プロトタイプ
政策研究所
Policy Research Institute

Newsletter No. 006 | April 5th, 2024

Report of Working Group on Capital Market Regulations and Asset Management Task Force of the Financial System Council

-"Promotion of Utilization Investment Corporations and Framework for Incorporating Unlisted Equities in Investment Trusts" and "Activation of Trading in Unlisted Securities"

Atsumi & Sakai
Policy Research Institute

The Financial Services Agency of Japan recently published a "Report of the Working Group on Capital Market Regulations and Asset Management Task Force of the Financial System Council" (the "Report"), which describes a strategy for improving the capabilities of asset management companies who are playing important roles in managing financial assets and making returns for households. The strategies include promoting a virtuous cycle of growth and asset-based income in the investment chain through enhancing fund-raising for startups and feeding those returns back to households and promoting initiatives for achieving a leading asset management center.

This newsletter discusses the sections of the Report on "Promotion of Utilization Investment Corporations and Framework for Incorporating Unlisted Equities in Investment Trusts" and "Activation of Trading in Unlisted Securities".

1. Promotion of Utilization Investment Corporations and Framework for Incorporating Unlisted Equities in Investment Trusts

(1) Incorporation of Unlisted Equities in Investment Trusts

In Japan, there is no legal prohibition against including unlisted equities in investment trusts; however, due to the lack of clarity regarding the evaluation methods for unlisted equities, in practice they have not been included. Currently, the Investment Trusts Association is considering an appropriate framework to enable the inclusion of unlisted equities in investment trusts in practice.

There is an aspect where the clarity of product characteristics and risks becomes less apparent for investors when listed equities with high price transparency and unlisted equities are mixed within the same publicly offered investment trust. Each asset management company should consider appropriate scheme selection based on their investment policy, content, etc. Also, in addition to the existing framework and practices of publicly offered investment trusts, it is desirable to design product types such as those primarily investing in illiquid assets, with measures taken for the assurance of liquidity, such as redemption restrictions, etc. When such investment trusts are marketed, from the perspective of investor protection, it is necessary to appropriately assess the suitability of investors based on the nature of their funds to be invested and their risk tolerance, and also to provide sufficient explanations to investors regarding the risks associated with investing in unlisted equities.

(2) Listed Venture Funds

The Venture Fund Market of the Tokyo Stock Exchange was established in December 2001 with the aim of creating a new funding scheme for startup companies and providing individual investors with opportunities to invest in unlisted companies. Currently, there are no listed equities on the market, but it is anticipated that risk-tolerant investors will be able to invest in startup companies through Venture Funds, leveraging the expertise of investment professionals and the functionality of diversified investments, similar to 1.(1). Therefore, it is important to consider reviewing necessary regulations and so forth from the perspective of enabling flexible operation of Venture Funds to activate the utilization of the Venture Fund Market.

Regarding the disclosure of information for listed venture funds, disclosure requirements are established not only through statutory disclosures such as financial statements but also through the Tokyo Stock Exchange's listing rules. Given the different nature of unlisted companies compared to listed ones, it is important for the Tokyo Stock Exchange to consider the content and frequency of information disclosure.

Furthermore, in listed venture funds, acquiring self-investment units may be considered as an option for surplus funds from stock sales or for diversifying financial strategies, particularly when reinvestment is challenging. Therefore, considering the acquisition of self-investment units under the applicable insider trading restrictions could enable such acquisitions.

2. Activation of Trading in Unlisted Securities

(1) Relaxation of Entry Requirements for Financial Instruments Business Operators' Intermediary Functions of Unlisted Securities Transactions Targeting Professional Investors

Regarding the cashing out of shares of unlisted companies such as startup companies, the current practice predominantly involves bilateral purchases by issuing companies or secondary funds, making it challenging to broadly approach potential investors who could become buyers and adequately address the cashing-out needs of shareholders and the investment needs of investors. Moreover, given the limited alternatives to fulfill such cashing-out needs other than through listings, there are observations that domestic startup companies tend to go public at smaller scales compared to those in other countries. The revitalization of secondary trading in unlisted equities is not only conducive to facilitating fundraising by startup companies (primary transactions) but also essential for diversifying exit strategies for startup companies, including M&A (mergers and acquisitions), and ensuring continuous funding at appropriate scales according to their growth stages. Therefore, it is believed that institutional arrangements related to secondary trading of unlisted equities should be further developed.

Furthermore, when selling foreign investment securities issued by foreign investment trusts or foreign investment corporations established and managed by overseas asset management companies to domestic investors, it is necessary to establish a domestic corporation and obtain registration as a Type I Financial Instruments Business Operator in Japan. Registration as a Type I Financial Instruments Business Operator imposes high financial requirements and other hurdles, leading to cases where sales are ultimately abandoned. To address the diversification of investment targets for domestic investors, it is necessary to address these challenges.

Therefore, to encourage new entrants into the intermediary business for trading unlisted securities, it is appropriate to relax the registration requirements for Type I Financial Instruments Business Operators specialized in intermediating primary and secondary transactions of unlisted securities, particularly when they do not handle securities or money deposits, such as by relaxing capital requirements, self-capital adequacy ratio regulations, and regulations on concurrent employment. However, for highly liquid securities where general investors may participate, adequate investor protection measures are necessary. Therefore, it should generally be limited to intermediating unlisted securities transactions targeting professional investors (specific investors). Additionally, when holders of unlisted securities conduct sales as secondary transactions, as it effectively separates the risk associated with holding unlisted securities from holders, it may be appropriate to allow sales by general investors, such as founders of the issuing company, for example.

(2) Relaxation of Entry Requirements for PTS Operations Handling Only Unlisted Securities

Currently, regulations for Private Trading System (PTS) operations operated by Type I Financial Instruments Business Operators are primarily geared towards handling listed securities, regardless of the liquidity of the securities involved. Under the approval system, these regulations require substantial capital (over 300 million yen) and impose net asset (over 300 million yen) and system requirements (including attachment of third-party evaluation reports). These regulations pose high hurdles for operators intending to electronically intermediate secondary transactions of unlisted securities on small-scale trading platforms. Additionally, due to the absence of such operators providing trading venues, it is suggested that these regulations contribute to the lack of activity in secondary trading of unlisted securities.

To promote the entry into the PTS operation market by operators providing venues for secondary trading of unlisted securities, it is appropriate to establish entry requirements for PTS operations based on expected trading volumes. Specifically, for PTS operations exclusively handling unlisted securities with limited liquidity and trading volumes, it is proposed to allow entry under the registration system of Type I Financial Instruments Business Operators without requiring approval, under the assumption of applying necessary regulations regarding transaction management. This includes relaxing requirements related to capital, net asset, and system, among others.

Authors/Contacts

Takafumi Ochiai
Atsumi & Sakai
Head of Policy Research Institute
E: takafumi.ochiai@aplaw.jp

Kenichi Tanizaki
Atsumi & Sakai
Deputy Head of Policy Research Institute
E: kenichi.tanizaki@aplaw.jp

Tatsuhiro Hirayama
Atsumi & Sakai
Policy Research Institute
Principal Researcher
E: tatsuhiro.hirayama@aplaw.jp

Kyosuke Nishiyama
Atsumi & Sakai
Policy Research Institute
Researcher
E: kyosuke.nishiyama@aplaw.jp

If you would like to sign up for Policy Research Institute Newsletters, please fill out the sign-up form.

Back issues of our newsletters are available here.