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JAPAN

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I INTRODUCTION

In Japan, there are four stock exchanges, the largest of which is the Tokyo Stock Exchange (TSE). In recent years, roughly 100 issuers per year have listed their shares on the stock exchanges in Japan, most of which were listed on the TSE. The TSE has three market sections, the prime market, the standard market, and the growth market, from among which most issuers select the growth market for their initial public offerings (IPOs).

In 2022, 91 issuers were newly listed on the main stock exchanges in Japan, of which 87 were newly listed on the TSE, and 21 were newly listed on the TOKYO PRO Market.² On 31 May 2023, there were 3,880 issuers listed on the TSE, of which 1,835 were listed on the prime market, 1,441 were listed on the standard market, 529 were listed on the growth market, and 75 were listed on the TOKYO PRO Market.³ The total market capitalisation of the TSE was approximately ¥785 trillion on 31 May 2023.⁴

In many IPOs, Japanese issuers select the offerings for domestic investors in Japan only. However, in some cases, such as larger IPOs, issuers select Rule 144A offerings in the United States or Regulation S offerings outside Japan, or both, in addition to domestic offerings.

II GOVERNING RULES

i Main stock exchanges

Of the four stock exchanges in Japan, many issuers choose the TSE, which is the largest stock exchange in Japan in terms of the number of issuers and trading volume. As previously mentioned, the TSE provides three main market sections for cash equity:

- a* the prime market;
- b* the standard market; and
- c* the growth market.

Foreign companies are, in the same manner as domestic companies, required to choose one of these three market sections for their listing.⁵ The prime market is a market for companies that

¹ Kyohei Mizukoshi and Yuichi Miyashita are partners at Nagashima Ohno & Tsunematsu.

² https://www.jpx.co.jp/english/equities/listing-on-tse/new/basic/04_archives-01.html.

³ <https://www.jpx.co.jp/english/listing/co/index.html>.

⁴ <https://www.jpx.co.jp/english/markets/statistics-equities/misc/02.html>.

⁵ <https://www.jpx.co.jp/english/equities/market-restructure/market-segments/index.html>.

TOKYO PRO Market is also available for domestic and foreign issuers. For further details of TOKYO PRO Market, see Section III.iii.

have appropriate levels of market capitalisation (liquidity) to be investment instruments for many institutional investors, maintain an enhanced level of corporate governance, commit to sustainable growth and improvement of mid- to long-term corporate value, and place constructive dialogue with investors at the core of their management. The standard market is a market for companies that have appropriate levels of market capitalisation (liquidity) to be investment instruments in the open market, maintain a basic level of corporate governance expected of listed companies, and commit to sustainable growth and improvement of mid- to long-term corporate value. The growth market is a market for companies that have a certain level of market value based on their disclosure of business plans for realising high growth potential and their progress towards achieving this growth in an appropriate and timely manner, while posing a relatively high investment risk based on their business track record. To be listed on the growth market, an issuer is required to have 'high growth potential', and whether each company has such potential is required to be evaluated and determined by a lead underwriter (a listing sponsor) based on the company's business model and the business environment in which it operates.

After the initial listing, companies may transfer to another market section in line with their growth stage and the characteristic of each section above.

ii Overview of listing requirements

Generally, an issuer is required to meet certain listing requirements to be listed on the relevant market section, including liquidity, governance, business performance and financial status criteria.⁶ The following is an overview of the listing requirements for Japanese companies seeking to be listed on each market section of the TSE.

Prime market

In terms of liquidity criteria, an issuer must have at least 800 shareholders, at least 20,000 units⁷ of tradable shares,⁸ a tradable share market capitalisation of at least ¥10 billion and a market capitalisation of at least ¥25 billion. In terms of governance criteria, the tradable share ratio must be at least 35 per cent. This ratio requirement has been established for the purpose of ensuring constructive dialogue with institutional investors while maintaining 'public market control' by maintaining the tradable share ratio at a certain level. For business

6 The TSE published English versions of 'New Listing Guidebook' available at <https://www.jpx.co.jp/english/equities/listing-on-tse/new/guide/index.html>.
<https://www.jpx.co.jp/english/equities/market-restructure/market-segments/index.html>.

7 In Japan, shares constituting less than a full unit are not tradable on the stock exchanges on which they are listed and 100 shares of common stock generally constitute one unit.

8 The following shares are excluded from tradable shares: (1) shares held by shareholders who hold 10 per cent or more of the listed shares; (2) shares held by 'officers, etc.' as defined under the listing rules; (3) treasury stocks; (4) shares held by domestic banks, insurance companies or business corporations (corporations other than financial institutions and financial instruments business operators); and (5) shares that the stock exchange deems inappropriate to treat as tradable shares. 'Officers, etc.' listed in (2) above refers to directors, accounting advisors, auditors of the company, and in the case of a 'company with three committees,' executive officers, and includes officers' shareholding associations. Interested parties of such officers are also included. 'Interested parties' denotes (1) a spouse of an officer of a listed company and relatives within the second degree of kinship; (2) a company in which an officer or a person listed in (1) holds a majority of the voting rights; and (3) affiliates of listed companies and their officers.

performance and financial status criteria, an issuer is required to demonstrate that its revenue and financial base are both stable and excellent. Specifically, an issuer is required to have the following:

- a* at least ¥2.5 billion in total profit for the most recent two years; or
- b* at least ¥10 billion in sales for the most recent year and at least ¥100 billion in market capitalisation.

Net assets of at least ¥5 billion on a consolidated basis are also required.

Standard market

In terms of liquidity criteria, an issuer must have at least 400 shareholders, at least 2,000 units of tradable shares, and a tradable share market capitalisation of at least ¥1 billion; however, there is no requirement for market capitalisation. Regarding governance criteria, the tradable share ratio must be at least 25 per cent. This ratio requirement has been established for the purpose of ensuring a basic level of tradable share ratio required of a public company (same level as global stock exchanges). For business performance and financial status criteria, an issuer is required to show a stable revenue base and financial status. Specifically, an issuer is required to have had at least ¥0.1 billion in profit for the most recent year. It is also required to have positive net assets on a consolidated basis.

Growth market

In terms of liquidity criteria, the growth market requires certain minimum criteria to ensure appropriate liquidity for smooth trading by public investors. Specifically, the issuer must have at least 150 shareholders, at least 1,000 units of tradable shares and a tradable share market capitalisation of at least ¥0.5 billion. However, there is no requirement for market capitalisation. In terms of governance criteria, the tradable share ratio must be at least 25 per cent. Instead of the business performance and financial status criteria required for the prime and standard markets, the growth market requires an issuer to have a business plan for realising high growth potential and that enables investors to make reasonable investment decisions based on the information that is disclosed. For this business plan requirement, all of the following requirements must be met:

- a* reasonable business plans are in place;
- b* a lead underwriter (a listing sponsor) has submitted the basis for its opinion on the company's high growth potential; and
- c* the issuer makes, and will make after its listing, appropriate disclosure of business plans and matters related to its high growth potential (business model, market size, source of its competitive advantages and business risk).

To maintain its listing on the growth market, the issuer is required to have a market capitalisation of at least ¥4 billion 10 years after its listing.

Other listing requirements

In addition to the above-mentioned listing requirements for each market section, inter alia, the issuer is required to have continuously conducted its business activities as a joint stock corporation for at least three years (one year for the growth market) before the initial listing application date.

The issuer is also subject to listing examination based on substantive criteria. The stock exchange examines from the perspectives of, inter alia, corporate continuity and profitability, soundness of company management, effectiveness of corporate governance and internal management system, appropriateness of the disclosure of corporate information and other matters deemed necessary by the stock exchange.⁹

For foreign companies, not all listing requirements discussed above are applicable. For example, the 35 per cent or 25 per cent tradable share ratio requirement is not applicable. In the case of a foreign company whose shares have already been listed on a foreign stock exchange and whose principal market is a market other than the stock exchange, the stock exchange can treat the foreign company as satisfying all or part of the examination criteria for the listing application when the stock exchange deems it appropriate.

iii Overview of law and regulations

In general, apart from an obligation to file a securities registration statement under the Financial Instruments and Exchange Act of Japan (the FIEA), as discussed in Section III, there is no governmental approval or licence requirement in connection with an IPO or listing of shares in Japan.

A foreign issuer may be subject to certain reporting obligations in connection with a public offering in Japan under the Foreign Exchange and Foreign Trade Act of Japan.

III THE OFFERING PROCESS

i General overview of the IPO process

For a listing examination, an issuer must file a listing application accompanied by the required documentation, and the stock exchange then reviews these application documents. Although the normal examination period is three months, it may vary depending on, inter alia, whether there have been any change in the issuer's organisational structure or substance of business, the size of the applicant group and seasonal peaks. The stock exchanges usually accept a 'preliminary application' in advance of the formal application. Such preliminary application can be made prospectively from three months prior to the end of the fiscal year preceding the listing application. For example, issuers that have complex organisational or business structures involving potential issues in its listing examination can use the preliminary application so that the stock exchanges can examine the formal application smoothly.

Under the FIEA, an issuer must file a securities registration statement with the director general of the local finance bureau. A public offering of shares cannot be implemented unless the securities registration statement has been filed and offered shares cannot be sold unless the securities registration statement has become effective. Although a securities registration statement becomes effective 15 days after the initial filing in principle, the effective date may vary depending on the timing of amendments to the securities registration statement. In practice, the securities registration statement for an IPO becomes effective one day after the

⁹ The substantive criteria for the growth market are appropriateness of the disclosure of corporate information and risk factors, soundness of corporate management, effectiveness of corporate governance and internal management system, reasonableness of the business plan and other matters deemed necessary by the stock exchange.

amendment to the securities registration statement incorporating the pricing information, which occurs after a certain roadshow and book-building period, which usually takes about one month. For further details, see Section III.ii.

The securities registration statement for the IPO must contain certain information concerning the issuer and the offering, including detailed information on the offering and the company, and audited financial statements for the preceding two fiscal years, together with an audit report prepared by a listed company audit firm (independent auditors).

For foreign companies, financial statements can be prepared in accordance with the International Financial Reporting Standards (IFRS), or generally accepted accounting principles in their home or other country if the Commissioner of the Financial Services Agency of Japan approves.

ii Pitfalls and considerations

There are many pitfalls and considerations for IPOs in Japan. Some of these are as follows.

Enhancement of governance system as a public company

An issuer that intends to go public needs to complete various tasks to become a public company, including the establishment of a corporate management system, budget control, compliance with laws and regulations, and effective internal controls. The preparations generally take several years. In Japan, lead underwriters (listing sponsors) advise issuers on their preparations for an IPO and review them meticulously in light of the listing criteria discussed in Section II. After the review process, the lead underwriters submit listing recommendation letters to the stock exchange. The stock exchange then conducts a listing examination. In addition, an issuer must submit a draft securities registration statement under the FIEA to the competent local finance bureau for its review prior to the launch of the IPO. Issuers can officially file their securities registration statements only after completion of the review by the local finance bureau. The review process is carried out on a confidential basis.

One of the biggest issues in the preparation stage is whether issuers can smoothly retain independent auditors. As discussed in Section II.i, audited financial statements for the preceding two fiscal years, together with an audit report prepared by a listed company audit firm (independent auditors), are required for an IPO. In recent years, it has been very difficult to find independent auditors to retain for the audit of the financial statements for the purpose of an IPO in Japan, mainly because of a mismatch between supply and demand. In other words, many issuers would like to retain big audit firms as their independent auditors. However, the big audit firms have had no choice but to decline some of the offers from the issuers due to their capacity issue, among other things. In connection with this issue, in March 2020, the Financial Services Agency published a report summarising the current issues in relation to supply and demand and proposing various measures to be taken by audit firms, the Japanese Institute of Certified Public Accountants, underwriters, venture capital firms, stock exchanges and issuers. Following the publication of the report in 2020, the mismatch between supply and demand has been gradually easing each year.

Gun-jumping considerations

The FIEA generally prohibits any solicitation for the sale of shares to investors in Japan prior to the filing of securities registration statements with the director general of the local finance bureau. As there is no definition of ‘solicitation’ in the FIEA and it is considered to include a broad range of activities, any communication with investors prior to the filing of

securities registration statements must be carefully considered. Under current practice, the securities registration statements are filed with the director general of the local finance bureau on the same date as the listing approval by the stock exchange, and therefore the issuers and other parties must carefully control publicity prior to the listing approval in light of the gun-jumping rule.

Conversely, prior to the filing of securities registration statements, many issuers wish to sound out the investors' views on the valuation of the shares in order to determine whether their IPOs will actually be successful. Considering this wish, in Japan, the practice of engaging in certain communication with investors has become established to the extent that it does not violate the gun-jumping regulations. The disclosure guidelines issued by the Financial Services Agency with respect to the FIEA clarify that the distribution of information concerning an issuer, at least one month before the filing date of the securities registration statement, does not constitute 'solicitation' for the sale of shares if it does not refer to the offering of the shares and takes reasonable measures to prevent the re-distribution of the information by others.

Relying on these disclosure guidelines, 'information meetings' with institutional investors can be held by issuers with support from investment banks (potential future underwriters) in the form of introducing corporate information without referring to the IPOs. By conducting these meetings, issuers can use the feedback from investors who attended the meeting for their IPO preparation. To prepare these meetings, it is necessary to pay attention to the timing, content of the presentation and manner of the meetings so as not to fall within solicitation, and to also consider the risk of incurring liability in relation to claims brought by investors regarding the presentation.

In addition, in some IPOs in Japan, research analysts at investment banks (potential future underwriters) distribute 'pre-deal research reports' to institutional investors for the purpose of facilitating the investors' understanding of the issuers. The distribution of pre-deal research reports to domestic institutional investors is conducted based on the disclosure guidelines above, and therefore it must be conducted at least one month before the filing date of the securities registration statements and cannot refer to the IPOs. In cases of global offerings, the distribution of pre-deal research reports must comply with international rules and practices in the relevant jurisdictions, and with Japanese regulations.

A 'pre-hearing' survey may also be conducted in Japan. A pre-hearing survey is a survey of potential demand from institutional investors that refers to an IPO and is allowed if certain strict conditions are met, such as the execution of a confidentiality agreement pursuant to the disclosure guidelines. However, it is uncommon to conduct the survey under current IPO practice in Japan partly because there are many small-sized IPOs in Japan and sophisticated institutional investors cannot participate in such small deals due to their investment criteria.

Reform of IPO pricing process

In 2021, the Japanese government raised the issue of underpricing in some IPOs in Japan where the opening price at which shares begin to be traded in the market after the IPOs may be much higher than the offer price at which the issuers sell their shares to investors in the IPOs; in other words, the issuers could have raised more proceeds from investors in the IPOs if the offer price had not been underpriced. Thereafter, the Japan Securities Dealers Association established a working group to discuss reform of the IPO pricing process, and in 2022 it published a report proposing this reform.

One of the topics of this reform was to shorten the IPO process. The report pointed out that the period between the listing approval by the stock exchange and the listing date

is generally about one month. This long period would cause investors and issuers to bear the risk of price fluctuations based on changes in market conditions, and the risk of these price fluctuations may be incorporated into the offer price, thereby increasing IPO discounts. On the basis of the discussion, the relevant authorities and parties are currently considering changing the relevant rules and practices to shorten the IPO process.

Another topic was the determination of the offer price. In Japan, an estimated offer price is set based on discussions among the issuer and underwriters in advance of the IPO launch and is disclosed in the securities registration statement. An indicative price range is set based on the views of institutional investors expressed during the pre-marketing stage post launch. Thereafter, the indicative price range is presented to investors and book-building is conducted. The offer price is then determined based on the result of the book-building, which is a method that can be expected to discover an appropriate price based on investors' actual demand. However, the report pointed out that under the current practice, the offer price is set at the upper limit of the indicative price range, even in cases where investor demand well exceeds the upper limit in the book-building, and therefore the current practice for determining offer prices may not appropriately reflect investor demand. Accordingly, the report proposed that the offer price should be set outside the indicative price range without having to redo the book-building if the excess is within a certain range. As of 31 May 2023, the necessary amendments to laws and regulations are ongoing.

iii Considerations for foreign issuers

One of the benefits for foreign issuers to list their shares in Japan is the possibility for them to increase their credibility and reputation in Japan. Through IPOs in Japan, there are more opportunities to increase their credibility and reputation among customers, businesses partners, financial institutions and prospective employees in Japan. However, there have been only a small number of foreign issuers listed on the stock exchanges in Japan. According to the TSE, since 2011, there have been only four IPOs for companies registered outside Japan, seven corporate inversions from foreign companies to Japanese companies, eight Japanese companies run by non-Japanese representatives and two Japanese subsidiaries of foreign companies.¹⁰

As discussed in Section II.ii, while the listing criteria for foreign issuers are basically the same as those for domestic issuers,¹¹ the listing examination by the stock exchange is conducted by considering the home country's legal system and business practices, among other issues. In addition, the ratio of tradable shares required for domestic issuers is not applicable under the listing criteria for foreign issuers. The involvement of law firms is required to confirm the differences between Japanese laws and foreign local laws, check the legal matters required for the listing and prepare legal opinions. In addition, domestic law firms often prepare the necessary documents for initial listing applications and carry out the disclosure of corporate information as representatives of listed foreign issuers following their listing. In the case of a secondary listing on a stock exchange in Japan (i.e., the foreign issuer was already listed on a foreign stock exchange that is its primary market), the stock exchange in Japan may treat the foreign issuer as conforming to certain listing criteria if it deems it appropriate.

10 <https://www.jpx.co.jp/english/listing/ir-clips/relations-with-foreign-country/index.html>.

11 <https://www.jpx.co.jp/equities/listing-on-tse/new/guide-new/nlsgeu000005p6yq-att/nlsgeu000005p72q.pdf>.

There are four types of listings on stock exchanges in Japan that are available to foreign issuers:

- a* listing of the shares issued by foreign issuers;
- b* listing of Japan depositary receipts (JDRs);
- c* corporate inversions from foreign companies to Japanese companies; and
- d* listing on the TOKYO PRO Market.

For (b), a JDR is a beneficiary certificate of a beneficiary-certificate-issuing trust whose trust assets consist of the shares of a foreign issuer pursuant to the Trust Act of Japan. To use the JDR scheme, investors in Japan are able to smoothly trade the foreign issuers' securities without opening foreign securities trading accounts. For (d), the TOKYO PRO Market is a stock market where only professional investors are allowed to trade securities, and an offering of shares on the TOKYO PRO Market technically constitutes a private placement under the FIEA. The TOKYO PRO Market adopts the J-Adviser system and a J-Adviser approved by the TSE investigates and confirms the listing eligibility of a company that it supervises before listing, provides advice and guidance concerning timely disclosure after listing, and examines the status of compliance with requirements to maintain the listing.

IV POST-IPO REQUIREMENTS

i Continuous disclosure obligations

After an issuer has filed a securities registration statement for the purpose of listing its shares, it is subject to ongoing annual, interim and current reporting requirements, including the obligation to file an annual securities report, a quarterly securities report and an extraordinary report under the FIEA. These annual and interim reports should include certain corporate information that is substantially the same as that contained in the securities registration statement, and audited or reviewed financial statements, together with an audit or review report prepared by a listed company audit firm (independent auditors). The issuer is also subject to timely disclosure obligations under the listing rules of the relevant stock exchange.

ii Delisting criteria and continued listing criteria

The listing rules of each stock exchange provide certain delisting criteria,¹² including delay in the submission of an annual securities report or quarterly securities report, certain false statement in an annual securities report or quarterly securities report or certain adverse opinion presented in an audit or review report prepared by a listed company audit firm (independent auditors) and material breach of the listing agreement. In addition, failure to satisfy continued listing criteria¹³ also constitutes grounds for delisting. In short, each listed company is required to continuously meet the listing criteria discussed in Section II.ii to maintain its listing. A listed company will be delisted after one year (six months in the case of falling below the trading volume requirement listed in the continued listing criteria), in principle, has passed since the listed company came to no longer satisfy the relevant continued

12 <https://www.jpx.co.jp/english/equities/listing/delisting/index.html>.

13 <https://www.jpx.co.jp/english/equities/listing/continue/index.html>.

listing criteria. The listed company is required to submit a plan, specifying its actions and schedule for satisfying the continued listing criteria, within three months from when it came to no longer satisfy the continued listing criteria.

iii Fair disclosure rules and insider trading rules

The fair disclosure rules and insider trading rules under the FIEA are applicable to issuers whose shares are listed on a stock exchange in Japan. In general, foreign companies whose shares are listed on a stock exchange in Japan are not exempted from these rules.

Under the fair disclosure rules, if a listed company discloses certain material non-public information to a specified person, it must make such information publicly available at the same time as the disclosure to such person.

Although the fair disclosure rules apply to listed companies, the insider trading rules apply to both listed companies and their affiliates (insiders), including:

- a* directors;
- b* officers;
- c* employees;
- d* agents;
- e* shareholders holding at least 3 per cent of the total voting rights or total issued and outstanding shares of the listed issuer; and
- f* any person who has entered into, or is in the process of negotiating, a contract with the listed issuer.

Under the FIEA, in general, an insider is prohibited from trading listed shares when the insider is aware of any material non-public facts of the issuers of the listed shares. The FIEA provides the specific definitions of ‘material facts’, such as the issuance of shares, the reduction of capital, the repurchase of shares, mergers or corporate splits. The FIEA also provides *de minimis* thresholds at which a specific fact will be deemed to be immaterial.

V OUTLOOK AND CONCLUSIONS

The IPO market in Japan has been, and may continue to be, affected by global macroeconomic conditions, such as the conflict between Russia and Ukraine and other geopolitical developments, the sustained inflation, the recent instability in the banking industry and the covid-19 pandemic. Looking forward, in addition to considering unpredictable market conditions, issuers that intend to go public in Japan and the other relevant parties need to pay close attention to the developments in the reform of the IPO pricing process discussed in Section III.ii.