# Mizuho Custody Newsletter

**November 2022 | Japan**

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## I. Market News

### 1. Stirring up controversy on a review of the quarterly disclosure system

The Report by the Working Group on Corporate Disclosure of the Financial System Council, released in this June, has recommended that the quarterly securities reports (1st and 3rd quarters) required under the Financial Instruments and Exchange Act be abolished, and that the requirement should be revised unifying the reports into "quarterly earnings reports" (Kessan Tanshin) from the perspective of disclosure timing, investor usage, and encouraging active information disclosure to companies. The working group agreed to further examine issues related to ways to consolidate the overlapping reports into the quarterly earnings reports (Kessan Tanshin).

However, according to Nikkei Shimbun, Japan's leading financial daily, the review of the quarterly disclosure requirements in which companies publish their financial results every three months, has been causing controversy. At the working group, some participants called for an abolishment of the requirement to submit earnings reports (Kessan Tanshin). The Financial Services Agency ("FSA") will consider criminal penalties for incorrect statements on the reports, but some say they are unnecessary. It's not easy to draw conclusions.

In June, the FSA decided to abolish the legal requirement for listed companies to issue quarterly securities reports (Shihanki Houkokusho) and to integrate to the quarterly earnings reports (Kessan Tanshin) that are issued on the rules of the exchange. The decision aims to make disclosure process more efficient. The working group will debate on the issue until the end of this year. It plans to submit a bill to revise the Financial Instruments and Exchange Act at the ordinary session of the Diet in 2023.

The FSA brought up whether to make the filing of quarterly earnings reports (Kessan Tanshin) voluntary as an issue. "It seems as the clock have turned back," some market participants said, as they thought that the mandatory quarterly disclosure of financial results would remain in place under the plan to integrate the quarterly securities reports (Kessan Houkokusho) into the quarterly earnings reports (Kessan Tanshin).

A professor at a local university said, "I do not understand why such a theme (voluntarization of Kessan Tanshin) is on the agenda." Another said, "In order to rectify the short-term profit oriented mindset and to reduce administrative burden, the requirement for quarterly earnings reports (Kessan Tanshin) should be abolished." At the working group held on 5th October, the participants were divided into two.

Quarterly disclosure is voluntary in Europe and Singapore, while it is mandatory in the United States and China. Many members of the working group supported to make it mandatory for all listed companies, saying it would be useful for checking the progress of mid- and long-term business plans.

The focus is also on how to ensure accuracy of information. There is no penalty for misstatements in the current earnings reports (Kessan Tanshin). There are concerns about its credibility, as it does not come with an auditors' review. The quarterly securities reports (Shihanki Houkokusho) were introduced in 2006, when the authority could not hold the company that made the misstatements of quarterly results criminally liable.

The FSA now studies to position the quarterly earnings reports (Kessan Tanshin) as an "extraordinary report," which is required by law. Legal disclosure would hold individuals and corporations criminally responsible. However, a number of processes will be needed such as to address corrections, to establish standards to determine whether the information is recognized as false statement, and to coordinate with exchanges.

Opinions are also divided among investors. In the result of a survey released by the Japan Securities Analysts Association on 7th October, more than 50% of the respondents said, "No review or statutory disclosure required in order to emphasize promptness," while just over 40% said, "Review needed to ensure credibility of financial statements." It appears to be a difficult task to strike balance between accuracy and promptness of information.

*Information compiled from Financial Services Agency, Nikkei Shimbun & Mizuho research*

## 2. Postponing the introduction of carbon tax

According to "The Clean Energy Strategy Interim Report" by the Ministry of Economy, Trade and Industry released in May, the public and the private sectors altogether will have to invest around JPY150 trillion for green transformation ("GX") over the next 10 years. Of that amount, the government will pay JPY 20 trillion, aiming to encourage investment from the private sector. The government intends to raise the funds for this purpose by issuing new government bonds, tentatively called "GX transition bonds".

On the other hand, according to Nikkei Shimbun, Japan's leading financial daily, the government and ruling parties will postpone the introduction of a carbon tax, which would require companies to pay a share of their carbon dioxide ($CO_2$) emissions, in fiscal year 2023. They concluded that it would not be practical to create a new tax that would further raise the public burden in the midst of soaring energy prices.

Redemption of the GX transition bonds will be funded by revenue from the carbon pricing, which sets a price on $CO_2$ emissions. Finance Minister Shunichi Suzuki said that the framework of GX transition bonds should be concluded and legislated by the end of the year. The government aims to submit related bills to the regular session of the Diet in 2023.

Options in relation to carbon pricing include (i) carbon tax, (ii) a "levy" added to electricity bills, and (iii) emissions trading between the companies. At a government meeting in October, Prime Minister Fumio Kishida did not mention about tax, saying "both the levies and the emissions trading market would be combined as carbon pricing."

There already is a global warming tax levied on the use of fossil fuels. The tax is added on to the oil and coal tax. The government would have to take complicated procedures to reposition the tax as carbon tax, such as raising tax amount, defining clearly how revenue from the tax would be spent.

It is necessary to obtain agreement from the ruling parties to proceed the tax reform. Senior officials of the Tax Commission of the ruling parties remain cautious about introducing such a taxation in the tax reform in fiscal year 2023.

The government will examine if the levy could be used as a source of redemption. The ruling tax commission is not directly involved in formulating policies for levies, such as revision of the relevant laws. While levies could be modified or adjusted more flexibly than taxes, that could make the price of carbon more volatile. Emissions trading still remains in the demonstration phase.

Postponement of the implementation of carbon tax could weaken incentives for companies to curb their use of fossil fuels. Concerns persist that Japan's tardy efforts will be criticized by European countries, where carbon taxes are common.

*Information compiled from Cabinet Secretariat, Ministry of Economy, Trade and Industry, Nikkei Shimbun, Nomura Research Institute & Mizuho research*

## 3. The Audit Firm Governance Code becomes mandatory in principle in 2024

Financial Services Agency ("FSA") will obligate small and medium-sized audit firms to accept the governance code aimed at reinforcing their structures, reports Nikkei Shimbun, Japan's leading financial daily.

The governance code, which is currently voluntary for them to adopt, will be revised to mandatory in principle in 2024. Audit firms will be required to enhance their information disclosure framework, including whether they have a structure in place to well cover the number of companies they audit. While issuing companies are required to disclose their efforts on climate changes and human capital, it turned out that some small and medium-sized audit firms provided low-quality audit services. The introduction of the code aims to enhance transparency and to gain investors' confidence.

The Audit Firm Governance Code was established by the FSA in March 2017 to improve the organizational strength of audit firms, in response to an account fraud case. Some experts pointed out that the code was not suitable for small and medium-sized audit firms as it assumed large audit firms at that time.

In recent years, the regulator issued business improvement order to several small and medium-sized audit firms. The FSA has recognized that it needed to strengthen the audit firms' structure of own governance. Audit firms that audit listed companies are the 4 major firms, the 5 semi-major firms, and about 120 small and medium-sized firms. The major and semi-major firms have accepted the current code, but it has been only nine small and medium-sized audit firms that have accepted the current code as of the end of September.

The FSA will put together a draft of the revisions to the Audit Firm Governance Code at the panel of experts by the end of the year. The code will also be applicable when the revised Certified Public Accountants Act, which stipulates the registration system for audit firms to conduct listed companies' audit, comes into effect in April 2023. The code will in principle become mandatory for small and medium-sized audit firms from July 2024 in order to give them a transition period. Those who wouldn't accept the code must explain why not.

Instead of not being required to establish a body with a certain size to supervise and evaluate effectiveness of management functions as required by the current code, they would have to prove that they conduct audits under a proper system. It is also assumed to seek outside experts' opinion at their regular management meeting.

The code would also require them to enhance information disclosure. They will be required to announce about their auditing process on their website such as whether they have taken sufficient steps to express appropriate opinions on clients' financial statements, and whether they have implemented ICT (information and communication technology) to cope with digitalization of society.

Small and medium-sized audit firms have been needed more and more by issuers. Large audit firms are narrowing the number of companies they audit in order to reduce risks assuming audit duties on a global basis. In a year period from July 2021 to June 2022, 97 listed companies in Japan left large audit firms for small and medium-sized firms, more than 4 times the number 5 years ago. The share of small and medium-sized audit firms (by the number of firms) currently exceeds 20%.

There are about 120 small and medium-sized audit firms that audit listed companies. Some audit firms have more than 100 employees, while some others set up personal office and audit jointly.

Small and medium-sized audit firms could gain confidence from investors by enhancing transparency of their business situation. "We are anxious that just a change of the auditor from a large one to a small or medium-sized one could raise concerns from market participants about the reliability of our financial statements," says the CFO of a TSE Prime-listed company.

Review and refinement of operational structure for small and medium-sized audit firms cannot be achieved overnight. "It is desirable that the Japanese Institute of Certified Public Accountants (self-regulatory organization) would take an initiative to strengthen its support and guidance for small and medium-sized audit firms, and to foster independence of each of them," the FSA official said.

The code was published in March 2017 under the initiative of the FSA in order to establish a principle to systematically organize an audit firm. Provisional translation of the Audit Firm Governance Code could be referred to from the following FSA's website: https://www.fsa.go.jp/news/28/sonota/20170331-auditfirmgc/3.pdf

Further, the list of audit firms which have adopted the code as of December 2021 can be referred to from the following FSA's website (in Japanese only):
https://www.fsa.go.jp/news/28/sonota/20170331-auditfirmgc/4.pdf

*Information compiled from Financial Services Agency, Nikkei Shimbun & Mizuho research*

### 4. A flight of capital from China to Japan

Why do stock prices in Japan remain relatively strong in spite of domestic and global economies being unpredictable? According to Nikkei Shimbun, Japan's leading financial daily, movements of foreign investors explains. Some overseas investors, who had had little interest in Japanese stocks for years, have begun to direct their money toward them. Some say China prompted this trend, as overseas investors got cautious of the authoritarianism being strengthened by extension of tenures of those who are now in power, which drove them selling their holdings on China and shift funds to Japanese stocks.

"Have I been this popular?" An economist at a leading securities firm was dazzled by the number of people attending to his meetings wherever he went, which he had never experienced in the past.

He visited U.S. institutional investors in late September to early October. He is a well-known economist to foreign investors, but it had been usually one or two persons per firm attending to his meeting, due to his expertise being Japanese economy. This time, wherever he went, more than five fund managers and analysts attended his meetings.

He says, "Global investors are pulling money out of Chinese stocks in earnest. The primary candidate for those funds is Indian shares, with good growth potential. The second candidate is Japanese shares, where the market is stable and the shares have been undervalued."

At the moment, foreign investors came to be interested in Japanese stocks as a result of their process of elimination, "Which is better, Japan or China?" Still, it is a drastic change in the area, where most of foreign investors rushed into China, passing through the neighboring market, Japan.

Looking back, over the past 10 years, market capitalization of Chinese shares has grown from 1.7 to 2.8 times that of Japanese shares. Even a partial outflow of foreign money from the huge Chinese shares has a strong impact to the market. The economist says, "Years and years of 'Japan Passing' is coming to an end."

A strategist of another leading securities firm, who visited nearly 50 investors in the western countries at the same time as the above-mentioned economist, said he got a same impression from his clients.

The dollar price charts for Japanese and Chinese stocks, which have generally moved in tandem, have diverged sharply since the global pandemic. The dollar price of Chinese stocks has plummeted to about 1/3 of its peak level in 2021.

Dollar-denominated prices of the Japanese stocks were eroded by the yen depreciation, but Chinese stocks fell more than Japanese stocks did. The dollar price charts imply that shift in foreign money from Chinese to Japanese stocks has already begun.

The keys for Japanese companies are to accelerate management reforms to increase the earning power, and to better attract foreign money that has regained some interest in Japanese stocks. They must be aware that foreign money is so changeable that it would leave countries soon if they find the market not enterprising.

According to researches by the Bank of Japan, foreign investors purchased a net JPY 863 billion worth of Japanese stocks between April and October this year. This is contrary to net selling of JPY 1,818.7 billion in the last fiscal year and JPY 2,841.3 billion in the fiscal year before the last respectively in this sector.

*Information compiled from Bank of Japan, Nikkei Shimbun & Mizuho research*

## New Equities Listing Approvals

| Listing Date | Name of Company | ISIN Code | MKT |
|---|---|---|---|
| Nov-30 | Wellplayed Rizest | JP3155440005 | G |
| Dec-01 | Cyfuse Biomedical | JP3311800001 | G |
| Dec-06 | Advance Create | JP3122100005 | S |
| Dec-06 | MANABE INTERIOR HEARTS | JP3869880009 | P |
| Dec-13 | property technologies | JP3833870003 | G |
| Dec-14 | Daiei Kankyo | JP3480470008 | PR |
| Dec-14 | Skymark Airlines | JP3396000006 | G |
| Dec-15 | SmartDrive | JP3400130005 | G |
| Dec-15 | AnyMind Group | JP3164770004 | G |
| Dec-16 | Foodison | JP3802110001 | G |
| Dec-16 | OpenWork | JP317357000 | G |
| Dec-16 | Rebase | JP3974840005 | G |
| Dec-19 | toridori | JP3636800009 | G |
| Dec-20 | INFORICH | JP3153830009 | G |
| Dec-20 | monoAI technology | JP3922920008 | G |
| Dec-21 | note | JP3759300001 | G |
| Dec-21 | EYEZ | JP3102340001 | G |
| Dec-21 | St.Cousair | JP3328700004 | G |
| Dec-22 | COACH A | JP3283720005 | ST |
| Dec-22 | jig.jp | JP3386830008 | G |
| Dec-22 | Agent Insurance Group | JP3160490003 | N |
| Dec-23 | GENOVA | JP3386840007 | G |
| Dec-23 | ASO INTERNATIONAL | JP3120120005 | ST |
| Dec-26 | DAIWA TSUSHIN | JP3504300009 | ST |
| Dec-26 | Alpha Purchase | JP3126420003 | ST |
| Dec-26 | UPCON | JP3121210003 | N |
| Dec-27 | BTM | JP3799810001 | G |
| Dec-27 | ELEMENTS | JP316825000 | G |
| Dec-29 | Sumasapo | JP3400140004 | 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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http://www.mizuhobank.com/service/custody/index.html