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

-“Issues surrounding venture capital” and “Establishment of systems for public offerings, private placement, and investment crowdfunding”-

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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, promoting initiatives for achieving a leading asset management center.

This newsletter discusses the section of the Report on “Challenges Surrounding Venture Capital (VC) funds” and “Establishment of Systems for Public Offerings, Private Placements, and Investment Crowdfunding”.

1. Issues Surrounding Venture Capital (VC) funds

(1) Promotion of Fair Value Measurement

The fair value measurement of VC funds achieved certain progress in 2023, in May, with the Japanese Institute of Certified Public Accountants revising related practical guidelines and organizing audit considerations concerning the audit of VC funds.

On the other hand, issues such as the following have been pointed out:

- Holders of equity interests in VC funds are required to evaluate at acquisition cost, necessitating dual management of fair value and acquisition cost.
- For GPs (General Partners, fund management operators), securing personnel for middle and back office operations, establishing and operating internal controls, and system implementation are necessary, thus requiring a certain fund size.
- It is necessary to permeate the above practical guidelines into the practices of auditing firms.
- In the future, should the introduction of fair value evaluation increase and audit demand rise, the reallocation of resources within auditing firms or the need for new auditors for fund audits will be necessary.



The introduction of fair value evaluation, which includes benefits such as expanding fund sizes through obtaining funds from overseas investors and enhancing the transparency of securities valuation, should be promptly continued with the necessary environmental preparations. Simultaneously, it is necessary to cooperate with relevant parties to address these issues. Specifically, regarding the issue of dual management, the Japan Venture Capital Association proposed, in July of 2023, to the Corporate Accounting Standards Advisory Council of the Financial Accounting Standards Foundation, to reconsider the accounting treatment of equity interests in VC funds held by listed companies and others, and it is essential to closely monitor the trends in these discussions. Furthermore, from the perspective of reducing the cost burden towards the introduction of fair value evaluation, it would be useful that VC funds share points to note to introduce fair value evaluation with other companies in the same industry. Moreover, it is expected that activities to permeate the above practical guidelines into the practices of auditing firms will be advanced by the Japanese Institute of Certified Public Accountants.

(2) Principles for VC funds

To facilitate the supply of funds to startup companies, it is crucial to expand the flow of funds from domestic and foreign institutional investors to domestic startup companies through VCs. In addition to promoting the fair value evaluation of VC funds, it has been pointed out that it is necessary for domestic VCs to ensure governance and information equivalent to that of foreign VCs in their operations. This include conflict of interest management by GPs, and the information provided by GPs to LPs (Limited Partners, investors in the fund). . Also, it has been pointed out that VC investments' exits are biased towards startups' Initial Public Offerings (IPOs), becoming a factor for so-called small-lot listings, and the discontinuation of VC management support after IPOs, leading to a break in the support for sustainable growth of startups.

For VCs aiming to acquire LP investments from a broad range of institutional investors, it is important to ensure proper governance and discipline while referencing practices abroad. To enhance the appeal of VCs as an asset class conducive to long-term operations, support the development of the VC industry, and ultimately stimulate the supply of funds to startups, it is appropriate to formulate



Venture Capital Principles (tentative name) based on the situation surrounding startups in our country and global practices, aiming to improve the level of governance among VCs soliciting LP investments from a wide range of institutional investors. It is considered appropriate to discuss the scope and content of these principles, keeping in mind that there are VCs, such as Corporate Venture Capital (CVC), that do not plan to raise LP investments from numerous investors.

Moreover, it is hoped that efforts to create opportunities for matching between domestic VCs and foreign institutional investors, to encourage investment in domestic VCs by foreign institutional investors, will spread.

2. Establishment of Systems for Public Offerings, Private Placements, and Investment Crowdfunding

(1) Simplification of the Matters on Disclosure of Small Amount Public Offerings

For public offerings of securities to more than 50 general investors with a fundraising amount of 100 million to less than 500 million yen (small amount public offerings), although a securities registration statement must be submitted, there is no need to include consolidated information, and the content to be described is simplified.

Given the recent emphasis on the disclosure of non-financial information, particularly among listed companies, it is considered that, currently, there are matters in the securities registration statements related to small amount public offerings that pose a significant disclosure burden for startup companies. Therefore, from the perspective of reducing and rationalizing the disclosure burden related to fundraising by startup companies, it is appropriate to further simplify the disclosure content in these statements.

Specifically, considering the actual needs for small amount public offerings and aiming to balance investor protection with the information provision to investors and the corporate burden, the following revisions should be considered:



- **Making the disclosure of 'Sustainability Information' optional**
- **Eliminating the requirement to disclose financial statements for the last five fiscal years and only requiring those for the most recent two fiscal years**
- **For the non-financial information part, making items such as 'Overview of Corporate Governance' equivalent to the content described in the business reports under the Companies Act**

(2) Activation of Investment-type Crowdfunding

A) Issuance Limits, etc., for Investment-type Crowdfunding

Crowdfunding (CF) is a mechanism that allows startup companies to raise small amounts of funds from many people via the internet. The investment-type CF system (regulatory framework for small electronic solicitation business) was introduced in 2015.

In Japan, the total amount of securities that a company can issue via investment-type CF is capped at less than 100 million yen per year. In contrast, other countries allow for higher amounts of fundraising, with necessary investor protection measures such as disclosure in place, with the United States setting the limit at 5 million dollars (approximately 750 million yen) and Europe at 5 million euros (approximately 800 million yen).

Given that the demand for fundraising by startup companies in Japan is increasing yearly, with many companies needing to raise funds of 100 million to less than 500 million yen, particularly at the current stage, it is appropriate to raise the issuance amount limit to less than 500 million yen, assuming necessary disclosures are made by companies raising more than 100 million yen. In this case, companies raising funds between 100 million and less than 500 million yen could use a simplified securities registration statement form (further simplification of the content of such statements, as mentioned above, would encourage its use). Such system improvements are expected to enhance the fundraising environment for startup companies. However, to ensure proper



administration, the role of CF service providers, who conduct intermediary services, becomes more critical. From this perspective, it is essential that CF service providers disclose items related to the review of issuers and business plans, and conduct proper reviews in accordance with those items. Additionally, while investor protection is taken into account, further simplification beyond the content described in '2.(1) Simplification of the Matter on Disclosure of Small Amount Public Offerings' should also be considered.

Furthermore, the issuance amount limit is set from the perspective of investor protection, assuming solicitations include general investors. When conducting specific investor private placements as a small amount electronic public offering service, it is considered unnecessary to set an issuance amount limit of less than 500 million yen, including solicitations to general investors. However, even in private placements, given the high risk associated with unlisted stocks, it is appropriate to set a certain limit on the range that can be handled as a small amount electronic public offering service.

B) Investment Limits for Investors in Investment-type Crowdfunding and Methods of Solicitation to Investors

In our country, the annual investment limit for investors (excluding specific investors) in investment-type CF is set at 500,000 yen per investment target. However, the system that sets a uniform limit for all investors is considered to have room for improvement from the perspective of investing according to the risk tolerance and investment capacity of each investor. In this regard, in other countries, the annual investment limit for investors in equity investment-type CF is set according to their annual income or net assets.

Regarding the method of solicitation, to prevent investors from suffering unforeseen losses without fully understanding the risks associated with startup companies, the current system is limited to displaying information on websites and sending emails in conjunction with such displays. There has been criticism that, even when investors want to know more details about an investment



opportunity, the inability of CF operators to provide oral explanations due to this restriction should be improved from the perspective of investor protection. Setting a limit based on the risk tolerance and investment capacity of investors is considered beneficial for both protecting investors and improving convenience. Therefore, it is appropriate in our country as well, while referring to examples from other countries, for CF operators to understand the annual income and net assets of their clients and set the investment limits for CF according to the investors' annual income and net assets. Considering the administrative burden of timely understanding the annual income and net assets of all investors, it is conceivable to allow investments without verifying annual income or net assets if the amount is within a certain small range.

Furthermore, regarding the method of solicitation, while it is considered that face-to-face solicitation should continue to be handled cautiously due to the typically high risk of exerting undue pressure on investors, providing careful oral explanations in response to investor requests can lead to more appropriate investment decisions. Therefore, it is deemed appropriate to allow product explanations via voice calls only upon request from investors. In such cases, CF operators should take measures that allow for post-verification of customer interaction appropriateness, such as recording the voice call exchanges. Additionally, the information that can be provided during voice call explanations should be based on content available on websites or in emails, to ensure that no information disparity occurs among investors.

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