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Equity Finance 2025

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Japan: Law & Practice and Trends & Developments

Sosuke Kimura and Miho Susuki
Nagashima Ohno & Tsunematsu

JAPAN

Law and Practice

Contributed by:
Sosuke Kimura and Miho Susuki
Nagashima Ohno & Tsunematsu

Contents

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Authors

Sosuke Kimura is a lawyer at Nagashima Ohno & Tsunematsu with a long career in the capital markets industry and provides high-quality advice on various transactions, covering all equity, debt and hybrid securities. Sosuke specialises in structuring securities with extremely complicated terms and conditions (such as hybrid securities) and equity offerings, amid turbulent market conditions, leveraging his past experience from handling various transactions in challenging situations. Sosuke obtained an LLB from Kyoto University in 2006 and an LLM from Duke Law School in 2013. He was admitted to the Japan Bar in 2007 and the New York Bar in 2014.

Miho Susuki is a lawyer at Nagashima Ohno & Tsunematsu provides advice on various domestic and international corporate legal matters, with a focus on IPOs, public equity offerings, class shares, corporate bonds and other capital market transactions. She obtained her LLB from Keio University in 2018 and was admitted to the Japan Bar in 2020.

Nagashima Ohno & Tsunematsu

JP Tower
2-7-2 Marunouchi
Chiyoda-ku
Tokyo 100-7036
Japan

Tel: +81 3 6889 7000
Fax: +81 3 6889 8000
Email: info@noandt.com
Web: www.noandt.com

NAGASHIMA OHNO & TSUNEMATSU

1. Equity Finance Techniques and Structures

1.1 Early-Stage Venture Capital Financing

In Japan, early-stage venture capital financing typically uses preferred shares, which have a liquidation preference that is equal to (ie, 1x) or is a multiple of (eg, 1.5x or 2x) the amount of the investment. Accordingly, if a start-up experienced constant growth during its life up to the IPO and its valuation increased during this time, investors would likely hold different classes of preferred shares with varying liquidation preferences (eg, Series A, B, C, and D) and possibly different levels of seniority. However, as such preferred shares must be converted into common shares before the common shares are listed, the articles of incorporation of the issuer typically include a provision for the mandatory conversion of such preferred shares upon a resolution by the board of directors. It is uncommon for the "Qualified IPO" concept to be provided in the mandatory conversion provisions, but a defined set of investors (preferred shareholders) often holds a consent right over the IPO.

Convertible loans (bonds) and convertible equity (an instrument called J-KISS) are popular financing instruments for start-ups. These instruments are commonly used by early-stage start-ups, but they also serve as a convenient bridging tool for late-stage start-ups between priced financing rounds. In these cases, the loans and equity are typically converted into preferred shares in later financing rounds and into common shares before the initial public offering (IPO).

1.2 Growth and Private Equity Financing

Private equity firms historically utilised leveraged buyouts in their investments in Japan, which are less complex on the equity side. Usually, they use only common shares, but there are cases in which mezzanine investors invest through preferred shares (structured similarly to debt instruments). There is a natural difference between venture capital financing and private equity financing, as they target different types of companies – venture capital focuses on start-ups, while private equity targets mature businesses. However, private equity firms are increasingly investing in late-stage start-ups by purchasing preferred shares, often alongside venture capital firms. As it takes longer for start-ups to become listed (mainly due to their desire to grow in size before the IPO), private equity firms are becoming an increasingly important source of capital for late-stage start-ups in Japan, as well as in other markets.

1.3 Public Equity Markets

In order for Japanese companies to list their shares on the Japanese stock exchange (eg, the Tokyo Stock Exchange), they are required to undergo listing examinations by the relevant stock exchanges; these begin upon the submission of an application for listing (a "listing application"), which usually takes about three months to be approved. Before submitting the listing application, companies need to retain lead underwriters, who primarily arrange for the listing procedures (including those for making an IPO), and have undergone the underwriting examinations conducted by such underwriters. In practice, it takes 12 to 18 months from the kick-off until the completion of the underwriting examinations. In addition, as companies seeking to make IPOs are required to prepare audited financial statements for the most recent two financial years, it is necessary to retain an independent auditor to audit past financial statements while the companies deal with the aforementioned underwriting examinations.

Regarding the listing criteria, the Tokyo Stock Exchange has three market segments outlined below. Each of these market segments has its own listing criteria – both quantitative and qualitative – reflecting its characteristics and concept, as follows.

- Prime market – the market for companies with a level of market capitalisation (liquidity) sufficient enough for multiple institutional investors to invest in them, and that meet a higher standard of corporate governance and commit to sustainable growth and improvement of medium- to long-term corporate value, prioritising constructive dialogue with investors.
- Standard market – the market for companies with a level of liquidity sufficient to make them investment targets in the open market, and that maintain the basic standard 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 that (to some extent) the market evaluates positively, owing to their disclosed business plans for realising 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.

All of the above-mentioned market segments provide the listing criteria related to the liquidity of the shares of the listed companies. The criteria for liquidity are designed to indicate the number and monetary value of shares traded on the market. As such, it is common in practice for IPOs to be conducted with the support of underwriters in the case of listings.

In addition, the Prime Market and the Standard Market require companies to meet specific criteria regarding 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 growth. In practice, it is common that venture companies seek to list their shares on the Growth Market.

An equity listing involving an IPO is frequently presented as a method of exit for investors in venture companies. For companies to be listed, the main purposes of listing their shares are usually to have access to capital markets for fundraising, improve their credibility and brand recognition, boost employee morale, and strengthen corporate governance.

1.4 Equity Restructurings

As a method for equity restructuring by Japanese listed companies, share buybacks are quite common and are sometimes conducted concurrently with an offering of convertible bonds to increase return on equity (ROE). Listed companies facing financial difficulties sometimes seek debt-to-equity swaps or capital increases that dilute existing shareholders. However, securing a lender's agreement to a debt-to-equity swap or finding suitable investors who can provide sufficient funds presents various practical challenges.

For non-listed companies that are seeking IPOs in the future, additional financing by way of a "down round" can also be an option to raise the necessary funds for continued business growth.

1.5 Corporate Governance

Under the Companies Act of Japan, a joint stock company (*kabushiki kaisha*), which is the most common form of Japanese corporation, may select its corporate governance structure subject to certain rules. In practice, listed companies and non-listed companies that intend to go public in the future need to adopt any one of the following corporate structures:

- company with a board of corporate auditors;
- company with an audit and supervisory committee; and
- company with three statutory committees – a nomination committee, an audit committee and a compensation committee.

Each of the above-mentioned corporate structures requires the relevant company to have a board of directors. Among the above-mentioned structures, a "company with a board of corporate auditors" is a traditional structure, under which a board of directors has the authority to make decisions regarding management and important matters.

Even in a "company with an audit and supervisory committee", a board of directors has ultimate responsibility for the administration of the affairs of the company. However, in order to facilitate prompt decision-making, the board of directors may, by its resolution, delegate to individual directors its authority to make a decision on important business and affairs, except for specific matters prescribed in the Companies Act.

- In a company with three statutory committees, executive officers (*shikko yaku*) must be appointed, separating the monitoring and supervision of management from the execution of business.
- A board of directors is responsible for the supervision of management.
- A board of directors is responsible for establishing the company's basic management policy. It may delegate its authority to make decisions on important business matters to executive officers through

a formal resolution, except for specific issues outlined in the Companies Act.
- Executive officers are responsible for conducting all business operations of the company within the scope of the authority delegated to them by the board of directors.

1.6 Mix of Debt and Equity Financing

In Japan, as a matter of market practice, it is uncommon for one investor to provide both equity and debt to the same company. Although there is no specific legal restriction on doing so, investors usually have their own investment strategies that focus on particular types of instruments. In addition, Japanese companies often maintain strong, established relationships with their banks, which typically serve as their "main bank." These companies usually fulfil their debt financing needs by borrowing from these banks. Consequently, they generally expect external investors to provide equity financing only.

2. The Equity Finance Market

2.1 Types of Equity Finance

In Japan, the term equity finance by listed companies usually refers to offerings of common stock to the public that involve underwriting by securities firms. In Japan, there are several stock exchanges (including the Tokyo Stock Exchange), and the Japanese capital market – where companies can reach out to many investors with the involvement of securities firms – is well-developed, thanks to the support of various related laws and regulations (including the internal regulations of the relevant stock exchanges). In addition, Japanese listed companies sometimes decide to issue common stock directly to specific business partners through private placement to establish capital and business alliances for business purposes. Hybrid forms of financing (such as issuances of preferred stock to certain financial investors) are also an option, especially when the financial condition of issuer companies is deteriorating and it is difficult to find investors who can provide capital through an issuance of common stock.

On the other hand, a market where non-listed companies can raise funds by way of equity finance has not yet been established in Japan. As such, equity finance by non-listed companies (such as venture capital financing and private equity financing) may be conducted following bilateral negotiations between issuer companies and investors.

2.2 Equity Finance Providers and Potential Restrictions on Them

In cases of equity finance by non-listed companies, investors who provide funding are usually venture capital and private equity firms. Generally, there are no quantitative or qualitative restrictions on providing equity financing to Japanese companies.

Notwithstanding, in Japan's capital market, retail investors play a crucial role, making them the primary source of funding for public offerings of common stock. In public offerings involving underwriters, the underwriters are required to distribute the offered shares widely to the public; therefore, investors are not necessarily allocated the number of shares they wish to purchase.

In the case of offerings of listed shares to investors by way of third-party allotment, which may be authorised by a board resolution of an issuer company, if the ratio of dilution caused by such offering is 25% or more, an approval by a shareholders' meeting or an option from independent third parties (such as independent directors) as to the rationality of such offering needs to be obtained pursuant to the listing rules of the stock exchanges. Additionally, if the dilution ratio caused by the offering is 300% or more, it is considered a delisting event. As such, listed companies may not, in practice, conduct equity financing with a dilution ratio of 300% or more by way of third-party allotment.

2.3 Equity Finance Seekers

In Japan, there is no particular tendency with regard to companies that seek capital. Equity finance and detailed structures thereof are usually discussed depending on the circumstances surrounding individual companies.

2.4 Deal Flow and Size

As stated in **2.1 Types of Equity Finance**, in Japan, the equity capital market has been well-developed and supported by stock exchanges and securities firms that realise public offerings. However, according to the reports published by the Japan Securities Dealers Association (a self-regulatory body of Japanese securities firms), the number of equity financing deals conducted by Japanese listed companies by way of public offerings – including offerings of common stock or convertible bonds in overseas markets and secondary offerings by major shareholders – that have happened between January and June 2025 is 52 and the total deal size is approximately JPY130 billion, which is significantly lower compared to the number of cases in 2024. The reason for this decline is unclear, but it is believed that factors such as US tariff policies have contributed to instability in the Japanese stock market. Although predicting future market trends is challenging, there may be an increase in cases in 2026 as companies that adopted a wait-and-see approach in 2025 begin new projects.

2.5 Privately Allocated Equity Versus Public-Raised Equity

Recently, supported by high stock prices of Japanese stocks, the Japanese IPO markets have been relatively active. However, the size of the IPOs conducted by Japanese venture companies, which are the main players in this field, and their market caps are often so small that it is sometimes difficult to achieve further growth after their listing. In response to this, the Japanese government published the "Start-Up Development Five-Year Plan", which provides various initiatives to enable Japanese start-ups to raise more funds while they are unlisted companies and to diversify their exit strategies.

2.6 Deal Sourcing and Market Players

In cases of public offerings by listed companies, securities firms that will underwrite offered shares and sell them to investors typically originate deals by proposing them to potential issuers. Securities firms can provide their views on potential market demands and other related information that enable issuer companies to examine the appropriate size and conditions of a contemplated equity offering and make a "go" or "non-go" decision.

Nonetheless, private deals often take place due to several factors. These can include personal connections between the management of the issuer and officials of potential investors, introductions made by external advisors to potential investors, and a bidding process organised by external advisors to attract investors.

2.7 Exit Considerations and Realisations

Investors in private equity often seek IPOs to realise the value of their investments. Recently, there have been an increasing number of cases where investors and issuers seek opportunities to contemplate M&A transactions as a means of exiting investments. However, IPOs remain the primary exit path for investors in non-listed companies, such as venture companies.

With regard to investments in the common stock of listed companies, investors usually sell their shares in the markets to realise profits. However, for example, if the amount of shares to be sold is large and it is practically difficult to sell all of such shares in the market for a reasonable price over a certain period, off-market transactions such as secondary offerings or block trading conducted with the support of securities firms can be an option as well.

2.8 Equity Finance Versus Debt Finance

As noted in **1.6 Mix of Debt and Equity Financing**, Japanese companies have traditionally relied on bank borrowings as their primary source of financing. Notably, companies that are not publicly listed and do not pursue IPOs typically refrain from securing equity financing from external investors. However, for non-listed companies seeking an IPO, equity finance, typically provided by venture capital funds and private equity funds, is crucial in increasing their corporate value, enabling them to achieve successful IPOs.

Regarding Japanese listed companies, they typically meet their daily financial needs through bank loans, even though they can access the capital markets. As there has been a recent trend of emphasising return on assets (ROA), many Japanese listed companies are prioritising shareholder returns (including share buybacks) over equity financing through share offerings, which could cause dilution.

2.9 Time Required for Equity Finance

In practice, it usually takes two to three months from a kick-off for a listed company to launch a public offering of equity and it also takes about three additional weeks to close the deal. During the preparation period until the launch, the issuer needs to deal with the due diligence procedures by the underwriters in such a deal, during which the issuer is requested to answer a very long list of queries in respect of various aspects and reflect the results thereof (including the identified risk factors) in the disclosure documents, such as the statutory prospectus. Once the deal is launched, the issuer and the underwriters conduct marketing activities for about two weeks and price the deal. The closing usually occurs one week after the pricing.

In respect of equity financing by non-listed companies, it may be legally possible to close the deal within one day if all of the existing shareholders of the companies agree. The lead time for these cases is determined by the time required for negotiations between the issuer and investors.

3. Regulation and Related Legal Issues

3.1 Investment Restrictions

In Japan, investment by foreign investors into the equity of Japanese companies is generally not restricted. However, certain regulations/restrictions may apply, as follows.

Regulated Industries

Investments by foreign investors in certain regulated companies – such as aviation companies, designated holding companies with licensed broadcasting stations as subsidiaries, and NTT (Japan's leading telecommunications business operator) – are subject to specific foreign investment regulations. For example, the Civil Aeronautics Act of Japan effectively limits foreign investors' ownership of shares in Japanese aviation companies to a number of shares representing less than one-third of total voting rights. Under the Civil Aeronautics Act, Japanese aviation companies may refuse to register the shares held by foreign investors in their register of shareholders in cases where the total voting rights held by foreign investors would account for one-third or more of the total voting rights if they were to accept such registration. In such a case, the foreign investors whose shares are not registered would be unable to exercise certain shareholder rights, including voting rights with regard to such shares.

Foreign Exchange Regulations

The Foreign Exchange and Foreign Trade Act (FEFTA) of Japan, along with its related regulations, may also impose restrictions on the acquisition and holding of shares and voting rights in Japanese companies by foreign investors. By way of example, under the FEFTA, if a foreign investor intends to consummate an acquisition of shares of a Japanese listed corporation that would constitute an "inward direct investment", in certain circumstances – such as where the foreign investor is a resident in a country that is not listed on an exemption schedule therein (eg, North Korea) or where that Japanese corporation is engaged in certain businesses designated by the FEFTA in terms of national security of Japan, and other factors – a prior notification of the relevant "inward direct investment" must be filed with the Minister of Finance and any other competent Ministers in advance of such inward direct investment, except where certain conditions for exemptions are met.

The definition of "inward direct investment" is broad and complicated; however, if a foreign investor desires to acquire shares of a Japanese listed corporation and – as a result of such acquisition – the foreign investor, in combination with any of its existing holdings, would directly or indirectly hold 1% or more of the total number of issued shares or the total number of voting rights of the relevant Japanese corporation, such acquisition constitutes an "inward direct investment".

If such prior notification is filed, the proposed inward direct investment may not be consummated until 30 days after the date of filing. During this time, the Ministers will review the proposed inward direct investment – although this screening period may be shortened by such Ministers if they no longer deem it necessary to review the proposed inward direct investment, or may be shortened to five business days if the proposed inward direct investment is determined not to raise concerns from the perspective of national security or certain other factors. The Ministers may also extend the screening period by up to five months and may recommend any modification or discontinuation of the proposed inward direct investment. If the foreign investor does not accept such a recommendation, the Ministers may order the modification or discontinuation of the inward direct investment. In addition, the Ministers may order the foreign investor to divest of all or part of the shares acquired or to take other measures if:

- the Ministers consider the proposed inward direct investment to be an inward direct investment that is likely to cause damage to the national security of Japan; and
- the foreign investor:
  (a) consummates such inward direct investment without filing the aforementioned prior notification;
  (b) consummates such inward direct investment before the expiration of the above-mentioned screening period;
  (c) in connection with such inward direct investment, makes false statements in the aforementioned prior notification; or
  (d) does not follow the recommendation or order issued by the Ministers to modify or discontinue such inward direct investment.

In cases of acquisitions by a foreign investor of shares of a Japanese unlisted company engaged in the designated businesses, a similar prior notification requirement will apply.

3.2 Repatriation of Money and Limitations on Capital Flows

In Japan, there are no statutory restrictions on Japanese companies making dividend payments to shareholders located outside Japan. Under the FEFTA, dividends paid on shares of Japanese corporations held by foreign investors may generally be converted into any foreign currency and repatriated abroad.

3.3 AML and Sanctions Regulation

In Japan, Japanese financial institutions (including securities companies) that serve as underwriters in public offerings of shares will be subject to the AML and KYC rules, pursuant to which they must conduct a KYC process when they open securities accounts for new clients to invest in Japanese listed shares. Additionally, Japanese securities companies have record-keeping obligations and are required to report suspicious activities to the supervisory authority if they identify such activities.

3.4 Choice of Law and Jurisdictions

In Japan, it is typically agreed in a contract for a Japanese company's equity financing transaction (eg, an investment agreement) that the governing law is Japanese law and that the jurisdiction is the Tokyo District Court. In contrast, the laws and courts in other jurisdictions may differ, depending on, among other things, the locations of investors. It is widely recognised that the courts in Japan (including the Tokyo District Court) are reliable and fair, regardless of whether equity investors are from abroad. On the other hand, it is not very common for an issuer company and equity investors to agree in an investment agreement to arbitrate or mediate in an international forum or body.

3.5 Noteworthy Regulatory Trends

In 2020, the FEFTA was amended to tighten the regulations applicable to acquisitions by foreign investors of shares in Japanese companies, taking into consideration global trends in Foreign Direct Investment (FDI) regulations. For further details, please see **3.1 Investment Restrictions**.

4. Tax

4.1 Withholding/Capital Gains Tax

Generally, individual non-residents of Japan or non-Japanese corporations without a permanent establishment in Japan – collectively, "non-resident holders" of shares of common stock of Japanese corporations – are subject to Japanese income tax collected by way of withholding on dividends paid by such Japanese corporations. Such tax will be withheld prior to the payment of the dividends.

In the absence of any applicable tax treaty, convention or agreement reducing the maximum rate of the Japanese withholding tax or granting an exemption from the Japanese withholding tax, the rate of the Japanese withholding tax applicable to dividends paid by Japanese corporations on their shares to non-resident holders is generally 20.42% (or 20% on or after 1 January 2038) under Japanese tax law.

However, with regard to dividends paid on listed shares issued by a Japanese corporation to non-resident holders (except for any non-resident holder who is an individual holding 3% or more of the total number of shares issued by the Japanese corporation), the 20.42% (or 20% on or after 1 January 2038) withholding tax rate is reduced to:

- 15.315% for dividends to be paid on or before 31 December 2037; and
- 15% for dividends to be paid thereafter.

Due to the imposition of a special additional withholding tax (2.1% of the original withholding tax amount) to secure funds for reconstruction from the Great East Japan Earthquake, the original withholding tax rates of 15% and 20% (as applicable) had been effectively increased to 15.315% and 20.42%, respectively, during the period beginning on 1 January 2013 and ending on 31 December 2037.

With respect to the capital gains tax, regarding the sale or other disposition of shares of Japanese corporations outside Japan by a non-resident holder who is a portfolio investor, the gains derived therefrom are not, in general, subject to Japanese income tax or corporation tax.

4.2 Other Taxes, Duties, Charges or Tax Considerations

The withholding tax rate applicable to dividends paid by Japanese corporations on their shares to non-resident holders may be reduced by the income tax treaties that Japan has with other countries; however, the reduced tax rates vary depending on the terms of these income tax treaties. In addition, under the income tax treaty between the USA and Japan, dividends paid to pension funds that are qualified US residents and eligible to enjoy treaty benefits are exempt from Japanese income taxation by way of withholding or otherwise – unless such dividends are derived from the carrying on of a business, directly or indirectly, by such pension funds. Similar treatment will be applied to the dividends paid to pension funds under the income tax treaties with certain other countries, including the UK.

Under Japanese tax law, any reduced maximum rate applicable under a tax treaty shall be available when such maximum rate is below the rate otherwise applicable under the above-mentioned Japanese tax law with regard to the dividends to be paid by Japanese corporations on their shares.

A non-resident holder of Japanese shares who is entitled under any applicable tax treaty to a reduction in respect of the Japanese withholding tax rate or an exemption therefrom is, in principle, required to submit – in advance through a withholding agent – a statutory application form (together with any other required forms and documents) to the relevant tax authority before any payment of dividends. A standing proxy for a non-resident holder may provide such application service. In this regard, a simplified special filing procedure is available for non-resident holders to claim treaty benefits, resulting in an exemption from or a reduction of the Japanese withholding tax, by submitting a special application form (together with any other required forms and documents).

4.3 (Double) Tax Treaties

As of August 2025, Japan has 75 tax treaties with 81 countries and regions, aimed at eliminating double taxation and preventing tax evasion and avoidance. These tax treaties are basically consistent with the "OECD Model Tax Convention on Income and on Capital".

5. Bankruptcy and Insolvency

5.1 Impact of Insolvency Processes on Shareholder Rights

In Japan, the following four types of in-court insolvency proceedings are available:

- liquidation-type proceedings – ie, bankruptcy proceedings under the Bankruptcy Act and special liquidation proceedings under the Companies Act; and
- rehabilitation-type proceedings – ie, civil rehabilitation proceedings under the Civil Rehabilitation Act

and corporate reorganisation proceedings under the Corporate Reorganisation Act.

Any of the aforementioned proceedings are available for Japanese joint stock companies whose shares may be owned by equity investors. However, as the purpose of Japanese in-court insolvency proceedings is to liquidate or restructure the debts of any debtors that become insolvent, generally – in cases where the debts of a debtor exceed its assets – the shareholders of such debtors are not expected to be involved in the proceedings and have no rights to object to such proceedings, with a limited exception in respect of the rehabilitation-type proceedings.

5.2 Seniority of Investors in Distributions

In respect of the liquidation-type proceedings described in **5.1 Impact of Insolvency Processes on Shareholder Rights**, the assets held by a company are converted into cash and such cash is distributed to the creditors first. The shareholders are entitled to such cash only to the extent that there is any remaining cash after distribution to the creditors. However, in practice, the shareholders are highly unlikely to receive any cash after the liquidation-type proceedings.

Furthermore, the purpose of the rehabilitation-type proceedings is to turn around the debtor's business by restructuring its debts, and such debts will be modified in accordance with a rehabilitation plan or a reorganisation plan, as the case may be, approved in the respective proceedings. In addition, as long as the debts of a debtor exceed its assets (ie, the economic value of the shares is zero), such rehabilitation plan or reorganisation may provide for, among other things, the acquisition of the shares of such debtor from its shareholders for no consideration with the permission of the court. In practice, such share acquisitions for no consideration are almost always made so that the debtor can introduce a new sponsor whom the creditors approve, and the investments of the existing equity investors lose all their value.

5.3 Length of Insolvency Process and Recoveries

Although the required period for insolvency proceedings may vary depending on various factors (such as the amount of the debts, the number and nature of the creditors, and the residual value of the assets, including the business conducted by the debtor), according to the standard timeline published by the Tokyo District Court, civil rehabilitation proceedings – which are the common option for restructuring Japanese corporations – would usually take five months from the filing date of the petition for such proceedings until the completion of the proceedings. Regarding recovery for shareholders, as stated in **5.2 Seniority of Investors in Distributions**, in practice, shareholders are highly unlikely to receive any cash from the assets of the insolvent debtor in Japanese insolvency proceedings.

5.4 Rescue or Reorganisation Procedures

In Japan, rehabilitation-type proceedings – especially civil rehabilitation proceedings – are usually prioritised over liquidation-type proceedings. However, in practice, in any insolvency proceedings in Japan, the shareholders of a debtor are highly unlikely to be in a position to collect any value in relation to their equity investments. These insolvency proceedings are usually handled by debtors, creditors, a court and new sponsor candidate(s), if any.

5.5 Risk Areas for Equity Investors

The shareholders of Japanese joint stock corporations have limited liability, which means the shareholders of an issuer company will assume no liability. The shareholders lose the value of their investments in the shares of such an issuer company if the issuer company becomes insolvent. It is uncommon for equity investors to be sued by insolvency administrators for any reason.

In respect of listed shares, it should be noted that – in the listing rules of the Japanese stock exchanges – any commencement of bankruptcy procedures is considered to be a delisting event. Therefore, if a listed company publicly announces the commencement of bankruptcy procedures, its share price is highly likely to fall, and it will become difficult to sell such shares on any market.

Trends and Developments

Contributed by:
Sosuke Kimura and Miho Susuki
Nagashima Ohno & Tsunematsu

Nagashima Ohno & Tsunematsu is based in Tokyo, Japan, and is widely recognised as a leading law firm and one of the foremost providers of international and commercial legal services. The firm's overseas network includes locations in New York, London, Singapore, Bangkok, Ho Chi Minh City, Hanoi and Shanghai, as well as an associate office in Jakarta. The firm also maintains collaborative relationships with prominent local law firms. In representing the firm's leading domestic and international clients, Nagashima Ohno & Tsunematsu has successfully structured and negotiated many of the largest and most significant corporate, finance and real estate transactions related to Japan. In addition to the firm's capabilities spanning key commercial areas, Nagashima Ohno & Tsunematsu is known for path-breaking domestic and cross-border risk management/corporate governance cases and large-scale corporate reorganisations. Approximately 600 lawyers work together in customised teams to provide clients with the expertise and experience specifically required for each client matter.

Authors

Sosuke Kimura is a lawyer at Nagashima Ohno & Tsunematsu with a long career in the capital markets industry and provides high-quality advice on various transactions, covering all equity, debt and hybrid securities. Sosuke specialises in structuring securities with extremely complicated terms and conditions (such as hybrid securities) and equity offerings, amid turbulent market conditions, leveraging his past experience from handling various transactions in challenging situations. Sosuke obtained an LLB from Kyoto University in 2006 and an LLM from Duke Law School in 2013. He was admitted to the Japan Bar in 2007 and the New York Bar in 2014.

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Nagashima Ohno & Tsunematsu

JP Tower
2-7-2 Marunouchi
Chiyoda-ku
Tokyo 100-7036
Japan

Tel: +81 3 6889 7000
Fax: +81 3 6889 8000
Email: info@noandt.com
Web: www.noandt.com

NAGASHIMA OHNO & TSUNEMATSU

Acceleration of the Reduction of Cross-Shareholdings

Background

Historically, Japanese listed companies have held other companies' shares not for investment purposes, but for strategic reasons, such as maintaining or strengthening relationships with those companies (known as cross-shareholdings). Recently, however, these shareholdings have been criticised for potentially lowering the capital efficiency of the holding companies and distorting the corporate governance of the issuing companies. Consequently, there has been a move towards unwinding cross-shareholdings. For example, the Corporate Governance Code (CGC), published by the Tokyo Stock Exchange (TSE), requires listed companies to disclose their policies related to shares held as cross-shareholdings, including those related to reducing cross-shareholdings, as well as examining the appropriateness of such holdings. In addition, in March 2023, the TSE requested that all listed companies on the Prime and Standard Markets accurately grasp their capital costs and efficiency, analyse and evaluate the current situation with regard to these factors and market evaluation, and then formulate and disclose improvement plans.

In response to these trends, sales of these shares have become very active in recent years.

Method for selling down shares held as cross-shareholdings

The major methods for selling shares in Japanese listed companies, which have been widely utilised for selling down shares held as cross-shareholdings, are as follows:

Public offering (secondary offering)

This involves offering shares to the public with underwriting by securities firms. In this type of transaction, the selling company can conduct full marketing through the underwriters, which allows them to maximise the offering size. However, the issuer company must be involved in the offering, as the underwriters need to conduct due diligence on the issuer company, and the prospectus and other marketing documents disclosing the various information about the issuer company must be prepared.

Block trade

In block trades, a seller company sells its shares to securities firms, and those firms subsequently resell them to investors overnight. Compared to public offerings, block trades are often smaller in size; however, they can be executed more quickly since the issuing company is not involved, and sales activities can be completed overnight without the need for prospectuses or other marketing documents. In practice, in order to be eligible for block trades, the shares offered must meet certain criteria set by the securities firms, such as liquidity, trading volume and disclosure of the issuer company.

Tender offer for treasury stock

If the seller company holds a large portion of shares in the issuer company, it is common practice for the seller company to sell its shares to the issuer company, which conducts a share-buyback as a method of selling shares held as cross-shareholdings. Under Japanese regulations, when an issuer buys back its own shares through market transactions, the purchase price must match the market price of those shares.

Conversely, if the issuer company acquires shares through a tender offer outside the market, it is possible to set an acquisition price that differs from the market price. In practice, when an issuer company conducts a tender offer to purchase its shares from a seller company, the acquisition price is set below the prevailing market price so that other shareholders are not incentivised to participate. Regarding the seller company, under Japanese tax law, if shareholders holding a certain percentage of shares sell shares in response to an off-market buyback conducted by the issuer company, they may receive tax benefits compared to selling shares on the market. Therefore, major shareholders may be incentivised to participate in a tender offer, even if the acquisition price is discounted compared to the market price. This effectively realises a private transaction between the issuer company and the seller company.

Recent Amendment to Disclosure Requirements

Japanese listed companies are required to disclose the following in their annual reports:

- the criteria and policy for classifying shares held for the purposes of "investment" or "cross-shareholding";
- the method used to verify the rationale for holding shares held for the purpose of cross-shareholding;
- the number of shares held for the purpose of cross-shareholding;
- the total book value of these holdings.

Due to amendments to the relevant regulations in November 2024, information about shares held for "investment" purposes must also be disclosed if the purpose of holding such shares has changed from "cross-shareholdings" to "investment" within the last five fiscal years. In such cases, companies are also required to disclose the reason for this change in purpose, as well as their policy regarding the holding or selling of these shares.

Additionally, the term "investment purpose" has been clarified to mean "exclusively for the purpose of gaining profit from fluctuations in the value of the shares or dividends related to the shares". For example, if the company's ability to sell the shares is hindered by its relationship with the issuer company – for instance, if the issuer holds shares in the company, or if the issuer's consent is required for the company to sell the shares – these shares cannot be considered to be held for investment purposes.

Due to this amendment, it had become challenging to declare shares primarily held for cross-shareholdings as held for investment purposes, thereby avoiding their inclusion as targets for reduction.

Future outlook

From 2024 to 2025 in particular, stock prices of Japanese companies generally remained steady, likely accelerating the unwinding of cross-shareholdings further. According to some reports, the volume of shares held as cross-shareholdings sold in the fiscal year ended March 2025 reached a record high. This trend is expected to continue for some time.

Introduction of the "Form S-1" Method for IPOs

Background: underpricing issue

In Japan, a company conducting an IPO must file a Securities Registration Statement with the relevant local finance bureau before offering its securities. This regulation is commonly referred to as the "gun-jumping regulation". The Securities Registration Statement for listing had to include the listing schedule, including the timing of determining the IPO price. Consequently, the Securities Registration Statement could not be filed until the listing approval date, when the stock exchange approves the listing and the listing schedule is finalised. This has led to the common practice of filing the Securities Registration Statement on the listing approval date, after which solicitation activities can commence.

However, as the period between the listing approval date and the actual listing date generally lasts about one month, price fluctuation risk due to changes in market conditions during this period may be reflected in the IPO price. This has been identified as a factor contributing to the so-called IPO discount.

Additionally, prohibiting solicitation activities prior to filing the Securities Registration Statement prevented investor solicitation and demand surveys from being executed, which has also been considered one of the factors that make proper pricing difficult. In fact, it has often been observed that, especially in the case of small-cap IPOs, the initial market share price significantly exceeds the IPO price. This is referred to as the "underpricing issue".

Therefore, shortening the listing schedule and allowing flexibility in scheduling have been identified as challenges in Japanese IPO practices.

Amendments to regulations to introduce the "Form S-1" method

In response to such concerns, the relevant regulations were amended in 2023 to introduce a new form of the Securities Registration Statement on the premise that it would be filed prior to the listing approval date. While the previous form continues to be utilised even after the introduction of the new form, commonly referred to as Form S-1, the Securities Registration Statement in Form S-1 allows certain items that were mandatory in the previous form to be omitted or simplified. This omitted or simplified information can be disclosed through an Amendment to the Securities

Registration Statement, which shall be filed on the listing approval date.

In Japan, the traditional IPO process requires about one month between the listing approval date and the listing date. However, by utilising Form S-1, this period can theoretically be shortened to around 21 days.

The details of Form S-1 are as follows:

Description of the IPO schedule

Traditionally, the Securities Registration Statement required a description of the listing schedule, including the listing date, payment date, delivery date and pricing date. This led to the practice of filing the Securities Registration Statement on the listing approval date, when the schedule is finalised. On the other hand, in the Form S-1, it is sufficient to specify the listing schedule within a certain range. Consequently, it is now possible to file the Securities Registration Statement and conduct investor solicitation and demand surveys before the listing approval date.

Number of shares to be offered and offering size

In the Form S-1, information about the number of shares to be offered may be omitted, whereas it was mandatory in the previous form of the Securities Registration Statement. Consequently, information about the expected offering amount may also be omitted in Form S-1, whereas it was required to be described based on certain assumptions in the previous form. However, if new shares are to be issued in the IPO, the expected amount of offering such new shares still needs to be specified in the Form S-1, so that prospective investors can understand the expected size of the offering. However, the basis for calculating the expected amount does not need to be disclosed and it is permissible to provide such descriptions within a reasonable range.

Others

In the Securities Registration Statement in Form S-1, the following information shall also be included:

- types of investors that the issuer company will contact before the listing approval date;
- the statement to the effect that the purpose of such contact is limited to surveying demand for the shares to be offered; and
- the timing of the commencement of the offering to a large number of investors.

In practice, after the Securities Registration Statement on Form S-1 has been filed, only investors who are considered to be capable of accurately valuing prices, such as institutional investors, will be contacted for the demand survey. This may continue until the listing approval date, at which point the full marketing campaign will commence.

Practical considerations

Testing the water

After filing the Securities Registration Statement in Form S-1, the gun-jumping regulation will no longer apply. This means that it will be possible to conduct investor demand surveys during the period. It is expected that the underwriters will communicate with investors for such survey purposes before listing approval, a practice referred to as "testing the water" ("TTW").

Even in the traditional IPO method, it has been interpreted as permissible to invite potential investors to information meetings ("IMs") held before listing approval and to engage in communication that does not constitute solicitation. However, to avoid the possibility of communication at the IMs violating the gun-jumping regulation, IMs are usually held more than one month before the Securities Registration Statement is filed (ie, the listing approval date), since, according to guidelines published by the relevant authorities, information dissemination occurring more than one month before the Securities Registration Statement is filed is not generally considered to be solicitation.

Conversely, with the S-1 method, it is possible to conduct TTW closer to the listing approval date, after filing the Securities Registration Statement. Additionally, the conditions of the offering can be referred to based on a concrete IPO plan. However, it should be noted that the underwriters may bear statutory liability for any false statements or misrepresentations in the explanations or materials used in the TTW. Therefore, careful attention must be paid to the accuracy of these materials.

Pre-deal research report

In the case of IPOs, analysts from the underwriters typically provide prospective investors with a Pre-Deal Research Report (PDRR) containing an analysis of the issuer company, prior to the Securities Registration Statement being filed on the listing approval date. The purpose of this is to educate investors in advance. However, when distributing the PDRR to investors in Japan, care must be taken to ensure that it is not regarded as solicitation, as this could violate the gun-jumping regulation. In the traditional IPOs, relying on the guidelines described above, it has become common practice to distribute PDRRs in Japan more than one month before the Securities Registration Statement is filed (ie, the listing approval date).

In contrast, with the S-1 method, the Securities Registration Statement is filed earlier than with the traditional IPO method. Consequently, if the traditional schedule were to be followed, the PDRR would need to be distributed considerably earlier, meaning it would have to be created and distributed well before the offering (marketing) period after listing approval. However, if the PDRR needs to be created too early, it may be difficult to produce a useful PDRR from the perspective of providing information to investors.

When adopting the S-1 method, one option could be to distribute the PDRR during the period between filing the Securities Registration Statement and the listing approval date. In this case, since the Securities Registration Statement has been filed by the time the PDRR is distributed, the distribution of the PDRR does not violate the gun-jumping regulation. However, PDRRs that are distributed after the Securities Registration Statement has been filed, when specific IPO plans have been disclosed, carry the risk of being regarded as marketing materials. In this situation, it is said that the underwriters, to whom the analysts belong, may be held liable for any false statements in the PDRR.

Therefore, when adopting the S-1 method, there are challenging issues regarding the distribution of PDRRs in Japan, and currently, no clear solution has been found.

Future outlook

Even after the amendment to the relevant regulations in 2023, Japanese companies' IPOs can still be conducted using the traditional form of the Securities Registration Statement. In fact, all IPOs were conducted using the traditional method for some time, until the first IPO to adopt the S-1 method appeared in December 2024. When adopting the S-1 method, the required documentation increases, and various practical issues remain as mentioned above. Therefore, many cases currently determine that the traditional method is sufficient. Nevertheless, given the emergence of a real-world example, it cannot be ruled out that more IPOs will adopt the S-1 method in future.

Recent Developments in Regulations Relating to Japanese Equity Capital Markets

Mandatory disclosure in English

From 1 April 2025, the TSE requires listed companies on the Prime Market to disclose financial results and timely disclosure information in English. Financial information subject to this new English disclosure requirement includes supplementary materials explaining annual and quarterly financial information.

Full English disclosure of all documents is ideal; however, listed companies can determine the extent of English disclosure based on their interactions with overseas investors. Subsequently, it is acceptable to provide only partial disclosures or summaries in English. Furthermore, English disclosures are considered translations of the original Japanese disclosures for reference purposes only, and any inaccuracies in the content will not result in penalties for regulatory violations. However, failure to provide an English disclosure itself may constitute a breach of the listing rules.

In principle, English and Japanese disclosures should be made simultaneously. However, if this results in delays to the Japanese disclosure, this requirement does not apply, and timely Japanese disclosure should be prioritised.

Listed companies notifying the TSE between 6 January and 14 March 2025 can defer this requirement by one year, so that it applies from 1 April 2026 onwards.

Discussions on amendments to the Companies Act of Japan

Since February 2025, various discussions have been initiated regarding the next amendments to Japan's Companies Act.

The topics under discussion are diverse and include:

- the allocation of shares to employees as a stock incentive without consideration;
- a review of the regulations on in-kind contributions;
- establishing rules for virtual shareholder and virtual bondholder meetings;
- the beneficial shareholder identification system;
- other revisions related to shareholder meetings.

The beneficial shareholder identification system, in particular, is being discussed. This system would give the issuer company the right to request that custodians and beneficial shareholders provide information about their shareholdings. Currently, in Japan, the issuer company has access only to its share registry, which only lists the names of custodians who have opened securities accounts to hold shares. It has no way of identifying beneficial shareholders. Several sanctions are being considered in the event of a refusal to provide the requested information. One of the draft proposals considers including penalties involving the suspension of voting rights, which could have significant implications if implemented.

The specific contents and schedule of the amendments have not yet been finalised.

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