



TOKYO STOCK EXCHANGE: Opening Corporate Japan to Foreign Investors

Stock exchanges everywhere are changing from mutually owned, monopolistic marketplaces into business-oriented, competitive organizations diversifying their services beyond their traditional roles of providing secondary markets for investors. Tokyo Stock Exchange (TSE) is no exception. However, in Japan, the reinvention of TSE has taken place in the context of a financial marketplace undergoing massive restructuring at the institutional level as well as the trading, clearing, and settlement levels. One of the major goals of the broader restructuring program is to make it easier and more efficient for foreign fund managers and institutional investors to buy and sell Japanese securities, in the expectation that increased liquidity and competition will help to rejuvenate the industrial and commercial sectors of the economy as well. The reshaping of the market infrastructure to cut the costs of trading, clearing, and settling transactions is the most obvious sign that the Japanese securities markets are responding to the demand for easier and cheaper access. However, fund managers and institutional investors are under equal pressure to exercise their voting rights and ensure that they claim their entitlements. A series of corporate scandals around the world has intensified the pressure for improved corporate governance, and higher rates of voting by fund managers are seen as an important aspect of this. Equally, the long bear market has increased the interest of fund managers in protecting and claiming their entitlements to dividends, rights issues, stock splits, and other corporate actions that have economic value, so the demand for more efficient corporate actions processing also is rising on a global scale. In practice, these two demands are difficult to separate. Unless investors receive information about corporate actions promptly, and can respond electronically, it will be difficult to increase the proportion of stock that they vote. It is to meet these twin demands that TSE will launch an electronic proxy-voting platform in the fall of 2004, for fund managers to vote their proxies, and enhance the Tokyo Market Information (TMI) corporate action information service, launched in 2001, which already has secured a large following abroad. Plans are in hand now to enhance it further by TSE joining SWIFT and making use of the ISO 15022 corporate actions message types. To learn more about the two services, Global Custodian interviewed Yoshiaki Tamura, Senior Vice President, Information Products (the TSE official responsible for the proxy voting platform), and both Hitoshi Izumi, Manager, Information Products, (the official responsible for the corporate actions service) and Kazuhisa Fujimura, the SWIFT Regional Director for Japan.

AGM. If an issuer publishes its agenda 14 days before the date of the AGM—the current minimum period allowed by the Commercial Code—this means that beneficial shareholders should have 13 days in which to study the agenda and decide how to vote.

GC: How does that compare with the present system?

Tamura: Under the present system, as the chart shows, when the beneficial shareholders are foreign investors, the issuing company's transfer agent sends the AGM agenda to the subcustodian, who then forwards the information on to the foreign institutional shareholder, usually via a global custodian. When the beneficiaries are Japanese institutional investors, the agenda goes to a trust bank that sends the material on to beneficial shareholders, who may be pension funds, fund managers, or even trust banks. The transmission is not automated, and can include fax or mail. After the beneficiary has decided how to vote, his vote travels back by the same route. The last stage of the return journey is a voting card mailed to the issuer's transfer agent by a trust bank or a subcustodian. At present, it takes one day to transmit an agenda to a subcustodian (or trust bank in the case of Japanese beneficial institutional investors) and, although most require only three days, some subcustodians require a longer period to process votes returned by beneficiaries. In some cases, when an issuer publishes the agenda for its AGM only 14 days ahead of the meeting, shareholders can be left with almost no time in which to decide how to vote, as you need to set aside a period for translation. Of course, there are other companies that allow as much as 40 days between publishing the agenda and the date of the AGM—but they are the exception.

GC: There is a legal barrier to voting, too. Under Japanese law, registered shareholders have the right to vote at shareholders meetings, but registered shareholders are normally trust banks or custodians, and the law does not provide for voting by beneficial shareholders. How have you got round this problem?

Tamura: It's correct that the Commercial Code gives registered shareholders the right to vote, and institutional investors, foreign investors,

PROXY VOTING

GC: We know that foreigners vote their stock successfully much less than domestic investors in Japan. Do we know how large the problem actually is?

Tamura: There are no official figures but, according to some estimates, almost 100% of shares held by Japanese banks and 95% held by investment trusts and insurance companies already are being voted. In the case of foreign investors, the proportion voted falls to 25%. Even so, foreigners are voting much more than they did a few years ago.

GC: Three-quarters of Japanese companies hold their AGMs in the last week of June, making it notoriously hard for foreign fund managers and their custodians to vote proxies. How will your

new electronic system give them more time?

Tamura: It will transmit the agenda for AGMs to institutional shareholders much more quickly than the present system. This applies to both domestic and foreign institutional investors. Issuers who use our system transmit their agenda electronically to the proxy-voting platform, which then sends it directly to beneficial shareholders. Shareholder votes return by the same route to the issuing company's transfer agent. Subcustodians (in the case of foreign beneficiaries) or registered shareholders (in the case of Japanese investors) are bypassed. The platform delivers AGM agendas to voters on the day of publication, and can deliver votes back to the transfer agent as late as one day before the

fund managers, and investment advisory firms are not usually registered shareholders. However, it won't be necessary to revise the Commercial Code for us to operate our service. The platform will be recognized as an "agent" or "messenger" acting on behalf of the registered shareholder. The Ministry of Justice has accepted this interpretation of the Code. In fact, the Ministry has strongly supported our efforts to launch the voting platform.

GC: Language is another barrier to voting. Will notifications, instructions, and voting results be available in English?

Tamura: Some Japanese issuers already translate AGM agendas into English, while others provide headline or summary translations. If the issuer does neither of these things, the platform will provide headline translations in English. We will be using a platform created by our US partner ADP to provide proxy-voting services in the US and Europe. It already can handle English and French, and can be adapted to handle Japanese.

GC: What other benefits has ADP brought?

Tamura: Many institutional shareholders in the US and an increasing number in Europe already use the ADP platform, so they will be using a system they are familiar with to vote their Japanese shares. If we had created our own platform from scratch, we also would have had to invest a much larger amount of money. Naturally, this would have meant charging higher fees to users, and might have made the whole project uneconomic.

GC: Many foreign fund managers believe that Japanese companies do not really want them to vote and have deliberately created a system that makes it difficult. How confident are you that issuers will support this initiative?

Tamura: Among issuers that might use the system, there are companies that are positive and others that are not so keen. However, the number that supports us is definitely increasing. The companies that have a high ratio of foreign shareholders also welcome the platform as a tool for better communication with foreign investors.

GC: What is the attitude of Japanese investors, and bodies such as the Pension Fund Association, to the new service?

Tamura: It seems to be very favorable. In fact, the Pension Fund Association (PFA), one of the largest institutional investors in Japan with ¥5.4 trillion under management, has supported the idea of an electronic voting platform. Of course, they want to find ways of voting their own huge share portfolio more efficiently.

GC: How far into corporate Japan will the proxy voting service actually penetrate?

Tamura: The TSE platform will be available for all Japanese public companies, regardless of where they are listed. However, initially, we are

attaching the highest priority to about 2,000 companies listed on TSE 1st section and JASDAQ, because these are the stocks most widely held in the portfolios of institutional and foreign investors.

GC: Is the platform being introduced in a single "Big Bang" with all eligible companies available through it at once, or will companies be added to the platform in stages?

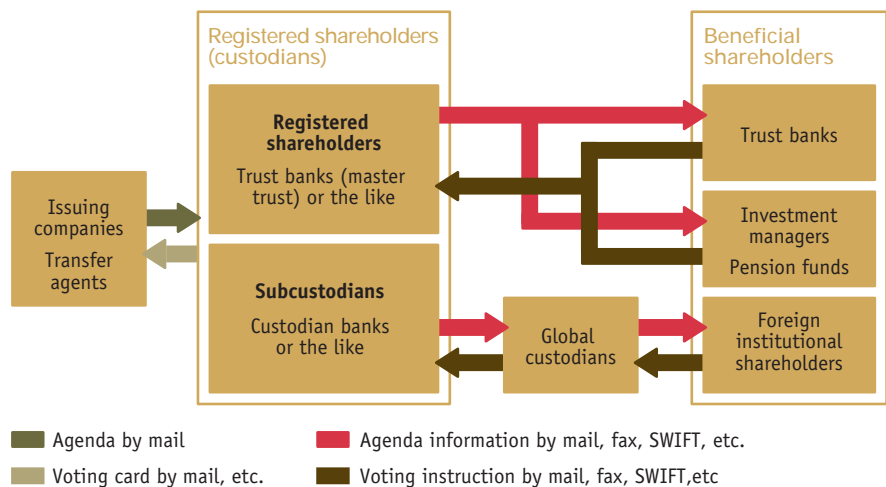
Tamura: It won't all happen at once. We will establish a joint venture to operate the platform soon, with TSE, the Japan Securities Dealers Association, and ADP as shareholders. The platform will be operational by the fall of 2004 so, for companies that close their books at the end of March—which means the overwhelming majority—the AGM of summer 2005 will be the

first at which the platform can be utilized. I can't say precisely how many users we will have by then, because we are still in talks with about 200 companies and we have contacted a total of about 3,000 companies by mail. So far, about 50 companies have agreed to join the platform but the number obviously will increase by summer 2005. Fund management companies want to see at least 200 to 300 companies using the platform by 2005. The number of participants is important to them because, if the number is small, they have to continue doing a lot of paper work at the same time as they start to vote electronically. We would like to satisfy the expectations of the fund managers.

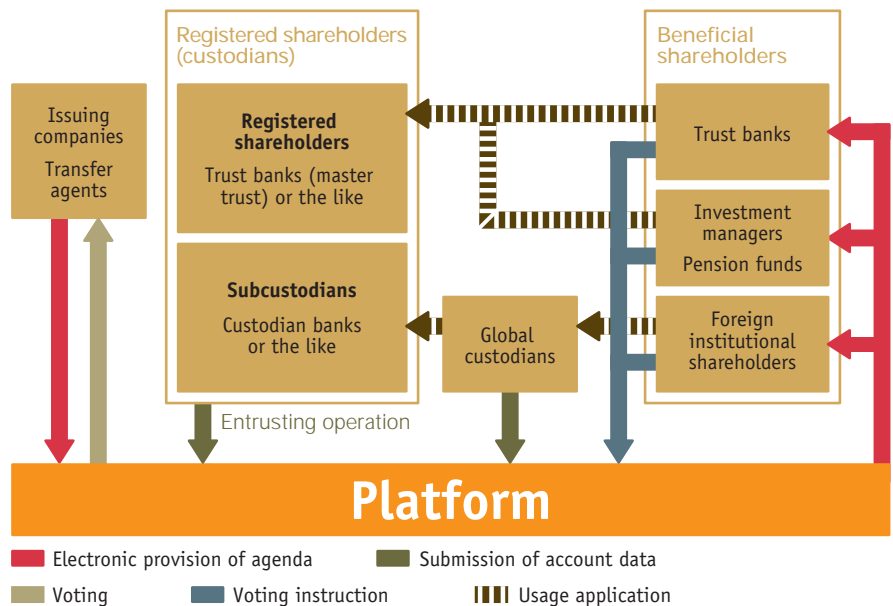
GC: Who actually will pay for the platform?

Tamura: Of course, costs are an issue. When we

The Voting Process Now



The Voting Process Then



Tamura



first started discussing this project, we considered asking all participants—issuers, custodians, and beneficial shareholders—to share costs. Then, we decided that it wasn't reasonable to ask foreign investors to pay for the privilege of buying Japanese stocks; so, we are asking issuers and custodians to pay an annual user fee of ¥1 million or less per company. The ¥1 million fee seems to be no problem for custodians but, for some issuers, it may be an obstacle.

GC: If they are paying, why don't custodian banks and trust banks object to being bypassed by the automated process?

Tamura: On the whole, this does not seem to be a problem. Because the timing of shareholder meetings is so uneven, custodians have to deal with an extremely heavy volume of work in June that does not exist, or barely exists, at other times of year. This creates staffing and other problems.

GC: Isn't it unusual for a stock exchange to operate a voting platform?

Tamura: We certainly will not be the only exchange to do this. The Deutsche Börse runs a voting service, while, in the UK, the local CSD, CREST, is offering an electronic voting service. In Japan, we seem to be the body that is most enthusiastic about promoting foreign investment in Japanese companies, so it was natural for JSDA and TSE to do this.

GC: Tokyo Stock Exchange does not own the only electronic proxy-voting platform in Japan. Do you favor competition or consolidation between providers?

Tamura: Stock transfer agents also operate platforms. These are used by registered shareholders—mainly individual investors, not institutions—and the degree of utilization is limited. We would expect them to continue as they are now. We have no plan for merging different systems.

GC: One of the primary reasons for creating an electronic proxy-voting platform is that the bunching of AGMs makes it difficult for investors to vote. Is this changing, or is it going to change?

Tamura: We are making progress on this. At present, more than 60% of listed companies

hold their AGMs on the same day (the last Thursday in June), but we are encouraging companies to choose different dates. The bunching problem occurs because most companies close their books on March 31, and are required to hold AGMs within a fixed interval after book closing. The requirement for companies to publish agenda a minimum of 14 days before the AGM is decided by the Commercial Code. The

Listing Department of TSE is asking listed companies to dispatch their agendas earlier than required by the law. ■

For more information on Electronic Voting Platform:
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CORPORATE ACTIONS

GC: Since 2001, TSE has offered a Web-based corporate action information service covering all listed companies in Japan. With the introduction of electronic proxy voting, foreign investors are bound to become more interested in using this service. What steps are you taking to assure foreign fund managers and custodians that the data are valid?

Izumi: We have internal data capture procedures that rule out any possibility of human error when data is being loaded onto our Web site. Also, in order to cope with complicated and exceptional events, data are produced by staff with long experience in this area. It is our advantage over competitors that we, as an exchange, can assign professional staff of this caliber to our daily operations. As far as the source of material is concerned, we are close to the companies generating the information, so we can obtain accurate information directly and quickly. Two years after the launch, I would say that the existing service has become a "must" for custodian banks, broker/dealers, trust banks, asset management companies, and

other institutional investors, including hedge funds. Other information vendors also subscribe to our service.

GC: How can foreign subscribers access your data?

Izumi: In the Web-based service, you can easily locate the current and historical data you are looking for, and download all data in the CSV file format, which means the information can be incorporated easily into spreadsheets and databases. In early 2002, we started offering a "push" service, dispatching data automatically—in formats that complied with the ISO 15022 messaging standard—so that subscribers do not have to initiate a download. At the moment, this is available only through a dedicated line, and the recipient needs to have an access point in Japan. In order to make life easier for foreign investors, we introduced an Internet FTP connection in February 2004 that can deliver the ISO 15022 data to subscribers outside Japan.

GC: So-called "market infrastructure" is a growing source of traffic for SWIFT. Is there any prospect of TSE joining SWIFT and using the ISO

TOKYO STOCK EXCHANGE | Tokyo Market Information

Corporate Action

Cash Dividend

Date/Time	Local Code	Name	Record Date	Effective Date	Detail
20040127 03:30	2794	S&A CORPORATION	20031005	20031101	Detail

URGENT

TOKYO STOCK EXCHANGE | Tokyo Market Information

Corporate Action Menu

- Cash Dividend
- Public Offer/Right Issue
- Bonus Issue
- Merger/Equity Swap/Equity Transfer
- Consolidation
- TOB/Buyback
- General Meeting

Bonus Issue Summary

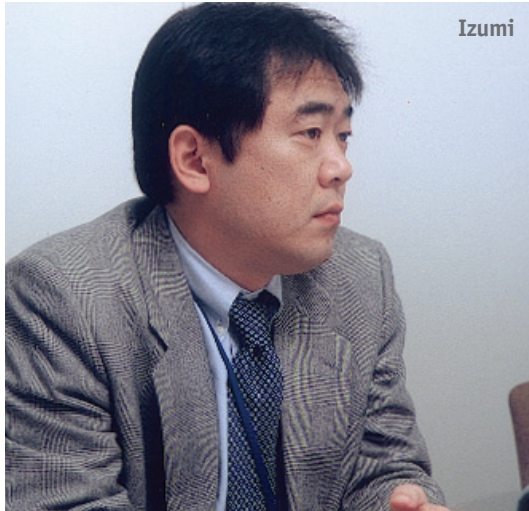
Date/Time	Date	Local Code	Name	ISIN	Record Date	Effective Date	Detail
20040127 03:36	New	4460	MESSO NETWORLD JAPAN	JF31410000	20040229	20040420	Detail
20040127 03:30	New	4663	INFOT	JF31410000	20040229	20040420	Detail
20040127 03:00	New	4670	INAF FINE CHEMICAL	JF71000000	20040331	20040520	Detail

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15022 corporate actions message standards?

Izumi: We are considering joining SWIFT and starting to provide our data over SWIFTNet. That would make our service automatically available to SWIFT's huge customer base worldwide. We probably will make a decision on joining SWIFT within the year. We are trying to determine now how many of our subscribers or potential subscribers would benefit. One reason for us to join would be that many of our custodian bank and subcustodian bank cus-



Izumi

tomers use the SWIFT network to transmit data they get from us onward to their clients. We were struck by the fact that the London Stock Exchange has started to deliver its corporate action data over SWIFTNet, at the request of the custodians.

GC: What progress has SWIFT made so far in encouraging the use of its message types in any market areas in Japan?

Fujimura: Japan differs from most other OECD countries in that ISO 15022, the standard used in SWIFT messages, is not used for domestic transactions, though it is, of course, used for international transactions. ISO 15022 is used in the pre-settlement matching system (PSMS) operated by JASDEC, and in other parts of the settlement process, but Japan has proprietary and unique systems for communication between market players.

GC: Lots of markets still use proprietary message formats, but SWIFT is making inroads. Is Japan uniquely problematic?

Fujimura: Many smaller players in Japan seem reluctant to use ISO 15022 because they regard the system as being based on the English language and have doubts about their language capabilities. Of course, ISO 15022 is actually a computer language, but there are occasions when something happens that requires the use of English. We don't think that would be a serious problem because most Japanese systems

operators can read and write English, though they may not speak the language.

GC: Are there any procedures peculiar to the Japanese market that would make it difficult to use a globally accepted message standard such as SWIFT for standardizing corporate action messages?

Fujimura: Corporate actions in Japan mostly follow international patterns, but there are one or two unique practices. For example, Japan has no "ex date." Instead, it has a "record date." This is the date on which a company closes its books at the end of the business year, and this date is used to determine shareholders' eligibility for dividend payments. Therefore, it is important to reach an agreement among market players on how to use ISO15022 for Japanese corporate actions. We are a member of the Japanese branch of ISITC, and are working with other local members on the problem. Late last year, ISITC Japan produced a first draft of a Japanese Market Practice Guide to ensure the ISO 15022 standard can accommodate Japanese requirements.

GC So, what are the pros and cons of TSE becoming a member of SWIFT?

Fujimura: TSE's push data format already is compliant with ISO 15022, so no serious technical problems would be involved. The question is simply whether it makes economic sense for TSE to join a system that would provide a link with our global subscribers. We think this would be a great breakthrough because it would help to introduce international investors to the Japanese market. We expect to make the connection within the year.

GC: Does TSE corporate actions service undermine, or even disintermediate, data vendors or custodian banks?

Izumi: Up to a point, we compete with data vendors but, as large vendors tend to cover global markets, we are competing in only one part of their territory. Also, as vendors are customers for our service, too, we have common interests and are building good relationships with them. With custodians, the situation is different. We provide data that custodians customize according to the needs of individual clients. As we cannot calculate the entitlements of their customers, nor process their instructions, we are just complementing their services and, therefore, there is no competition.

GC: Corporate actions vary hugely in nature, from dividends to mergers. Is TSE seeing greater use of its service in some areas than in others?

Izumi: It depends on the type of client. Derivatives traders, for example, need to get from our TMI Corporate Action service the latest dividend forecast information, but custodians may not necessarily be interested in the



Fujimura

data. It was surprising to us that so many front-office traders subscribe to the service, as well as back-office staff. It is probably significant that TMI includes another service called TOPIX Data service, giving information on the TOPIX benchmark index for the Japanese equity market. This service is ideal for passive fund managers and portfolio traders that need to rebalance their portfolios to match them against the TOPIX. This service incorporates a corporate actions element, but the data are provided from a different angle. Whenever a corporate action takes place, the service notifies users in advance of any consequent change in the number of shares, the type of action, and the effective date. Therefore, there are many front-office users who subscribe to both services.

GC: There is a view that exchanges, as the primary source of corporate action data, have the prime responsibility for standardization. What is TSE doing to achieve greater standardization?

Izumi: First, it is very difficult to standardize all corporate action data, though we recognize that this is the major obstacle to achieving higher rates of STP. The more complicated and irregular a corporate action, the more detailed the explanation that the company needs to provide, inhibiting standardization. Therefore, it is not realistic to force listed companies to disclose corporate action information in a specific standardized format, except for a limited range of relatively simple events. We see it as our responsibility to translate the information disclosed to the public by companies into standardized formats. That said, we often seek advice from SWIFT Japan and our users about ways to increase standardization. ■

