure of ASRs goes on. The International Corporate Governance Network (ICGN), an organization that brings together institutional investors from around the world, has opined for long that companies listed on the TSE 1st Section should issue ASR in English before the annual shareholders meetings. This is because even if ASRs in English are distributed in line with the current issuance practice of the original ASR which is after the annual shareholders meetings, it will not help overseas investors' analysis and decision making for their exercise of voting rights for the year.

Eighty percent of the companies listed on the TSE 1st Section selected the Prime market in the wake of the TSE's first market reorganization in about 60 years. The market presumes that companies listed on the market are open to having dialogues with global investors. In addition to issuing ASR reports in English and requests for disclosure on human capital, the companies would have to deal with the investors' requests for information on various issues on their business in detail. They have a lot on their plate.

Information compiled from Nikkei Shimbun & Mizuho research

4. JPX will establish Japan's first market for CO_2 emissions trading

Japan Exchange Group, Inc. ("JPX") in collaboration with the Ministry of Economy, Trade and Industry ("METI") will establish Japan's first market for trading carbon dioxide (CO_2) emissions. JPX plans to set up a special market in the Tokyo Stock Exchange ("TSE") and to start proof-of concept in September, aiming to start full-scale operations in FY2023, reports Nikkei Shimbun, Japan's leading financial daily. Existing emissions trades are not fully open to public, because being traded bilaterally. Trading in the market will enhance transparency of transactions and prices, which encourages more companies to participate and eventually leads to Japan's decarbonization to advance further.

Participating companies would set emission reduction targets by 2030, and the government would certify the amount that exceeded the target as "carbon credits". Companies that failed to meet the target would have to purchase credits in the market. Transaction price would be disclosed so that other companies could use it as a reference for their trades.

METI has set up a plan to create "Green Transformation ("GX") League" consisting of companies working to decarbonize, and 440 companies expressed their support for the plan. Companies participating to the GX League may join the proof-of-concept. Unlike the European Union ("EU"), which now goes ahead, it is solely up to each company whether to participate and to set a goal, which may draw people's attention about the extent the GX League would actually work.

In the EU, companies are obliged to participate in emissions trading. On the other hand, companies have no obligation to join the GX League and no penalties for non-participation in Japan.

The EU, which started emissions trading in 2005, obliges electric power and manufacturing plants to participate in the system. Companies acquire emission allowances based on their actual emissions performance, sell the allowances on the market if they are left, and buy them if they are short. If companies don't buy the shortfall, they need to pay a fine. The total amount decreases every year, and the participating companies are forced to reduce their emissions as a whole.

In Japan, on the other hand, companies voluntarily decide as to whether they participate in the trade and set their own reduction targets. There are no penalties even if they failed to achieve the target. Participating companies will be required to set ambitious emission reduction targets, but they may set low targets which are easily achievable, and consequently, emissions trading may not be as active as anticipated. If trading volume would not increase, that could weaken the effect of promoting decarbonization to be brought from forming emission prices through market trading.

According to a financial information vendor, the total volume of emissions trading in the EU in 2021 was a staggering EUR682.5 billion. The mandatory participation led to active trading and emission reductions.

METI is considering to set standards for companies' target setting process if the GX League framework could not reduce as much emission as anticipated. How the GX League could encourage companies' active participation in emissions trading, that is the name of the game.

Information compiled from JPX, METI, Nikkei Shimbun & Mizuho research

5. BOJ release an interim report on the introduction of CBDC

Bank of Japan ("BOJ") released an interim report on the introduction of Central Bank Digital Currency ("CBDC"). From this April, BOJ began examining the functions that are necessary to ensure stability of the financial system, such as improving conveniences of settlement services and setting the upper limit on the amount for holding CBDC. From now on, BOJ begins to design costs to maintain the CBDC system and how the system should be structured under the current legislation. It is up to the public as to whether CBDC system would actually be introduced, reports Nikkei Shimbun, Japan's leading financial daily.

BOJ divides the proof-of-concept phase into three stages. In the first phase, which ran from April 2021 to March 2022, BOJ examined whether there were any major problems with basic functions such as issuance and distribution of CBDCs. In the second phase from this April, BOJ will verify the functions necessary to enhance convenience and ensure system stability. In the future, BOJ plans to conduct pilot experiments involving private sector and consumers.

In the interim report, BOJ stated that commercial banks were considered to be the most promising candidates to act as intermediaries to exchange CBDCs between BOJ and users. But it also added that users did not necessarily have to maintain a bank account at an intermediary bank. BOJ would leave it up to further discussion as to whether non-bank settlement service providers, such as fund transfer companies, could assume the role of intermediaries of CBDC.

Information compiled from BOJ, Nikkei Shimbun & Mizuho research

New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
Jun-08	ANYCOLOR	JP3164780003	G
Jun-20	Yamaichi Uniheim Real Estate	JP3933900007	ST
Jun-23	Wellness Communications	JP3155430006	G
Jun-23	Japan Warranty Support	JP3389870001	G
Jun-23	Tsubota Laboratory	JP3535700003	G
Jun-23	Home Position	JP3837680002	ST
Jun-24	Microwave Chemical	JP3860340003	G
Jun-27	SUNWELS	JP3324410004	G
Jun-27	EDP	JP3130720000	G
Jun-28	M&A Research Institute	JP3167370000	G
Jun-28	Nulab	JP3757010008	G

**Information compiled based on postings from the Prime (PR), Standard (ST), Growth (G), Tokyo Pro Market (P), NSE (N)、FSE (F) & SSE (S).*

***Board lot size is unified to 100*

III. Foreign Ownership Limit Ratio

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