

JAPAN'S NEW ERA OF INVESTOR ENGAGEMENT, TRANSPARENCY AND INNOVATIVE ASSET MANAGEMENT

Japan is set to introduce targeted updates to the Financial Instruments and Exchange Act (FIEA), the key securities law in Japan, in 2024. The amendments are aimed at refining three critical areas: (i) large shareholding reporting rules, (ii) takeover bid rules and (iii) the framework for sophisticated and diversified asset management businesses. The proposed amendments to the FIEA will significantly enhance transparency and strategic engagement opportunities for equity investors, while offering asset management companies innovative business models and expanded investment options.

LARGE SHAREHOLDING REPORTING RULES

The amendment to the large shareholding reporting rules aims to enhance constructive dialogue between corporations and their stakeholders, with the goal of strengthening long-term corporate value.

First, the amendments seek to refine the definition of joint holders, a similar concept to 'acting in concert' in other jurisdictions, whereby shareholding is aggregated among such holders. They introduce specific conditions under which shareholders, who have agreed to acquire, transfer or exercise shareholder rights jointly, are not classified as joint holders. The conditions which have to be met are (i) the shareholders are Type 1 Financial Instruments Business Operators (Type I FIBOs), Investment Management Business Operators (each as defined in the FIEA), banks or other persons to be specified in a Cabinet Office Ordinance; (ii) the purpose of the agreement is not to make joint material proposals (the scope of 'material proposals' is currently under consideration for further clarification); and (iii) the agreement is solely for the purpose of jointly exercising voting rights on certain matters or certain other shareholder rights (each to be specified) on an *ad hoc* basis.

Secondly, the amendments also address the treatment of certain types of equity derivative transactions where parties enter into such equity derivative transactions for certain specific purposes. Details of the specific purposes and calculation of the shareholding ratio in respect of such equity derivative transactions are to be outlined and clarified by a draft Cabinet Office Ordinance. It is expected that the purposes of (1) acquiring shares from the counterparty (i.e. where physical settlement is expected), (2) exerting a

Key issues

- Large shareholding reporting rules will be clarified, enabling investors to determine who their joint holders are and what percentage they should report.
- The tender offer threshold will be lowered to 30%, and on-market stake building will be more broadly regulated.
- A voluntary registration regime will be introduced so non-core functions of asset managers can be outsourced more easily.
- Registration requirements for Type 1 FIBOs will be relaxed to facilitate trading of unlisted securities and allow for Private Trading Systems.

degree of influence on the exercise of voting rights regarding shares held by the counterparty, and (3) making material proposals to the company leveraging the position such as in (1) and (2), are likely to be specified in the Cabinet Office Ordinance. While this reflects the current position of the Japan Financial Services Agency (JFSA), articulated in a Q&A, the amendments would enshrine it in legislation and require a higher level of compliance. At the same time, it is expected that further clarity will also be provided by the JFSA during the public consultation process in respect of the Cabinet Office Ordinance. Details of what type of equity derivative transactions would be in-scope and how shareholding ratios should be calculated in respect of such in-scope equity derivative transactions are still to be clarified.

While not covered in the amendments, in order for passive investors to have in-depth dialogue with companies, it is expected that amendments will be incorporated in the Cabinet Office Ordinance to allow passive investors to rely on the exempted large shareholding reporting rule, if all of the following conditions are satisfied: (a) the purpose of the engagement is not directly related to corporate control and (b) the manner of engagement leaves adoption or refusal up to the company's management.

The amendments are aimed at clarifying the regulator's current position, so holders of a substantial number of shares in the Japanese market will want to review their shareholdings and ensure that large shareholding reports are filed in compliance with these clarified rules.

TAKEOVER BID RULES

The amendments would broaden the scope of transactions that necessitate a mandatory takeover bid (TOB) as follows: (i) extending the mandatory tender offer bid rules to encompass on-market transactions, specifically those conducted via auction on exchanges (as a result, acquisitions of voting rights exceeding 30% through on-market transactions would also trigger a mandatory takeover bid); and (ii) decreasing the ownership threshold that triggers a mandatory takeover bid from one third to 30% of the voting rights.

The amendments are intended to enhance transparency and fairness, and reflect the evolving landscape of corporate acquisitions, which have seen an increase in unsolicited takeovers executed through on-market transactions, as well as diversification in the structure of mergers and acquisitions. Additionally, the adjustment of the ownership threshold, serving as a benchmark for acquiring significant control over a listed company, is intended to bring Japan's regulatory framework in line with international standards.

While not included in the amendments, the Administrative Ordinance on the FIEA will supplement the details of the new rules. One of the key matters is the incremental purchase of shares by the controlling shareholder. Pursuant to the existing framework, should a shareholder holding a majority stake – exceeding 50% of the share capital – acquire additional shares via off-market transactions that do not extend beyond a two-thirds threshold, the one-third rule would not be triggered. Similar rules will be implemented through the Administrative Ordinance, but the thresholds and other details are not clarified in the amendments themselves.

The amendments would, on the one hand, simplify the rules relating to TOBs in that some of the special courses of action which trigger mandatory TOBs, such as the combination of on-market and off-market transactions within a short period of time (aka 'rapid purchasing'), will be discontinued as a result of

the amendments. On the other hand, the broader coverage of the mandatory tender offer rules and the lowered threshold will require market participants to have a clear investment strategy, in particular in terms of stake building prior to a takeover bid.

SOPHISTICATED AND DIVERSIFIED ASSET MANAGEMENT BUSINESSES

INNOVATIVE ASSET MANAGEMENT BUSINESS MODEL

The proposed new voluntary registration regime is aimed at service providers specialising in ancillary investment management operations, such as compliance, legal, and accounting services. This initiative is intended to streamline the operational burden for investment management firms by enabling the outsourcing of non-core functions, thereby simplifying the regulatory prerequisites, especially those pertaining to the required personnel structure. Furthermore, the amendments propose that investment managers be enabled to concentrate exclusively on the strategic elements of fund management, such as conceptualisation and design, while outsourcing full investment execution responsibilities to other investment management professionals. This provision seeks to emulate the more sophisticated division of labour observed in the investment sectors in Europe and the United States.

Combined with efforts such as the launch of the Financial Market Entry Office, this proposed amendment seems designed to be a beacon for overseas asset managers, signalling an open, accommodating environment for international firms looking to enter the Japanese capital markets.

VITALISATION OF TRADING OF UNLISTED SHARES

Separately, the amendments aim to rejuvenate the market for securities issued by newer companies. To achieve this, they propose easing the registration requirements for Type 1 Financial Instruments Business Operators (Type I FIBOs) engaged in intermediating unlisted securities, contingent upon these transactions being directed at professional investors and without retaining any customer funds. Additionally, the legislation would allow for Private Trading Systems (PTS) to function as registered Type 1 FIBOs without needing separate permission, providing their transactional throughput remains below prescribed thresholds.

The amendments aim to transform the Japanese capital markets by broadening investment opportunities and diversifying trading options. This move signals a commitment to enhancing Japan's investment landscape, making it more appealing to both domestic and international investors.

TIMELINE

Detailed rules in connection with the amendments, including with respect to what type of equity derivative transactions would be in-scope and how shareholding ratios should be calculated for the purpose of the large shareholding reporting regime, will be set out in a Cabinet Office Ordinance after the amended FIEA has been passed by the Diet. Market participants, including financial investors and fund managers, should keep an eye out for further developments. The commencement date for the new voluntary registration regime and the eased registration requirement will be determined by a Cabinet Office Ordinance and shall occur within one year of the promulgation of the amendments. Similarly, the initiation of the large shareholding report rule and the new tender offer bid rule will also be determined by a Cabinet Office Ordinance and shall be within two years of the promulgation of the FIEA amendment.

CONCLUSION

To conclude, the amendments to the FIEA are aimed to clarify the rules for large shareholding reports and mandatory TOBs, as well as to introduce new regulations for asset managers and investment advisers. The amendments have implications for both domestic and international investors in the Japanese market as described above. Market participants are encouraged to review their shareholdings and investment strategies in order to comply with the to be clarified and revised rules.

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