

February 16, 2024
Institutional Investors Collective Engagement Forum

The welcoming message for the “Report by The Working Group on Tender Offer Rule and Large Shareholding Reporting Rule of the Financial System Council” by Institutional Investors Collective Engagement Forum (A general incorporated association)

On December 25, 2023, the “Report by The Working Group on Tender Offer Rule and Large Shareholding Reporting Rule of the Financial System Council” was published. The Institutional Investors Collective Engagement Forum welcomes this report.

1. Publication of the “Report by The Working Group on Tender Offer Rule and Large Shareholding Reporting Rule of the Financial System Council”

The report by The Working Group on Tender Offer Rule and Large Shareholding Reporting Rule of the Financial System Council (hereinafter, "WG Report") has been published (https://www.fsa.go.jp/en/refer/councils/singie_kinyu/20240130/01.pdf).

The WG Report made recommendations on three issues: I. The tender offer rule, II. The large shareholding reporting rule, and III. Transparency of beneficial shareholders.

- Regarding the tender offer rule, recommendations included:
 - (1) Obligating the implementation of tender offers even for on-market transactions when acquiring shares that significantly affect corporate control.
 - (2) Lowering the threshold for mandatory tender offer implementation from "one-third of voting rights" to "30% of voting rights".
- Regarding the large shareholding reporting rule, recommendations included:
 - (1) Clarifying the requirements for institutional investors to qualify for the "special exemption" for large shareholding reports.
 - (2) Eliminating the need to aggregate ownership ratios as "joint holders" unless multiple institutional investors enter into a specific agreement.
- Regarding the transparency of beneficial shareholders, to enable efficient understanding of beneficial shareholders, it was recommended that it should be explicitly stated as a principle of action for institutional investors to respond when asked by issuing companies about their shareholding status, and that making this a legal obligation should be considered.

2. Welcome to the recommendations for the review of the large shareholding reporting rule

The Institutional Investors Collective Engagement Forum welcomes the recommendations regarding the review of the large shareholding reporting rule, especially from its position of supporting constructive and effective collective engagement between companies and institutional investors, including passive investors, who invest broadly in Japanese equities from a long-term perspective.

The WG Report acknowledges that "regarding the large shareholding reporting rule, various issues have recently been pointed out due to changes in the market environment, such as the increase in passive investors, the spread of collective engagement, and the growing importance of constructive dialogue between companies and investors," and based on this recognition, a review of the system considering these issues was recommended.

The large shareholding reporting rule is a framework where anyone holding more than 5% of a company's shares must submit a large shareholding report within five business days, and also submit an amendment report within five business days if there are subsequent changes such as an increase or decrease of 1% or more, given that information on large shareholdings is important from the perspectives of "influence on management" and "supply and demand in the market". However, for institutional investors and others who conduct large volumes of stock transactions daily, frequent fluctuations in ownership ratios can occur, so the "special reporting rule" has been established to reduce administrative burden, allowing reports to be made on two pre-determined record dates per month.

- **① Review of the scope of "The act of material proposal"**

First, the Forum welcomes the direction indicated for clarifying the conditions for using the special reporting rule by reviewing the concept of "The act of material proposal". To use the special reporting rule, it is a requirement not to engage in "The act of material proposal" towards the investee company.

Regarding "The act of material proposal", current laws meticulously enumerate 14 items, such as disposition of important assets, significant changes in the composition of officers, and significant changes in dividend policies. Many of these items include matters where investors explain their views or request revisions during ordinary dialogue with companies. Concerns that speaking on these matters might constitute "The act of material proposal"

have been pointed out as potentially hindering active investor participation in dialogue with companies.

The WG Report recommends clarifying that the special reporting rule should be available for "proposal activities aimed at actions not directly related to corporate control, etc." when they leave the adoption or refusal up to the company's management. While specific actions constituting "actions not directly related to corporate control" are expected to be clarified through future legal revisions, the WG Report includes a description of "actions not directly related to corporate control, etc., such as changes concerning dividend policies and capital policies," suggesting that at least these are not considered significant proposals.

Furthermore, where current laws merely refer to "acts of proposing certain matters (enumerated in Cabinet Orders)," by also focusing on the "manner" in which they are made, specifically "in a manner that entrusts acceptance or rejection to the company's management," the WG Report indicated the view that opinions and proposals made by investors during ordinary "dialogue," which are not shareholder proposals at general meetings of shareholders, do not constitute "The act of material proposal".

- **② Clarification of the Scope of "Joint Holders"**

Next, the Forum welcomes the clarification of the scope of joint holders, especially from the perspective of promoting collective engagement.

Under the current large shareholding reporting rule, those who have agreed to jointly exercise voting rights and other shareholder rights are deemed joint holders (if deemed joint holders, different investors' holdings must be aggregated to submit a large shareholding report, making practical compliance extremely difficult). It has been pointed out that since this "agreement" includes "implied agreement," it has a chilling effect on collective engagement by institutional investors.

The WG Report recommends that cases where the purpose of the agreement is not to jointly engage in "The act of material proposal", etc., and where the agreement is related to non-continuous exercise of voting rights, should be excluded from the concept of joint holders.

3. Expectation for the Activation of "Dialogue" and "Collective Engagement" by Institutional Investors

Principle 4 of the Japan's Stewardship Code, introduced in 2014, established the discipline that "Institutional investors should seek to arrive at an understanding in common with investee companies and work to solve problems through constructive engagement with investee companies".

Furthermore, the 2017 revision presented the idea in Guideline 4-5 that "In addition to institutional investors engaging with investee companies independently, it would be beneficial for them to engage with investee companies in collaboration with other institutional investors (collaborative engagement) as necessary".

Following this code revision, the Institutional Investors Collective Engagement Forum was established in 2017 and has been supporting collective engagement to this day. However, collective engagement activities in Japan are still not as active compared to other countries.

In the latest version (published December 2023) of the annual survey conducted by the Japan Investment Advisers Association for its member firms, institutional investors who have engaged in collective engagement among those investing in Japanese equities, while gradually increasing, still only account for 36%.

Challenges in conducting collective engagement include (multiple answers):

- "Unclear judgment of applicability to the act of material proposal" (60%)
- "Unclear judgment of applicability to joint holders" (55%)
- "Heavy burden of responding to the large shareholding reporting rule when the above apply" (45%)

The WG Report is an ambitious attempt to respond to these challenges raised by investors, and is expected to have the effect of promoting the revitalization of institutional investor engagement activities and collective engagement in Japan going forward.

4. Opinion on the transparency of beneficial shareholders

The Forum believes that it is important for companies to understand their beneficial shareholders and their shareholdings to promote smooth dialogue with shareholders and investors. However, the Forum requests companies not to unduly favor only beneficial shareholders with large shareholdings, for instance, when providing opportunities for dialogue with management, simply by understanding who the beneficial shareholders are.

The Forum hopes that the development of related laws and regulations in line with the WG Report will proceed swiftly and be enforced. The Institutional Investors Collective Engagement Forum intends to continue its efforts towards improving the effectiveness of collective engagement.

End

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