CHAPTER I

The Securities Market and the National Economy

1. What Is a Security?

The financial markets provide a marketplace through which funds are channeled from sectors with idle cash (lenders) to cash-short sectors (borrowers), and the types of financing arranged on these markets are divided in terms of intermediaries into indirect and direct financing. Indirect financing means a form of transaction in which a financial institution acquires a primary security (due bills and notes, etc.) from a borrower with a fund raised by issuing an indirect security (certificates of deposit and insurance policies, etc.). In direct financing, a borrower raises funds by issuing a primary security (equity and debt securities, etc.) to lenders through a market intermediary. The marketplace on which direct financing is arranged is the securities market, and it is divided into a primary market (where securities are issued and distributed) and a secondary market (where securities are bought and sold).

Generally, the term "security" refers to instruments that give their legal holders the rights to money or other property. They are designed to facilitate the assignment of such rights and have the characteristic of combining rights and certificates. More specifically, securities are issued in various forms, such as stocks and bonds issued by business corporations; notes, checks, and bills of lading; government securities issued by national governments; and municipal bonds issued by local public bodies. Of these, securities traded in the securities markets are called "securities under the Financial Instruments and Exchange Act (FIEA)," as defined in Paragraphs 1 and 2, Article 2 of that law. Paragraph 1 defines securities whose interests are represented by securities or certificates that are physically issued as listed in the table on the right.

Paragraph 2 of Article 2 sets forth the definition of deemed securities. In the former part of the paragraph rights presented by securities that are listed in the preceding paragraph are deemed to be securities by themselves in cases where no physical certificates are issued. The latter part of the paragraph then goes on to define deemed securities as rights other than those represented by securities or certificates. The scope of the definition has been substantially

Table I-1. The Definition of Securities under the Provisions of Paragraphs 2-1 and 2-2 of FIEA

Paragraph 2-1 Securities

1. Government securities
2. Municipal bond securities
3. Bonds issued by special public corporations
4. Specified corporate bonds as provided for in the Act on the Liquidation of Assets
5. Corporate bonds
6. Subscription certificates issued by special public corporations
7. Preferred shares as provided for in the Law Concerning Preferred Shares in Cooperative Financial Institutions
8. Preferred subscription certificates or new preferred subscription rights certificates as provided for in the Act on the Liquidation of Assets
9. Stock certificates or subscription right/warrant certificates
10. Beneficiary certificates of investment trusts or foreign investment trusts
11. Investment certificates or bonds issued by investment corporations, investment equity subscription rights certificates or investment certificates issued by foreign investment corporations
12. Beneficiary certificates of loan trusts
13. Beneficiary certificates of special-purpose trusts as provided for in the Act on the Liquidation of Assets
14. Beneficiary certificates of certificate-issuing trusts as provided for in the Trust Law
15. Commercial paper
16. Mortgage securities
17. Foreign securities: foreign certificates that have the attributes of any type of securities as defined in Items 1 through 9 and Items 12 through 16 hereof
18. Beneficiary certificates of foreign loan claims trusts
19. (Financial) options securities or certificates
20. Foreign depository securities or receipts
21. Securities or certificates designated by government ordinance

Paragraph 2-2 Deemed Securities

(General description of the former clause)

Interests represented by securities that are listed in the preceding paragraph in cases where no physical certificates are issued

(Latter clause)

1. Beneficiary interests in trusts
2. Beneficiary interests in foreign trusts
3. Partnership interests in general or limited partnership companies (*gomei gaisha or goshi gaisha*), as designated by government ordinance, or interests in limited liabilities companies (*godo gaisha*)
4. Partnership interests in foreign corporations, with the attributes of interests defined in any of the preceding items
5. Interests in collective investment schemes as comprehensively defined
6. Interests in foreign collective investment schemes
7. Other interests as designated by government ordinance

Source: Based on Toshiro Ueyanagi, Yutaka Ishitoya, and Takeo Sakurai, *Shin Kin'yu Shohin Torihiki-ho Handobukku*, Nippon Hyoronsha, 2006, and Etsuro Kuronuma, *Kin'yu Shohin Torihiki-ho Nyumon*, Nihon Keizai Shimbun, 2006, and the Financial Instruments and Exchange Act as listed in e-Gov's legal data service.

widened compared with that of the former law, and, specifically, there are comprehensive provisions in Item (v) of the paragraph for the FIEA to be applicable to various types of collective investment vehicles, or funds. In addition to securities, the FIEA applies to derivatives trading in domestic financial instruments exchanges, over-the-counter markets and foreign markets.

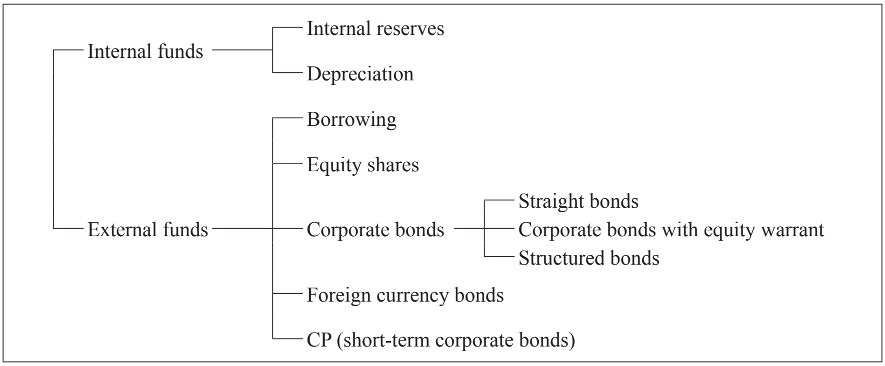
The electronically recorded transferable rights added to Article 2, paragraph 3 of the Act are the rights of each paragraph of Article 2 represented in property value that can be transferred using an electronic platform under Article 2, and are included in the category of Paragraph (1) Securities. In addition, by a Cabinet Office Ordinance, property values including deemed securities, etc. that are transferred by means of an electronic platform are defined as Electronically Recorded Transferable Rights to Be Indicated on Securities, etc.

2. Corporate Financing

The term "business corporation" (excluding financial service institutions) means economic entities whose objective is to make a profit from such activities as the production and sale of goods or services. Business corporations invest funds in real assets (such as facilities and products in inventories) to carry out production and marketing activities on a continuing basis. Business corporations raise the necessary funds by various means.

Funds raised by business corporations are divided into internal funds (those generated in the ordinary course of the production and sale of goods or services) and external funds (those raised from external sources), according to the method employed to raise them. Technically, internal reserves and depreciation charges are included in internal funds. They are considered the most stable means of corporate financing as corporations are not required to repay the principal of, or pay interest or dividends on, such funds. In actuality, however, business corporations cannot meet their funding requirements with internal funds alone, and most of the requirements have to rely on external funds. External funds are divided into three categories of loans, equity and corporate bond, according to the method employed to raise them. Loans are obtained primarily from banking institutions. This method of raising funds is termed "indirect financing." Business corporations issue equity share at the time of their incorporation, and issue additional equity shares (an increase of capital) to finance the expansion of their production capacity or for other purposes. As business corporations are not required to repay the principal thus raised, or pay interest thereon, the proceeds from the issuance of equity shares constitute the most stable form of funds among external funds. As is the case with equity shares, corporate bonds are also an instrument for rais-

Chart I-1. Corporate Financing



Note: Internal reserves refer to a company's after-tax income less any dividends and officers' bonuses. Depreciation charges are recognized as the economic benefits of tangible fixed assets, such as buildings and machinery, that are consumed each year and recorded as expenses. In other words, they are reserves for facility replacement.

ing funds from the capital markets, and issuers have to redeem them on or by a predetermined date of redemption and pay a definite rate of interest on them. Corporate bonds are largely divided into straight bonds (SB), corporate bonds with subscription rights/warrants, and structured bonds (see Chapter V regarding corporate bonds with subscription rights/warrants and structured bonds). The issuance of equity shares or corporate bonds is recognized as a means of raising funds by the "direct financing" method.

A survey of changes that have occurred in the amount of funds raised by companies from external sources as a percentage of the outstanding balance of financial debts shows that bank borrowings have stabilized after a declining trend since the 1980s. This decline reflects the impact of selling new shares and corporate bonds on the market following the liberalization and internationalization of the financial markets. Since the 2000s, funds raised through the issue of securities have outpaced those obtained through bank borrowings, and direct finance has become the mainstay for the structure of corporate financing in Japan. The total amount of funds raised has increased substantially, with the exception of a sharp drop in 2008 as a result of the Global Financial Crisis, and securities have accounted for about 60% of total funds raised. In particular, the proportion of funds raised by equities has been over 50% in recent years. The amount raised through corporate bonds has been increasing, due in part to monetary easing in response to the pandemic, and has picked up since July 2023 due to speculation of a revised approach to monetary policy.

Table I-2. Percentage of Funds Raised and Invested by the Corporate Sector

(balances at fiscal year-end)

	1980	1985	1990	1995	2000	2005	2010	2014	2016	2018	2020	2021	2022
Management													
Cash and demand deposits	10.0	7.6	6.6	9.1	13.3	15.5	18.4	15.4	14.8	15.9	19.2	19.1	18.6
Time deposits	14.5	14.8	12.8	10.8	7.7	4.1	6.3	5.0	6.0	4.3	5.4	5.5	0.2
CDs	0.1	1.2	1.1	2.6	3.3	1.5	1.8	1.3	1.5	1.2	1.3	1.1	5.3
Trusts	1.3	1.4	0.7	1.3	0.3	0.3	0.3	0.3	0.4	0.5	0.6	0.5	0.5
Investment trusts	0.1	0.6	0.2	0.4	1.0	0.7	1.8	0.5	1.2	0.1	0.2	0.2	0.2
Securities	15.7	25.9	30.9	24.2	22.9	36.4	19.4	32.1	32.3	34.3	31.9	29.3	29.8
(equity shares)	13.5	23.5	28.1	22.6	19.6	33.4	16.3	30.2	30.3	32.4	29.5	26.9	27.4
(debt securities)	2.2	2.3	2.8	1.6	3.3	3.0	3.1	1.9	2.0	1.9	2.3	2.4	2.3
Inter-business credits	45.5	35.2	30.5	35.3	33.5	24.4	27.1	20.2	19.4	20.1	17.1	18.5	18.1
Others	12.7	13.2	17.2	16.3	18.2	17.1	24.9	25.2	24.4	23.5	24.4	25.7	27.4
Total	312.4	483.5	835.7	783.2	738.9	950.3	792.6	1,110.9	1,146.1	1,192.0	1,229.6	1,256.3	1,363.1
Financing													
Borrowing	42.2	39.5	36.5	40.2	36.2	22.4	31.3	22.7	24.4	23.6	24.5	25.3	25.0
Securities	27.1	38.1	43.1	38.6	42.0	58.2	42.5	58.1	54.8	58.2	60.0	58.6	59.2
(equity shares)	23.1	33.9	37.3	32.7	35.2	52.9	35.2	52.9	50.0	53.3	54.7	52.9	53.7
(corporate bonds)	2.2	2.6	2.3	3.8	5.3	4.1	5.8	3.8	3.6	3.9	4.4	4.6	4.4
(foreign currency bonds)	1.8	1.6	2.6	1.5	0.6	0.8	0.8	1.0	1.1	0.7	0.6	0.7	0.7
(CPs)	–	–	0.8	0.6	0.9	0.4	0.7	0.4	0.1	0.2	0.3	0.4	0.3
Inter-business credits	24.3	17.0	14.6	15.4	16.2	12.8	15.4	11.1	11.9	12.2	9.8	11.0	11.0
Others	6.4	5.5	5.8	5.8	5.6	6.6	10.8	8.1	8.9	6.0	5.7	5.1	4.8
Total	477.4	760.6	1,358.7	1,351.7	1,198.0	1,421.8	1,056.7	1,521.3	1,658.8	1,748.5	1,871.5	1,853.1	1,955.6

Notes: 1. In percentages and trillions of yen.
2. Time and savings deposits include foreign currency deposits.
3. Figures in parentheses are a breakdown of securities, and equity shares include equity subscriptions.
4. Investment of equity shares is based on market prices and that of new shares issued in the years up to fiscal 1990, inclusive, is based on the capital plus capital reserve and that is based on the market prices since fiscal 1995.

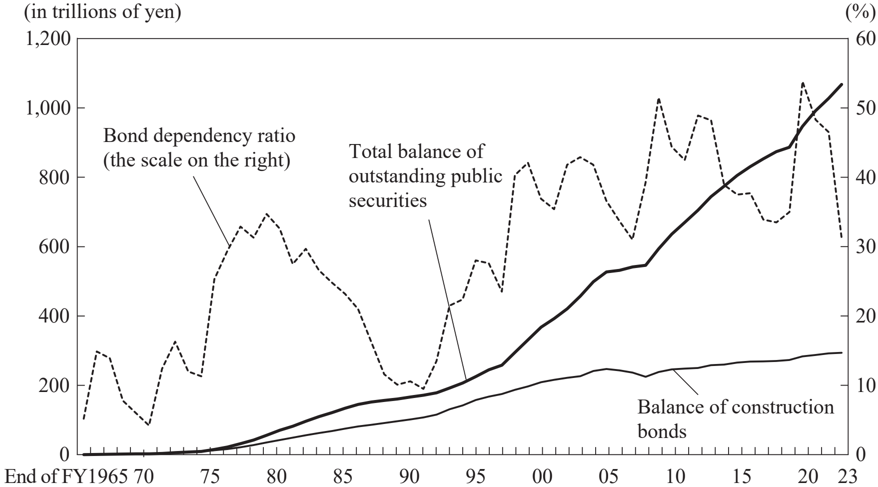
Source: Compiled from the Flow of Funds Account data published on the web site of the Bank of Japan.

With the enhancement of stock market for startups and the deregulation of the corporate bond market creating a fund-raising route through the capital markets for large and small-to-medium enterprises, the prevalence of securities-based financing is expected to remain stable in the coming years.

3. The Securities Market and Public Finance

Public finance is a type of economic activity carried out by the government (national and local). More specifically, the government conducts administra-

Chart I-2. Changes in the Balance of Outstanding Public Securities and the Degree of Dependence on Public Securities



Notes: 1. Figures for fiscal 2023 are estimates.
2. Based on straight government bonds.

Source: Compiled from the data issued by the Ministry of Finance.

tive services (law enforcement and education, etc.) and public investment based on the revenue largely from taxes. In practice, the government adjusts its fiscal policies in response to economic trends. When government expenditures exceed revenues, the deficit is met mainly by issuing public bonds (government and municipal government bonds).

A survey of changes that have occurred in the balance of outstanding public bonds and the government's dependency on debt financing shows that the government had issued special government bonds (deficit-financing) in fiscal 1965, the first time since the end of World War II, under a supplementary budget and also that the government has issued a series of construction bonds on a continuing basis since fiscal 1966. However, both the bond dependency ratio and the balance of outstanding government debt securities had remained at a low level until the first half of the 1970s. As tax revenues had leveled off due to an economic slowdown that began in the second half of the 1970s, the government had no choice but to issue a large amount of government bonds, and their outstanding balance had increased sharply to ¥71 trillion at the end of fiscal 1980. As a result, government bonds came to carry an increasing weight in the securities market, and the influence of government fiscal policies on the securities market had taken on a growing importance. In order to

Table I-3. Changes in JGB and Short-Term Government Bill Ownership by Investor Type

(in percentages)

Types of investors	FY2009	FY2011	FY2013	FY2015	FY2017	FY2018	FY2019	FY2020	FY2021	End of Dec. 2022
General government	1.9	1.9	2.4	0.4	0.3	0.3	0.3	0.2	0.2	0.1
Public pension funds	9.2	7.9	7.0	4.9	4.0	3.8	3.3	3.3	3.7	3.7
Fiscal loan funds	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bank of Japan	8.8	9.6	20.0	33.8	41.8	43.2	44.2	44.4	43.3	46.3
Banks	47.2	45.4	35.5	24.6	18.4	15.6	15.2	16.6	17.3	14.6
Life, nonlife, and other insurance companies	18.0	19.1	19.6	20.5	19.6	19.5	19.5	18.0	17.6	17.0
Pension funds	3.4	3.2	3.3	3.0	2.7	2.8	2.6	2.4	2.5	2.5
Overseas	5.6	8.3	8.2	10.3	11.0	12.7	12.9	13.2	13.6	13.8
Households	4.0	2.9	2.0	1.1	1.1	1.2	1.2	1.1	1.0	1.1
Others	1.9	1.6	1.8	1.4	1.0	0.9	0.9	0.7	0.7	0.8

Notes: 1. Figures for the end of fiscal 2022 are preliminary figures.
2. "Government bonds" includes "FILP bonds."
3. Banks include Japan Post Bank, securities investment trusts and securities companies.
4. Life, nonlife, and other insurance companies include Japan Post Insurance.
5. Others are composed of nonfinancial corporations and private nonprofit institutions serving households.

Source: Compiled from Saimu kanri ripoto 2023 (Debt Management Report 2023) published by the Ministry of Finance and the Flow of Funds Account data published by the Bank of Japan.

improve the fiscal situation, a fiscal restructuring policy was adopted from fiscal 1981. Once public bond dependency was reduced and increases in the balance of outstanding public bonds had been curbed, economic stimulus measures implemented in response to the prolonged recession since the 1990s and the financial crisis in 2008 have led to an increase in the issuance of public bonds. The public bond dependency ratio declined subsequently, but then rose sharply to 53.8% in 2020 following fiscal stimulus in response to the COVID-19 pandemic. Although the public bond dependency ratio has been on a declining trend since 2021, the balance of outstanding public bonds also continues to increase sharply and is expected to have reached approximately ¥1,068 trillion by the end of fiscal 2023.

Looking at the ownership structure of Japanese government bonds (JGB) as shown in the table on the right, the ownership of banks (including Japan Post Bank) who were previously major holders, has been on a reducing trend, with a marked decline after the introduction of quantitative and qualitative monetary easing by the Bank of Japan in April 2023. Meanwhile, the Bank of Japan has considerably increased its percentage of ownership and as of the end of 2022, its ownership ratio was a remarkable 46.3%.

Public pension funds, who used to be stable investors premising their investments on long-term ownership, have reduced their investment percentage to 3.7% as of the end of 2022, following a review in October 2014 by the Government Pension Investment Fund (GPIF) of its distribution of investment assets and a reduction in its domestic bond investment ratio. On the other hand, ownership by overseas investors has increased in recent years reaching 13.8% at the end of 2022. When considering the problem of Japan's budget deficit, overseas investors' ownership of JGBs has reached a level that cannot be ignored.

4. Financial Assets Held by the Household Sector

The financial assets held by the household sector in Japan have increased to ¥2,115 trillion as of the end of June 2023. Looking at the financial assets held by the household sector (excess savings) in terms of the flow of funds, the ratio peaked in the mid-1990s and then declined and stabilized. Households moved to secure liquidity during the COVID-19 pandemic, with a rapid increase in the amount held in cash and deposits. Thereafter, the cash surplus decreased to normal levels through 2022, but holdings of cash and deposits remained at a high level.

A survey of changes in the management of financial assets of the household sector found the following three characteristics. First, while the component ratio of cash and demand deposits has been rising, time deposits, which used to carry the largest weight within financial assets, has tended to decrease since the 1980s. This tendency of the component ratio is mainly due to the low interest rate policy and the quantitative and qualitative monetary easing measures adopted by the Bank of Japan. Second, the ratios of insurance and annuities rose consistently through to the end of fiscal 2000 and have since remained stable. This trend likely reflects that Japan has already become an aging society. Third, the weight of securities in household financial assets, especially stocks, declined considerably due to the sluggish stock market following the collapse of the economic bubble and the sharp sell-off in stock prices caused by the financial crisis in 2008. However, despite the turbulence in the stock market in the first half of 2020 due to the pandemic, the ratio recovered to 12.48% by end of fiscal 2022 with the market recovery trend after the end of 2012.

A comparison of household investment in financial assets between Japan and other countries (in the case of Japan, those of nonprofit-making institu-

Table I-4. Percentage Composition of Financial Assets of Individuals

(at fiscal year-end)

	1980	1985	1990	1995	2000	2005	2010	2015	2020	2021	2022
Cash and demand deposits	9.8	7.7	7.2	8.2	11.6	21.0	23.6	26.0	33.2	34.6	35.4
Time deposits	48.7	44.9	40.2	41.9	42.5	29.7	31.6	26.4	21.1	19.6	18.4
Trusts	4.5	4.0	3.7	3.4	1.5	0.4	0.2	0.2	0.2	0.3	0.3
Insurance funds	13.4	16.3	20.8	25.4	27.2	25.8	28.4	29.6	27.4	26.8	25.9
Investment trusts	1.2	2.3	3.4	2.3	2.4	3.4	3.6	4.2	4.3	4.5	4.4
Securities	16.1	19.7	19.6	13.9	9.7	15.3	8.6	11.0	11.1	11.3	12.8
(equity shares)	13.2	16.0	16.9	11.5	7.7	13.0	6.2	9.8	10.0	10.3	11.7
(debt securities)	2.8	3.7	2.6	2.5	2.0	2.3	2.4	1.2	1.1	1.0	1.0
Others	6.3	5.2	5.2	4.9	5.1	4.4	4.1	2.7	2.7	2.8	2.8
Total amount	372.0	626.8	1,017.5	1,256.5	1,388.8	1,516.6	1,480.6	1754.4	1945.8	2,004.5	2,055.9

Notes: 1. Composition in percentages and totals in trillions of yen.
2. Time and savings deposits include negotiable and foreign-currency deposits.
3. Figures in parentheses are a breakdown of securities, and equity shares include equity subscriptions.
4. Equity shares are based on market prices.

Source: Compiled from the Flow of Funds Accounts data published on the web site of the Bank of Japan.

Table I-5. Comparison of Japanese and U.S. Household Assets Composition (as of March 31, 2023)

	Japan	United States	Euro area
Cash and demand deposits	54.2%	12.6%	35.5%
Bonds	1.3%	4.9%	2.2%
Investment Trusts	4.4%	11.9%	10.1%
Stocks, etc.	11.0%	39.4%	21.0%
Insurance and annuity	26.2%	28.6%	29.1%
Others	2.9%	2.7%	2.1%

Source: Compiled from the Bank of Japan's "Comparison of the flow of funds between Japan, the United States and the Euro area" (August 25, 2023).

tions providing services to households are not included) as of the end of March 2023 still shows a large difference in the preference for types of assets. While Japanese households hold 54.3% of their funds in cash deposits and 16.7% of their funds in securities (including investment trusts), their American counterparts hold 12.6% of their funds in the former and 56.2% in the latter. In Europe, the figures are 35.5% and 33.3%, respectively. In choosing appropriate investment assets, while it is necessary to take into a consideration a wide range of differences, including social security systems, among the regions, these figures suggest that Japanese households prefer assets that guarantee principal, the Americans choose those with higher performance potential and Europeans sit somewhere between the two.

In Japan, however, the direct link between households and the securities markets is becoming stronger with the spread of defined contribution pension plans, the expansion of membership in individual-type defined contribution pension plans (iDeCo), and the fundamental expansion and establishment on a permanent basis of the Nippon Individual Saving Account (NISA), a small-amount investment tax exemption scheme, from 2024. In addition to an enhancement of investment trusts and exchange traded funds (ETFs), there is a demand for the dissemination of practical financial knowledge, as well as the provision of high-quality financial services.

5. Investment Behavior of Foreigners (Inbound Securities Investment)

Over a period of years after the war, international financial and capital transactions were banned, in principle. However, since the Foreign Exchange and Foreign Trade Act was amended in December 1980 (the new Foreign Exchange and Foreign Trade Act), the system of licensing international financial and capital transactions was changed from the prior permission system to the filing system, making them free in principle. Furthermore, by virtue of an amendment to the new Foreign Exchange and Foreign Trade Act in April 1998 (one of the main reforms under what was locally called “the Japanese version of the Big Bang”), the filing system of currency transactions was abolished, completely liberalizing direct financial transactions with overseas customers.

Looking at inbound securities investment in recent years, foreign investors were net buyers of Japanese stocks following the stock market crash in 2002, net sellers after the financial crisis in 2008, and net buyers again during the sharp rally in stock prices from the end of 2012. Since 2014 they have been either relatively modest net buyers or net sellers of Japanese stocks. However, the volume of stocks bought and sold by foreign investors has increased sharply since 1999, and as a result the difference between the two has fluctuated widely. In particular, from 2020 to 2022, following a sharp fall in share prices due to the pandemic, stock prices recovered following a significant fiscal stimulus package, and the volume of stocks bought and sold reached new record highs.

On the other hand, sales of medium/long-term bonds by foreign investors exceeded their purchase in 1999 after the abolition of securities transaction

Table I-6. Inbound Securities Investment

(¥100 million)

Calendar year	Equity and investment fund shares			Debt Securities (excluding bills)			Net balance
	Bought	Sold	Net	Bought	Sold	Net	
2000	835,593	837,932	− 2,339	571,013	470,246	100,767	98,429
2001	779,015	741,061	37,954	522,905	504,878	18,027	55,981
2002	644,372	657,039	− 12,667	582,775	618,928	− 36,153	− 48,819
2003	790,641	692,870	97,771	619,163	641,269	− 22,106	75,666
2004	1,161,630	1,056,357	105,273	727,773	683,161	44,612	149,885
2005	1,675,176	1,548,934	126,241	873,775	811,451	62,324	188,565
2006	2,671,452	2,590,472	80,981	1,035,501	970,532	64,969	145,950
2007	3,371,648	3,330,228	41,419	1,123,120	1,023,179	99,941	141,360
2008	2,640,366	2,714,152	− 73,786	895,747	933,021	− 37,274	− 111,060
2009	1,453,977	1,453,694	283	504,203	574,104	− 69,900	− 69,617
2010	1,736,099	1,717,710	18,389	695,100	688,976	6,125	24,513
2011	1,974,084	1,971,556	2,528	884,363	838,985	45,379	47,906
2012	1,867,789	1,846,517	21,272	811,683	790,007	21,676	42,948
2013	3,942,020	3,783,603	158,416	838,677	873,965	− 35,288	123,128
2014	4,115,951	4,089,468	26,483	762,694	676,154	86,540	113,022
2015	5,231,108	5,228,502	2,606	802,426	727,168	75,258	77,865
2016	4,955,097	5,011,755	− 56,658	965,053	921,289	43,764	− 12,894
2017	5,167,744	5,162,228	5,515	803,430	761,290	42,140	47,655
2018	5,817,386	5,877,281	− 59,896	841,269	817,331	23,938	− 35,958
2019	4,776,114	4,779,757	− 3,643	1,081,377	981,491	99,886	96,243
2020	5,712,328	5,805,004	− 92,676	1,043,869	1,069,475	− 25,607	− 118,283
2021	6,267,370	6,252,711	14,659	1,290,942	1,166,715	124,227	138,886
2022	6,884,092	6,892,983	− 8,891	1,713,749	1,821,620	− 107,871	− 116,762

Note: Up to 2004, figures were compiled based on "Changes in In-and Out-Bound Securities Investment (on a settlement basis)." Since 2005 and thereon, figures have been compiled based on "International Transactions in Securities (based on reports from designated major investors)."
Source: Compiled from materials listed on the web site of the Ministry of Finance.

taxes, during the depreciation of the yen in 2002 and 2003 and during the financial turmoil in 2008 and 2009 to cover arbitrage positions, and in 2013 when the Bank of Japan introduced quantitative and qualitative monetary easing. In addition to institutional factors such as the expanded market for medium-term government notes (with a maturity of two to five years), bond

Table I-7. Balance of Inbound Securities Investment and Related Indicators

Year-end	Stocks (¥b)		Bonds (¥b)		TOPIX	Interest rate (%)	¥/$ (¥)
2000	63,222	(30.4)	32,981	(15.8)	1,283.67	1.640	114.90
2001	49,563	(24.7)	33,546	(16.7)	1,032.14	1.365	131.47
2002	40,757	(21.4)	27,799	(14.6)	843.29	0.900	119.37
2003	60,085	(28.2)	27,108	(12.7)	1,043.69	1.360	106.97
2004	77,393	(31.2)	33,846	(13.6)	1,149.63	1.435	103.78
2005	132,842	(40.8)	41,428	(12.7)	1,649.76	1.470	117.48
2006	149,277	(43.5)	49,579	(14.5)	1,681.07	1.675	118.92
2007	142,031	(39.4)	60,203	(16.7)	1,475.68	1.500	113.12
2008	68,625	(23.4)	50,650	(17.3)	859.24	1.165	90.28
2009	76,372	(26.6)	42,236	(14.7)	907.59	1.285	92.13
2010	80,537	(26.4)	42,877	(14.0)	898.80	1.110	81.51
2011	65,841	(20.7)	45,730	(14.4)	728.61	0.980	77.57
2012	83,556	(23.2)	49,504	(13.8)	859.80	0.795	86.32
2013	152,323	(32.3)	50,168	(10.6)	1,302.29	0.740	105.37
2014	169,144	(29.2)	64,434	(11.1)	1,407.51	0.320	119.80
2015	186,919	(30.7)	72,623	(11.9)	1,547.30	0.265	120.42
2016	181,530	(28.0)	83,001	(12.8)	1,518.61	0.040	117.11
2017	219,841	(32.1)	95,167	(13.9)	1,817.56	0.045	112.65
2018	176,300	(26.1)	102,615	(15.2)	1,494.09	−0.005	110.40
2019	209,923	(28.6)	118,340	(16.1)	1,721.36	−0.025	109.15
2020	219,657	(27.8)	117,051	(14.8)	1,804.68	0.020	103.33
2021	243,602	(29.0)	135,946	(16.2)	1,992.33	0.070	115.12
2022	226,339	(24.6)	128,558	(14.0)	1,891.71	0.410	132.14

Notes: 1. Bonds include only long-term debt securities.
2. Figures given in parentheses are component ratios (%) to the total debts to overseas lenders.
3. Interest rate signifies the yield on 10-year government bonds newly issued and distributed on the secondary market.
4. ¥/$ represents the closing spot rates on the Tokyo market.

Source: Compiled based on the data released by the Ministry of Finance and the Bank of Japan.

trading has remained at a high level against the backdrop of increased arbitrage activity by foreign funds, and the trend of net buyers has continued from 2014. As in the case of equities, bond trading has seen a sharp increase in buying and selling volumes and the difference between purchases and sales has fluctuated substantially since 2020.

Looking at the trend in the balance, it turned upward again in 2003 due to

Table I-8. Percentages of Japanese Stocks and Bonds Held by Investors of Different Regions

(in percentages)

Year-end	United States	Europe	Asia	Cayman Islands	Others
Equity securities					
2014	47.4	36.9	5.4	0.6	9.8
2015	49.1	36.0	5.7	0.7	8.4
2016	49.9	34.9	6.2	1.0	8.1
2017	50.2	34.0	7.3	0.9	7.5
2018	52.6	32.5	6.4	0.9	7.6
2019	54.2	30.9	6.7	0.9	7.3
2020	51.7	33.1	7.1	0.7	7.5
2021	52.0	32.9	7.0	0.6	7.5
2022	52.3	33.3	6.9	0.7	6.8
Debt securities (bonds and notes)					
2014	21.9	33.7	21.6	6.1	16.6
2015	22.6	40.0	19.3	6.2	11.9
2016	20.4	40.7	22.0	5.8	11.2
2017	22.9	42.9	22.3	4.1	7.8
2018	23.1	47.9	17.8	4.3	7.0
2019	21.3	50.1	16.9	4.2	7.5
2020	23.7	54.0	12.7	3.2	6.4
2021	25.5	53.6	12.2	3.1	5.6
2022	27.4	50.5	13.6	1.1	7.4

Note: Stocks refer to equity and investment fund interests; bonds refer to medium- and long-term bonds.
Source: Compiled on the basis of data from the Ministry of Finance.

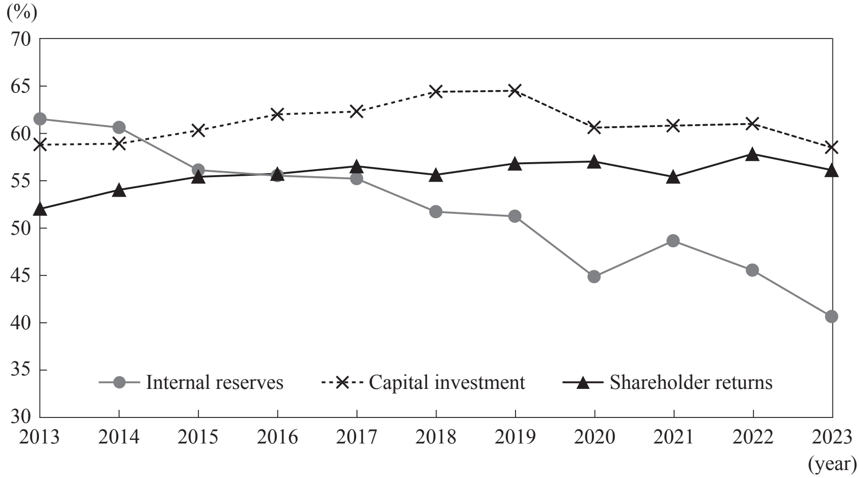
a recovery in stock prices, increasing to approximately ¥149 trillion at the end of 2006, but remained stagnant from 2010 to 2012 due to the impact of the global financial crisis. With the recovery of the stock market post-COVID, this balance increased to approximately ¥226 trillion by the end of 2022. The balance of domestic debt securities held by overseas investors, long- and medium-term bonds and notes combined, also increased steadily to a total of approximately ¥129 trillion at the end of 2022. Next, looking at the breakdown of Japanese stock ownership by region, American investors have maintained a high level of stock ownership at 52.3% at the end of 2022. For debt securities on the other hand, contrary to stocks, American investors’ share was 27.4% at the end of 2022, while European investors accounted for a majority of 50.5%. Asian bond holdings used to be close to the share of American investors, but gradually declined to only 13.6% at the end of 2022.

6. Call for Improvement of Capital Efficiency by the Tokyo Stock Exchange (TSE)

The review of the market classification of the Tokyo Stock Exchange implemented in April 2022 aimed to (1) clarify the concept of market segmentation, which was highlighted as necessary by the Report by the Working Group on Financial Markets under the Financial System Council in December 2018 and (2) motivate companies to improve their corporate value on a sustained basis. With regard to the latter, the top right-hand chart is based on a survey of large companies with capital of at least ¥1 billion concerning their allocation of profits. From this, it is clear that many companies have historically prioritized retaining internal reserves in anticipation of future risks over investing in growth. The TSE "Council of Experts Concerning the Follow-up of Market Restructuring" meetings, which have been held on 10 occasions since July 2022 to examine the status of the new market segments post-launch, has made various recommendations to encourage companies to take actions aimed at enhancement of corporate value over the medium to long term: (1) listed companies with a P/B ratio of less than 1x should seek to improve this ratio; (2) listed companies should make the voluntarily transition to a management focusing on balance sheet and cash flow; (3) the TSE should encourage company managers to improve their consciousness and literacy of the cost of capital and the importance of stock prices.

Based on the discussions at the follow-up meetings, TSE announced a framework to motivate autonomous actions to medium- to long-term corporate value in January 2011. In spring 2023, it issued a request to the managements and boards of directors of companies listed on the Prime and Standard Markets to disclose policies, specific initiatives, and progress toward accurate understanding and improvement of metrics such as cost of capital and return on capital; in particular, companies with a P/B ratio of less than 1x were strongly urged to act on this. Furthermore, in March of the same year, in its document "Action to Implement Management that is Conscious of Cost of Capital and Stock Price," TSE stated that approximately half of the listed companies on the Prime Market and 60% in the Standard Market have ROE below 8% and a P/B ratio below 1x. The requested actions included: (1) analysis of the current situation by the board of directors (cost of capital and return on capital); (2) planning and disclosure (specific initiatives considered by the board of directors), and (3) implementation of initiatives such as pro-

Chart I-3. Large company approach to profit allocation (capital of ¥1 billion or more) (All industries)



Note: Multiple choice of up to 3 out of 10 items. The figures are percentages of the total number of respondents.
Source: "Business Outlook Survey" POLICY RESEARCH INSTITUTE, Ministry Of Finance.

motion of management that is more conscious of cost of capital and stock price and dialogue with investors. Financial instruments exchanges (stock exchanges) uphold the quality of traded securities through initial listing standards and listing maintenance standards (Chapter 10). However, this request for improvement of capital efficiency is unusual from the point of view of the functioning of the secondary market. In response to TSE's request, an increasing number of listed companies appear to be actively returning profits to shareholders through increased dividends and share buybacks, but it is unclear whether this request will lead to improved capital efficiency over the medium to long term.

7. Financial and Economic Education as a National Strategy

The Japanese government and the Bank of Japan declared 2005 as the "First Year of Financial Education" because social interest in financial and economic issues increased with the full removal of the government's blanket deposit insurance in 2005. In the same year, the Livedoor Scandal amongst other events made the improvement of financial literacy an important social

Table I-9. Improving companies' consciousness and literacy concerning cost of capital and stock prices

(in percentages)

	Implementation	period	Target market segments
a	Request management and the board of directors to have an accurate understanding of their company's cost of capital and return on capital, engage in discussion on the status of the cost of capital and evaluation of the company's stock price and market capitalization, and disclose the policies and specific initiatives for improvement of these metrics and progress concerning these metrics as necessary. Companies with P/B ratios consistently below 1x are strongly urged to disclose their P/B ratio. Notification to listed companies concerning the application of principles in accordance with the intention of Principle 5-2 of the Corporate Governance Code (see note). (*Note*) Separate discussion to be held for companies listed on the Growth Market, in accordance with individual characteristics.	Spring 2023	Prime and Standard market
b	Clarify the responsibilities of listed companies such as awareness of cost of capital, respect for shareholder rights, and in particular the protection of minority shareholders' rights; conduct a comprehensive review of the Corporate Code of Conduct from the perspective of ensuring effectiveness and revise as necessary.	During 2023	All markets
c	In addition, promote and encourage understanding of stock compensation plans to contribute to management awareness (listed companies), check and update content of training programs, including elearning on capital markets and corporate governance, compile and publish case studies in sequence starting from spring 2023.	compile and publish case studies in sequence starting from spring 2023.	All markets

Source: "TSE's Future Actions in Response to the Summary of Discussions of the Follow-up Council" (January 30, 2023) Tokyo Stock Exchange, Inc.

theme. The importance of financial education has been recognized again and a wide range of financial education activities are being carried out by related government agencies such as the Cabinet Office, Ministry of Education, Culture, Sports, Science and Technology (MEXT), and the Financial Services Agency, as well as by financial organizations such as the Bank of Japan's Central Council for Financial Services Information, the Japan Exchange Group, and the Japan Securities Dealers Association, and other private financial institutions.

On the other hand, although financial and economic education activities have been conducted on a mutually cooperative basis, various organizations

Chart I-4. Outline of the bill to partially amend the Financial Instruments and Exchange Act regarding financial and economic education

Improvement of financial literacy

■Establishment of a "Basic Policy" to comprehensively promote measures to support asset formation

■Establishment of the Japan Financial Literacy and Education Corporation to provide a wide range of financial and economic education from the user's perspective

Business: Creation of teaching materials and content for financial and economic education, development of courses for schools and companies, individual consultations, etc.

Format: Licensed corporation

Officers: President (1), directors (up to 3), other officers

Governance: Management committee (committee members, president, and directors) established, approved and overseen by the Financial Services Agency

Reference: In addition to the above, the FSA has established an environment that facilitates access to consultation and advice on asset formation

Source: "Explanatory material for the bill to partially amend the Financial Instruments and Exchange Act" (2023) Financial Services Agency.

Chart I-5. FSA Initiatives on Financial and Economic Education

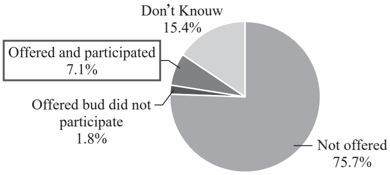
■ Establish the Financial Literacy and Education Corporation as a neutral organization. (the aim is to establish this by the end of 2024 subject to the passing and implementation of relevant legislation.)

■ Establish a "basic policy" as a national strategy for comprehensive and systematic implantation on throughout the country.

Note: Establishment of Financial Literacy and Education Corporation and the "basic policy" are under discussion in the House of Councillors.

Challenges

- Despite various efforts by the public and private sectors, financial and economic education on asset building has not been widely taken up by the public.
- Industry associations, which are the main players in this field, are not interested in this initiative because it is viewed as a sales tool.
- It is important for the government to work together across government ministries and agencies to comprehensively promote measures to ensure stable asset formation for households.



Source: "Financial Literacy Survey 2022," The Central Council for Financial Services Information.

<Enhancing financial and economic education>

- The Financial Literacy and Education Corporation will be established by law (during 2024) to provide financial and economic education from a neutral standpoint.
- The functions of the Central Council for Financial Services Information (Secretariat: Bank of Japan) will be transferred and taken over, and an operational system will be developed and established. In addition to the government and the Bank of Japan, cooperation from private-sector organizations such as the Japanese Bankers Association and the Japan Securities Dealers Association (JSDA) will be sought for covering operating expenses.
- With appropriate division of roles, the public and private sectors will work together to strategically implement financial and economic education.
- The specific duties of the organization are envisaged as
  ① Creation of teaching materials and content for financial and economic education
  ② Development of courses for schools, companies, etc.
  ③ Advisory services for individuals
  ④ Creation of an environment to facilitate consultation and advice related to asset formation, etc.
  (Provide assistance from the customer's perspective)

<Promotion of cross-ministerial initiatives>

- Formulate a "basic policy" as a national strategy to promote measures to support asset building in a comprehensive and systematic manner throughout the country, with the cooperation of related ministries, local governments, private organizations, etc.

Source: "Doubling Asset-based Income Plan and Initiatives to Support Asset Formation," FSA (2023).

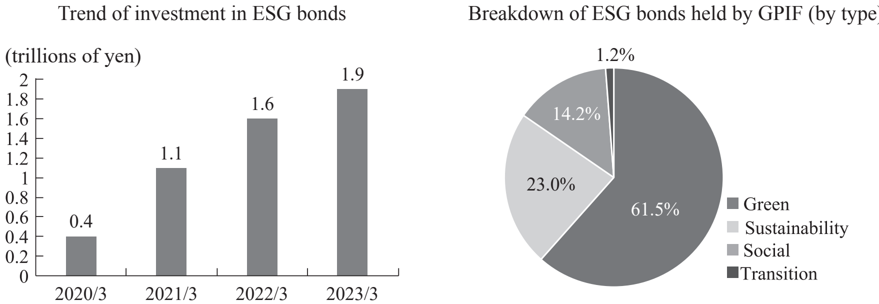
related to financial and capital markets and private financial institutions have looked to disseminate their financial and economic education based on their own ideas and curricula. It is difficult to carry out comprehensive education with these activities, and there is a view that the education has not been sufficiently effective because of limitations on human and physical resources.

The "Doubling Asset-based Income Plan" set out by the current Kishida administration in 2020 aims to increase household income from financial assets in addition to working income and has implemented measures such as expanding and making permanent the small investment tax exemption system (NISA) in 2024. In addition, it is also expected that Japan's economic growth will be enhanced through utilization of household assets that have been mainly kept as cash and savings, for effective investment. One of the seven pillars of the Doubling Asset-based Income Plan is "Enhancing financial and economic education to spread the importance of stable asset formation." The government recognizes financial and economic education as a national strategy and has stated that the government will take the lead in enhancing financial and economic education. In response to this administration's policies, the Financial Services Agency has included financial and economic education as a priority in its "Financial Administrative Policy" for fiscal 2023. In the bill to partially amend the Financial Instruments and Exchange Act passed at the 212th Diet session, the "Act on the Provision of Financial Services" was renamed the "Act on the Provision of Financial Services and Development of the Usage Environment." This bill resolved (1) to formulate a basic policy to comprehensively promote measures to support stable asset formation for citizens (Article 82, paragraph 1) and (2) to establish the Japan Financial Literacy and Education Corporation (Article 86) in 2024 to strategically promote financial and economic education from a neutral standpoint. This is expected to be the first officially authorized organization to truly oversee financial and economic education based on public-private sector collaboration.

8. The Rise of ESG Investing and Issues Associated with ESG Investing

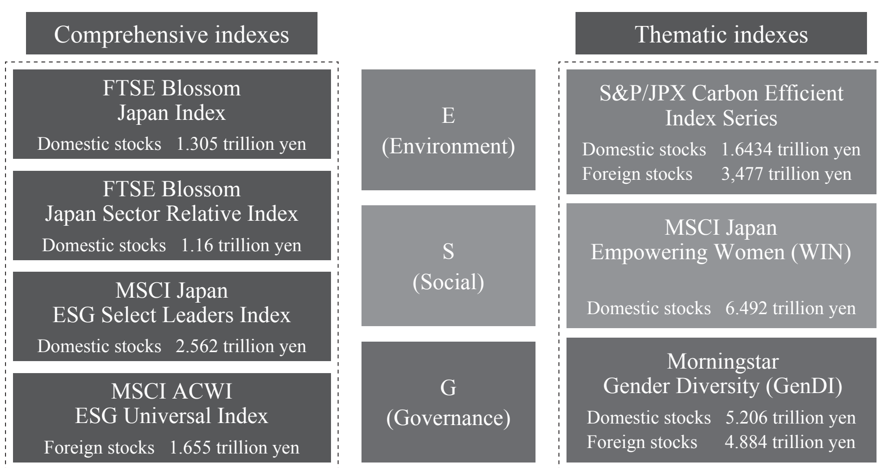
The Principles for Responsible Investment (PRI) were set out for institutional investors by the United Nations in 2006 and marked the start of ESG investing, an investment approach that incorporates environmental, social, and governance factors into asset allocation and risk decisions from an international perspective to generate sustainable, long-term financial returns. For example, Japan's Government Pension Investment Fund (GPIF) signed up to the PRI in 2015 with the revision of its investment principles and has been increasing its ESG investments. Types of ESG investment are classified into categories such as socially responsible investing (SRI), integrated investing,

Chart I-6



Source: "2022 ESG Report," GPIF.

Chart I-7. Trend of investment in ESG bonds



Source: GPIF website.

thematic investing, impact investing, according to investment style and strategy. GPIF holds a varied range of ESG investment bonds as shown in the diagram on the right.

Although ESG investing kept increasing worldwide, reports show that the number of ESG investment trusts, including those established in Japan, peaked in the summer of 2021 and have declined subsequently. One of the factors behind this is the problem of "greenwashing". Funds that claim to be "green" but whose investment practices are not consistent with the ESG ap-

Table I-10. Six principles of the FSA Code of Conduct

Principle 1: Securing quality ESG evaluation and data providers should strive to ensure the quality of ESG evaluation and data they provide. The basic procedures necessary for this purpose should be established.
Principle 2: Human resources development
Principle 3: Ensuring independence and managing conflicts of interest ESG evaluation and data providers should establish effective policies so that they can independently make decisions......and appropriately address conflicts of interest. With regard to conflicts of interest, providers should identify their own activities and situations that could undermine the independence, objectivity, and neutrality of their business, and avoid potential conflicts of interest or appropriately manage and reduce the risk of conflict of interest.
Principle 4: (Ensuring Transparency) ESG evaluation and data providers should recognize that ensuring transparency is an essential and prioritized issue, and publicly clarify their basic approach in providing services, such as the purpose and basic methodology of evaluations. Methodologies and processes for formulating services should be sufficiently disclosed.
Principle 5: Confidentiality
Principle 6: Communication with companies

Source: "The Code of Conduct for ESG Evaluation and Data Providers" (December 2022) Financial Services Agency.

proach are viewed as a problem. One of the reasons behind this is that there are no clear standards for ESG-related disclosure by issuers. ESG ratings used for investment decisions are also a problem. Rating providers assess companies according to their own proprietary rating frameworks, scales, key indicators and metrics, which leads to a lack of consistency in ratings.

To address these issues, the Financial Services Agency (FSA) published the "Code of Conduct for ESG Evaluation and Data Providers" outlining six principles for ensuring the quality of ESG ratings, and asked organizations engaged in ESG evaluation and data provision to sign up to this code of conduct. In March 2023, the FSA published a partial revision of the "Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc." regarding ESG investment trusts. This revision added "Points to Consider Concerning ESG Investment Trusts," clearly stating the requirements for recognizing investments as ESG investments and setting out a checklist for compliance with ESG principles. In January 2023, the FSA revised the Cabinet Office Order on Disclosure of Corporate. Affairs, etc. and called upon all companies to make disclosures on "Governance" and "Risk management" in sustainability information section of their securities reports, in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), as well as calling for reporting on "Strategy" and “Metrics and targets” based on each company’s judgment of their significance. New sustainability disclosure standards are due to be released by the Sustainability Standards Board of Japan (SSBJ) by 2025.