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Japan
CAPITAL MARKETS

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This country-specific Q&A provides an overview of capital markets laws and regulations applicable in Japan.

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JAPAN
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1. Please briefly describe the regulatory framework and landscape of both equity and debt capital market in your jurisdiction, including the major regimes, regulators and authorities.

Offerings of securities in Japan, both equity and debt, are primarily subject to the Financial Instruments and Exchange Act of Japan (the "FIEA") and related regulations. In principle, securities offerings in Japan need to be registered by the issuer companies under the FIEA for the purpose of making disclosures to investors, unless an exemption is available with respect to the registration obligations. A statutory prospectus, the contents of which are similar to those of registration documents, must be, in principle, delivered to prospective investors in securities offerings registered under the FIEA.

The Financial Services Agency (the "FSA") is primarily responsible for the administration of these disclosure regulations. Under the FIEA, the FSA's power to oversee the registration of securities offerings is delegated to the local finance bureaus of the Ministry of Finance, which actually review and accept registration documents.

The Securities and Exchange Surveillance Commission is responsible for inspecting registered financial instruments business operators as well as monitoring markets for insider trading and other illegal market activities.

In addition, if securities are listed on any Japanese stock exchange, such as the Tokyo Stock Exchange, the issuer companies of such listed securities will be subject to the rules and regulations set by such Japanese stock exchanges, such as timely disclosure rules.

2. Please briefly describe the common exemptions for securities offering without prospectus and/or regulatory registration in your market.

In primary offerings, the "small number private placement" exemption and "QII private placement" exemption are commonly used to seek exemptions from the registration obligations under the FIEA. In small number private placement transactions, the number of investors to which the securities are offered in Japan must be fewer than 50. In QII private placement transactions, the investors must be limited to qualified institutional investors (as defined in the FIEA), while there is no restriction on the number of investors. In both types of private placement transactions, certain transfer restrictions may need to be imposed. The details of such transfer restrictions vary depending on the type of private placement transactions and the type of offered securities. The private placement exemptions above may not be available for offerings of securities that are subject to the continuous disclosure obligations under the FIEA, such as listed securities.

With respect to secondary offerings, the FIEA provides for several types of transactions involving existing instruments to which registration obligations do not apply, such as trading on the Tokyo Stock Exchange and certain block trades. In addition, even if such secondary offerings are conducted for securities that are subject to the continuous disclosure obligations under the FIEA, the issuer companies will be exempt from the registration obligations because the continuous disclosures by the issuer companies are considered to be sufficient, while the companies conducting the secondary offerings, such as major shareholders, will still be obligated to deliver a statutory prospectus.

3. Please describe the insider trading regulations and describe what a public company would generally do to prevent any violation of such regulations.

Under the FIEA, a person who becomes aware of any material non-public information (the "MNPI") of a listed company through one of the specific routes prescribed

by the FIEA (e.g., an employee of the listed company becoming aware of any MNPI while performing his or her duties) is prohibited from selling or purchasing securities of such listed company, or conducting any other transactions involving these securities, including derivative transactions, unless one of the exemptions prescribed by the FIEA is available. Such person is also prohibited from making recommendations to a third party to conduct transactions in respect of the securities of such listed company or conveying the MNPI to a third party with the intention of having such third party gain profits or avoid losses. These insider trading regulations are lifted once the MNPI is made public by the listed company via one of the methods prescribed by the FIEA. Any breach of the insider trading regulations will be subject to administrative fines and criminal penalties.

The types of information that falls under the MNPI are provided in the FIEA, and these include: (a) any decisions of the listed company or its subsidiaries to conduct certain material corporate transactions (such as material M&A transactions and equity offerings); (b) the occurrence of certain material events concerning the listed company or its subsidiaries (such as changes in their major shareholders, and the occurrence of substantial losses and material litigation); (c) certain material financial information; and (d) other facts that would have a material effect on investors' investment decisions. In addition, if a third party decides to make a tender offer for the securities of the listed company, such decision would also constitute MNPI of such listed company.

In order to prevent their officers and employees from violating the insider trading regulations, listed companies usually take certain measures, including holding in-house educational seminars to ensure that their officers and employees have a proper understanding of the framework of these regulations, and introducing adequate information management systems by setting internal rules for the prevention of insider trading, etc.

4. What are the key remedies available to shareholders of public companies / debt securities holders in your market?

In the context of equity or debt securities issued by way of offerings that are subject to the registration obligations under the FIEA (i.e., public offerings), if an investor who purchased these securities incurs any losses due to any untrue statement of a material fact, or omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, in the disclosure documents (i.e., the "securities registration statement") or the statutory prospectus delivered to the investors for such offerings, such investor can bring a compensation claim against the issuer company and its officers, the selling shareholders (if any) and underwriters.

With respect to the issuer company's liability to pay compensation, such liability is a strict liability, and this means that the claiming party does not need to prove the intent or negligence of the issuer company. In addition, the amount of such liability is prescribed by the FIEA as the difference between the market price and the offer price, and the claimant does not need to prove the actual amount of losses.

With respect to the officers of the issuer company, the selling shareholders and the underwriters, the special liability rules for the issuer mentioned above do not apply, but the burden of proof regarding the intent or negligence of these officers is not on the claimant but on the officers. In addition, if the financial statements in the disclosure documents contain any untrue statements or omissions as described above, the accountants who issued the audit reports for such financial statements shall also assume statutory liability that is similar to the liability of the officers, the selling shareholders and the underwriters.

5. Please describe the expected outlook in fund raising activities (equity and debt) in your market in 2023.

While it is quite difficult to present any outlook on future capital markets, the IPO market in Japan has been slightly more active in 2023 compared to 2022, which had quite a low number of IPOs, mainly due to the volatile market resulting from Russia's invasion of Ukraine and related geopolitical risks, sanctions and tensions, trade tensions between the U.S. and China, and the like, and the current trend of the Japanese IPO market shown in 2023 to date could continue in the latter part of 2023.

Fund-raising activities through public offerings of debt securities have generally continued to be stable over the past few years, supported by strong demand from investors. Although there might be different views as to the direction of the interest rate policy of the Bank of Japan, as far as we know, no huge change in the trend with respect to the debt capital market is expected in later 2023.

6. What are the essential requirements for

listing a company in the main stock exchange(s) in your market? Please describe the simplified regime (if any) for company seeking a dual-listing in your market.

In April 2022, the Tokyo Stock Exchange restructured its stock market segments into the following three new market segments:

- Prime Market: the market for companies which have appropriate levels of market capitalization (liquidity) so that many institutional investors may invest in them, and which maintain a higher quality of corporate governance and commit to sustainable growth and improvement of medium- to long-term corporate value, putting priority on constructive dialogue with investors.
- Standard Market: the market for companies which have appropriate levels of market capitalization (liquidity) as investment targets in the open market, maintain a basic level of corporate governance that listed companies are expected to have, and commit to sustainable growth and improvement of medium- to long-term corporate value.
- Growth Market: the market for companies which to some extent the market evaluates positively owing to their disclosed business plans for realizing high growth potential and their progress towards achieving these plans appropriately and in a timely manner, but at the same time involve a relatively high investment risk from the perspective of their business track records.

Each of these market segments has its own listing criteria, both quantitative and qualitative, reflecting its characteristics and concept as described above. All of the markets stipulate listing criteria related to the "liquidity" of the shares of the listed companies and their "corporate governance", the details of which vary depending on the market segments. Fundamentally, the criteria as to "liquidity" are designed to be indicators of the number and monetary value of shares traded on the market and the criteria as to "corporate governance" are standards concerning the framework which enables companies to make decisions in a transparent, fair, timely, and decisive manner, taking into consideration the standpoints of shareholders and various other stakeholders.

In addition, the Prime Market and the Standard Market require companies to meet certain criteria as to their recent operating results and financial positions. On the other hand, the Growth Market does not have any criteria related to financial information but, instead, requests companies to prepare business plans that demonstrate the possibility of their future high growth.

If foreign companies that are listed on foreign stock exchanges seek to be listed on the Tokyo Stock Exchange as well (i.e., a dual listing), the listing criteria would be substantially the same as those for Japanese companies that are described above, although there are slight differences reflecting the difference of jurisdiction, etc. If such foreign companies are listed on the Tokyo Stock Exchange, in order to remain listed, they are required to keep their net assets positive and meet additional criteria with respect to the liquidity and market capitalization on the Tokyo Stock Exchange and the foreign stock exchange that they are listed on.

7. Are weighted voting rights in listed companies allowed in your market? What special rights are allowed to be reserved (if any) to certain shareholders after a company goes public?

In Japan, it is quite common for companies seeking to be listed on the Tokyo Stock Exchange to issue only common stock and to list such common stock after IPOs. However, under the rules of the Tokyo Stock Exchange, companies that issue multiple classes of stock with voting rights can be listed, although only the class of stock with the fewest number of voting rights can be listed.

Stock without voting rights may be listed in addition to common stock, both in the case of IPOs and also after going public.

Listed companies are not prohibited from issuing other classes of stock and, generally, there are no restrictions in respect of the terms and conditions of such stock, as long as such other classes of stock are not listed.

8. Is listing of SPAC allowed in your market? If so, please briefly describe the relevant regulations for SPAC listing.

Listing of SPAC is currently not permitted in Japan.

9. Please describe the potential prospectus liabilities in your market.

Please see our response to question 4 above.

10. Please describe the key minority shareholder protection mechanisms in your market.

Under the Companies Act, a listed company only needs to obtain the approval of its board of directors (through the passing of a board resolution) in order to issue equity instruments, such as shares. However, if such issuance of shares is conducted (i) at a "specially favorable" price, which is well below the market price of such shares or (ii) for the purpose of securing management's control over the company, the minority shareholders may seek an injunctive relief. In addition, if, as a result of the issuance of shares, any person to whom these shares are proposed to be issued would acquire a majority of the total voting rights, and existing shareholders holding 10% or more of the total voting rights object to such issuance, the issuer company must obtain its shareholders' approval before such issuance.

Further, if the proposed issuance of shares by a listed company could cause a dilution of 25% or more or a change in a controlling shareholder, the rules of the Tokyo Stock Exchange require the listed company to obtain its shareholders' approval or the opinion of independent third parties with respect to the necessity and rationale of such issuance.

11. What are the common types of transactions involving public companies that would require regulatory scrutiny and/or disclosure?

Securities offerings that are subject to the registration obligations under the FIEA require regulatory scrutiny and disclosure. Tender offers under the FIEA also require regulatory scrutiny and disclosure.

12. Please describe the scope of related parties and introduce any special regulatory approval and disclosure mechanism in place for related parties' transactions.

Material transactions between a company and its related parties are required to be disclosed in its financial statements. The term "related parties" includes its parent company, its subsidiaries, its affiliates, subsidiaries and affiliates of its parent company, its major shareholders who hold 10% or more of the total voting rights, and its officers and their family members.

With respect to listed companies, if a listed company makes a decision to conduct a material transaction with its controlling shareholder, such as the issuance of shares to the controlling shareholder or a tender offer made by the controlling shareholder for the listed company's shares, such listed company must obtain, from a person who has no conflict of interest with the controlling shareholder, an opinion regarding whether such decision is not disadvantageous to the minority shareholders of the listed company, and make necessary and sufficient disclosure. The term "controlling shareholder" is defined as the parent company, a shareholder who directly or indirectly owns a majority of the total voting rights, and family members of such shareholder.

13. What are the key continuing obligations of a substantial shareholder and controlling shareholder of a listed company?

Under the FIEA, a parent company of a listed company is required to file a report concerning the status of such parent company, which includes information on its shareholders, officers and financial information, etc. every year, unless such parent company itself is a company that is subject to continuing disclosure obligations under the FIEA (such as a company issuing listed securities), or a company listed in another jurisdiction that is subject to disclosure obligations under local laws and regulations.

The FIEA requires any person who has become, legally or beneficially, and solely or jointly, a holder of more than 5% of the total issued voting shares of a listed company, to file a report concerning its shareholdings with relevant local finance bureau of the Ministry of Finance, in general, within five (5) business days. A similar report must also be filed if the percentage of such holdings subsequently increases or decreases by 1% or more, or if any change occurs in respect of any material matter that is set out in reports that have been previously filed. For this purpose, shares that are issuable to such person upon the conversion of convertible securities or the exercise of warrants are taken into account.

14. What corporate actions or transactions require shareholders' approval?

Corporate actions or transactions carried out by listed companies that require shareholders' approval include: (a) amendments to the articles of incorporation; (b) material M&A transactions such as mergers; (c) decrease in amount of stated capital or capital reserve; (d) appointments and dismissals of officers, including

directors; and determinations of compensation for such officers; (e) dividend payments; and (f) issuance of new shares or stock acquisition rights at a "specially favorable" price or with "specially favorable" conditions, except as otherwise provided by applicable law or in each company's articles of incorporation

15. Under what circumstances a mandatory tender offer would be triggered? Is there any exemption commonly relied upon?

Japanese tender offer rules are quite complicated and should be carefully examined based on the relevant facts but, practically, the following two rules should be important to determine whether certain purchases of listed shares to be conducted outside of any Japanese stock exchange should be implemented by way of a tender offer: (a) 1/3 Rule: A purchase of securities entitling their holders to voting rights for a company that is subject to disclosure requirements under the FIEA (e.g., a listed company) is subject to tender offer regulations if, as a result of such purchase, the "Ratio of Shareholding" exceeds one-third (1/3). This "Ratio of Shareholding" is, broadly speaking, the sum of (i) the ratio of the number of voting rights held by the purchaser to the total number of voting rights of such company, and (ii) the ratio of the number of voting rights held by the purchaser's "Special Related Parties (Tokubetsu Kankeisha)" (as defined in the FIEA) to the total number of voting rights. (b) 5% Rule: A purchase of securities entitling their holders to voting rights for a company that is subject to disclosure requirements under the FIEA is subject to tender offer regulations if, as a result of such purchase, the "Ratio of Shareholding" exceeds five percent (5%) and such purchase is conducted with more than ten (10) sellers within sixty-one (61) days.

The "Special Related Parties *(Tokubetsu Kankeisha)*" include the purchaser's officers and entities that have certain capital relationships with the purchaser and officers of such entities

16. Are public companies required to engage any independent directors? What are the specific requirements for a director to be considered as "independent"?

The Tokyo Stock Exchange requires listed companies to have at least one (1) independent officer. The term "independent officer" is defined as an outside director or outside corporate auditor (both as defined in the Companies Act), who is not likely to have a conflict of interest with the minority shareholders. Whether an outside director or outside corporate auditor is not likely to have a conflict of interest with the minority shareholders should be determined by the listed company itself, but the Tokyo Stock Exchange has published guidelines regarding the independence of outside directors and outside corporate auditors, which provide examples of typical situations where an outside director or outside corporate auditor has a conflict of interest with the minority shareholders (e.g., he or she is an officer of a parent company or a subsidiary of the listed company; a major business partner of the listed company; or a consultant, accounting expert or legal expert who receives large amounts of money or other assets from the listed company). Listed companies need to comply with these guidelines as a minimum, and if any of these situations apply, the relevant person will not be regarded as being independent.

In addition, under the Corporate Governance Code of Japan, which is set by the Tokyo Stock Exchange, it is recommended that, for companies listed on the Prime Market, at least one-third (1/3) of its directors should be "independent outside directors," who meet the independence criteria established by the companies, which take into consideration the guidelines mentioned above. Even companies that are listed on the Standard Market or the Growth Market are recommended to appoint two (2) "independent outside directors." Although this is not a mandatory obligation, if a listed company does not comply with this recommendation, it is required to explain why.

17. What financial statements are required for a public equity offering? When do financial statements go stale? Under what accounting standards do the financial statements have to be prepared?

The securities registration statement, which is a document that must be filed for the registration of a public offering under the FIEA, must contain audited non-consolidated financial statements and audited consolidated financial statements (if applicable) for the "most recent two fiscal years." As the FIEA does not define the "most recent fiscal year" or provide clear rules about when financial statements go stale, it is necessary to consult with the relevant local finance bureaus of the Ministry of Finance, especially if the offering is being arranged around the same time as the preparation of the financial statements for the latest fiscal year. The financial statements contained in the securities registration statement must be prepared in accordance with JGAAP, USGAAP or IFRS

18. Please describe the key environmental, social, and governance (ESG) and sustainability requirements in your market. What are they key recent changes or potential changes?

In Japan, listed companies were encouraged to make voluntary disclosures on their activities relating to ESG and sustainability but it was not a mandatory requirement. However, the regulations under the FIEA were amended on January 31, 2023, and these regulations now require corporate initiatives regarding sustainability to be disclosed in annual securities reports and other disclosure documents. Under the amended regulations, information on the company's policies and initiatives regarding sustainability and human capital, including diversity-related matters, such as the ratio of female managers, the ratio of male employees taking childcare leave and gender wage gap, need to be disclosed.

19. What are the typical offering structures for issuing debt securities in your jurisdiction? Does the holding company issue debt securities directly or indirectly (by setting up a SPV)? What are the main purposes for issuing debt securities indirectly?

In Japan, direct issuance is the typical offering structure for debt securities. Even when a holding company is an issuer, direct issuance is common, although they could elect the issuance of debt securities through operating subsidiaries if these subsidiaries have a higher credibility.

20. Are trust structures adopted for issuing debt securities in your jurisdiction? What are the typical trustee's duties and obligations under the trust structure after the offering?

As a matter of Japanese law, it is possible for a trustee to issue notes on behalf of trust assets. In this case, the trustee's duties include the obligation to separately manage trust assets, its own assets and assets of other trusts, and to prepare reports and keep relevant records related to trust assets.

21. What are the typical credit enhancement measure (guarantee, letter of credit or keep-well deed) for issuing debt securities? Please describe the factors when considering which credit enhancement structure to adopt.

In Japan, it is quite common to issue notes as unsecured bonds without any credit enhancement measures.

Pursuant to the Secured Bond Trust Act of Japan, if a Japanese company issues secured notes, a person who owns the assets to be offered as collateral, including the issuer company, is required to execute a trust agreement with the licensed trust company that performs the administration of the notes on behalf of noteholders, and comply with the terms of the agreement. However, as there is hardly any company that provides financial services as trust companies for secured notes, it is quite rare for secured notes to be issued in Japan. With respect to other credit enhancement measures, such as guarantees, letters of credit or keep-well deeds, there is no statutory restriction on secured bonds. Specifically, guarantee arrangements are sometimes considered where notes are issued by way of private placements, where the parent company, owner, or subsidiary of the issuer has a higher credibility than the issuer.

22. What are the typical restrictive covenants in the debt securities' terms and conditions, if any, and the purposes of such restrictive covenants? What are the future development trends of such restrictive covenants in your jurisdiction?

With respect to notes issued in Japan by way of public offerings, it is common to not have any restrictive covenants, except for a negative pledge clause, which prohibits the issuer from creating a lien on other unsecured notes issued in Japan, unless the same lien is created on all unsecured notes. The purpose of the negative pledge clause is to keep all unsecured notes issued in Japan rank pari passu. This market practice is not expected to change in the near future

If notes are issued by way of a private placement in Japan, the details of the restrictive covenants are up to the issuer and investors to decide through discussions and agreements. Practically, the parties discuss financial covenants, which result in an event of default if an issuer cannot comply with the prescribed financial targets.

23. In general, who is responsible for any profit/income/withholding taxes related to the payment of debt securities' interests in your jurisdiction?

Generally, Japanese income tax and/or corporate tax related to payments of interests on notes issued by Japanese companies will be withheld by the issuer or, in cases where the notes are held via a Japanese payment handling agent, such Japanese payment handling agent.

24. What are the main listing requirements for listing debt securities in your jurisdiction? What are the continuing obligations of the issuer after the listing?

In Japan, it is quite common that debt securities are not listed and are traded through OTC transactions. However, the Tokyo Stock Exchange is opening the TOKYO PRO-BOND Market, which is a market that is specifically aimed for professional-oriented bonds, including bonds issued by domestic and foreign companies and bonds issued by government agencies, etc. In the TOKYO PRO-BOND Market, only professional investors designated under the FIEA, such as qualified institutional investors and non–residents of Japan, are eligible for trading listed debt securities. There are only two criteria to be eligible for listing, and these are the following:

- A rating from a rating agency is obtained for these debt securities.
- A lead underwriter for the offering of these debt securities for listing is registered on the list of the Tokyo Stock Exchange. Issuers will be subject to timely disclosure obligations pursuant to the regulations of the TOKYO PRO-BOND Market, but the scope of matters that are required to be disclosed on a timely basis are quite limited, and include matters such as defaults on notes, bankruptcy and dissolution. Issuers are also required to disclose annual reports that contain its financial information, unless it is subject to continuing disclosure obligations under the FIEA or other local regulations.

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